

BUILDING A PRODUCTIVE VICTORIA

JANUARY 2008

**Ai Group Submission on 2008-09
Victorian Government Budget Priorities**

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Key themes

The Australian and Victorian economies have grown solidly over recent years, through a period of transition characterised by increasing competitive pressures from the higher exchange rate and low cost economies like India and China. This solid growth performance has resulted in an ongoing fall in the unemployment rate, one of the key enablers of rising living standards in an economy. As economic growth continues however, there are signs of strains emerging.

These strains include skills shortages in some sectors, despite persistent unemployment in some areas of the country and within Victoria. Inflationary pressures are also rising. The latter has caused the Reserve Bank of Australia (RBA) to increase official interest rates with the aim of slowing the economy.

In addition, the exchange rate has shifted upwards and this will persist. The exchange rate will remain higher in reflection of a structural shift up in Australia's terms of trade. This reflects higher commodity prices due to demand from China's surging economy. The lift in Australia's terms of trade also reflects lower global manufactures prices in part reflecting China's low labour costs.

The ongoing development of the Chinese and other low cost economies into producers of not just simple, but also elaborately transformed, manufactures is adding to the negative competitiveness implications of the higher exchange rate for Victorian firms.

In this kind of economic climate the surest way of continuing to lift the State's economic growth performance and lift Victorians' living standards is to focus on enhancing productivity growth and raising the economy's overall efficiency. This involves continuing to build an innovative, internationally competitive and globally connected economy. While manufacturing is the largest sector in the State economy, the service sector is making an increasing contribution in such areas as tourism, financial services and higher education.

Ai Group recognises the significant policy measures taken by the current government. It must continue to focus its efforts on playing its role in lifting the productivity bar which will offset the competitive pressures the Victorian economy is undergoing.

To this end Ai Group has proposed a number of initiatives, both practical and affordable and consistent with the government's fiscal policy and reform agendas.

Raising productivity

Raising productivity growth is the key means of sustaining economic growth and rising living standards over the long-term. The major elements of achieving this are as follows:

- Raising the level of and efficiency of use of existing infrastructure.
- An efficient, competitive and simple system of taxation.
- Investment in new developments in science, technology and innovation and their application in business and industry.
- Improved government administration, including reductions in red tape and administration costs.
- Lifting standards and effectiveness of education.
- Developing better supply chain links.

Ai Group is putting forward a number of specific initiatives which will act to meet some of these objectives for improving Victorian productivity. Some of these include:

- Development of a new Victorian industry strategy and use of the Government's purchasing power to support new innovative initiatives.
- Development of a Victorian centre for innovation excellence.
- Victorian Government support for the Federal Government's plans to coordinate infrastructure policy through a new statutory body *Infrastructure Australia*.
- An additional 0.25 per cent cut in the payroll tax rate from July 2008.
- A 10 per cent reduction in WorkCover premiums in 2008-09.
- Continued focus on reforms to reduce the regulatory burden on business.
- Simplified application processes for export programs.
- Optimisation by the Government of existing facilities for management of Prescribed Industrial Waste.
- Ensuring that the Victorian Government considers the full impact of water pricing decisions on business.
- The establishment of an independent water agency.



Economic and fiscal setting

Victoria's economic performance, in line with that of the national economy, has improved since the second half of 2006. State final demand has accelerated over the last three quarters reaching 3.2 per cent over the year to September 2007. The State's unemployment rate has continued to decline, falling to under 4.5 per cent in the second half of 2007.

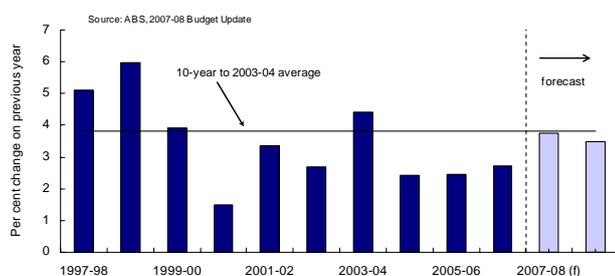
In terms of gross state product, the comparative picture is mixed. Victoria has seen its rate of growth fall from an average of 3.8 per cent a year over the decade to 2003-04 to 2.5 per cent in 2005-06 and 2.7 per cent in 2006-07.

However, this performance is significantly better than that of New South Wales, South Australia and Tasmania, which have seen slower growth over the past two years.

The resources states of Queensland and Western Australia have performed more strongly than Victoria, but this largely reflects the benefits of the mining boom on those states' investment levels and manufacturing's larger share.

Manufacturing accounts for close to 14 per cent of Victoria's industry gross value added compared with a share of 11 per cent in New South Wales, 10 per cent in Queensland and 8 per cent in Western Australia.

Chart 1: Growth in Victorian real Gross State Product



Victoria's economy remains subject to the impact of competitive pressures on manufacturing which are likely to persist. This will act to constrain Victoria's relative economic performance.

The improvement in Victoria's economic growth rate since the second half of 2006 reflects many of the same factors which have driven the national economy. Household spending and private investment have been the key drivers of growth over the past year. However, under the impact of competitive pressures from China and other low cost economies, Victorian exports have fallen during 2007.

Ai Group acknowledges the current Victorian forecasts of growth of 3.75 per cent in 2007-08 and 3.5 per cent in 2008-09.

The ongoing inflationary risks to the Australian economy arising from tight labour markets, high levels of capacity utilisation and weaker productivity growth suggest the risks are to the downside if monetary policy is tightened as a result of rising inflation.

An additional risk to the economic outlook is the ongoing and uncertain potential for the global credit squeeze to cause both a steeper slowing of global growth than currently expected. This would be compounded by higher borrowing costs as risk aversion increases.

Despite the risks to the economic outlook, Ai Group expects that Victoria's budget will remain in a very strong position over the next few years. This reflects the Government's sound approach to financial management, through strong control over recurrent spending and capital expenditure.

Revenue growth, subject to the above risks, will remain strong. Economic growth will drive solid employment, and thus payroll tax, growth. Rising national household consumption, employment and business investment will underpin rising State tax revenues and GST revenues.

This, along with the Victorian economy's solid performance, has been reflected in the upward revisions to the fiscal outlook announced recently. These revisions include stronger taxation revenue driven by stronger economic and population growth. The revised projected operating surplus of an estimated \$842 million in 2007-08 is expected to be \$517 million higher than at Budget time.

This places the State government in a sound position to undertake the productivity-enhancing infrastructure development and policy reform which will support sustained economic growth in Victoria by boosting industry competitiveness.



Industry policy

Victorian industry has entered a challenging new period. The policies and strategies of the State Government will go a long way to ensuring industry can meet the challenges and take advantage of the opportunities that lie ahead.

Victorian industry continues to adapt to life in a highly competitive and ever-changing global environment.

Businesses are finding they need to be globally engaged, innovative and flexible in order to meet the changing needs of customers, and to contend with evolving competitors.

The Victorian Government's industry policies must be targeted at ensuring local industry can develop the attributes required to thrive in the global environment. To help guide this process, Ai Group is calling on the Government to develop a new Victorian industry strategy.

Victoria's manufacturing sector, which makes a significant contribution to the state's production, is especially influenced by global competitive pressures, namely growing competition from low-cost competitors. As such, it is essential the Victorian industry strategy places particular emphasis on manufacturing.

Ai Group's recommendations for industry policy are outlined below:

Victorian industry strategy

Ai Group calls on the Victorian Government to develop a new Victorian industry strategy.

Ai Group recommends the Victorian Government consolidate all existing industry policy activities and strengthen funding under the four major streams of support:

- Fostering global engagement;
- Enhancing innovation and the adoption of advanced technologies;
- Building skills and capabilities; and
- Adopting environmentally sustainable production processes.

Reflecting the importance of manufacturing to the Victorian economy, Ai Group believes the Victorian industry strategy should contain a particular focus on a strategy for manufacturing.

Government purchasing arrangements

Ai Group urges the Victorian Government to use its purchasing power to support new innovative initiatives.

A number of Victorian businesses have invested substantially in developing new and innovative products.

Ai Group believes that, where possible, the Victorian Government should look to move their purchases away from foreign products and towards these locally developed, innovative goods.

Such a move would both strengthen local industry and help promote the quality of locally produced goods to overseas customers.

Companies not only need government support from a purely commercial perspective, but also when seeking overseas government contracts. The confidence that government contracts engender with potential export clients is difficult to quantify. However, the frequency with which Australian exporters are asked whether they have local government contracts shows the importance that it has for potential buyers.

Local industry participation in Victorian Government projects should be further encouraged by extending 'whole-of-life' costing criteria across all State Government agencies and projects.

Ai Group commends the Victorian Government on its amendments to the Victorian Industry Participation Policy (VIPP), particularly its decision to lower the thresholds above which VIPP Implementation Plans are required from:

- \$50 million in metropolitan Melbourne to \$10 million; and
- \$5 million in regional Victoria to \$2.5 million

A detailed presentation of Ai Group's innovation proposals is provided in the [Innovation](#) section.



Innovation

To survive and prosper in today's competitive global environment, Victorian businesses must be innovative, and in turn agile, in order to take advantage of commercial opportunities. The Victorian Government can play an important role in boosting the agility of local businesses, through proposals that support increasing levels of innovation.

Ai Group believes that increasing the current levels of innovation in Australia and improving the agility of local companies is one of the most important tasks facing both state and Federal Governments. As such, it is crucial that Victoria works closely with the Federal Government to develop coordinated and considered innovation policies.

Ai Group has identified the following ways in which the Victorian Government can work with industry, and develop policy within the context of the National Innovation Agenda

Victorian industry agility initiative

The Victorian Government should look to strengthen the new Australian Industry Productivity Centres (AIPC) Program's focus on key elements of business agility.

The newly established AIPC program, funded by the Federal Government, offers to meet up to 50 per cent of the cost of professional services aimed at providing solutions in business planning, process improvement and lean manufacturing, up to \$20,000.

Ai Group believes the Victorian Government should offer a similar \$20,000 grant to businesses.

The Victorian Government could also offer supplementary support in the:

- Development of strategic business plans;
- Building of innovative capabilities; and
- Development of global supply chain networks and linkages.

Management capabilities

The Victorian Government should consider the establishment of a management capability advisory and mentoring scheme.

Such a scheme could assist companies; particularly SMEs, develop organisational capability to allow them to be agile and flexible.

Management development for firms would provide managers with techniques/strategies to manage new business models. These would be approached via elements of the industry agility framework.

Victorian centre for innovation excellence

The Victorian Government should develop a centre for innovation excellence, modelled on successful developments in South Australia.

The centre could help boost local innovation by offering a range of useful services to industry, including:

- Seminars and workshops;
- Best practice training;
- Regular company visits to learn from best practice;
- Collaboration and networking initiatives;
- Assistance with the development of new products;
- Support for mentoring initiatives;
- Assistance in commercialisation and;
- Sponsorship for overseas missions on innovation.

Victorian innovation skills audit scheme

Ai Group believes the Government should establish a scheme that focuses on lifting the skills required to be innovative.

The scheme, based on the allocation of small skills grants to firms, could incorporate:

- A review of existing innovative skills of employees and managers in participating companies;
- Identification and development of innovative talent held by particular employees in companies to allow them to realise their full potential; and
- Assistance with long-term workforce development strategies that provide planning tools and links to education and training sectors, school and industry models



Transport and infrastructure

In an economic climate marked by capacity constraints and skills shortages, investment in world-class transport links and infrastructure is an avenue through which the State Government can boost the productivity and efficiency of firms.

Transport and infrastructure projects must be selected carefully to ensure final products are of the highest quality and widely available to end-users. They must lead to permanent improvements in the productivity and efficiency of business operations.

A long-term approach that ensures adequate public and private sector investment in Victorian infrastructure is crucial in ensuring that future needs are met. In particular, strong consideration must be given to efficient regulation; best practice PPPs; the willingness of the public sector to borrow to invest; macroeconomic conditions; and providing a rigorous approach to project evaluation.

Another key focus for Victorian transport and infrastructure policy is ensuring there is a balance between freight transport needs and passenger transport.

Victorian industry is increasingly building links with overseas markets and they need to be supported by the Government through committed freight transport reform.

Specific transport and infrastructure strategies supported by Ai Group are detailed below:

East-West Link

Ai Group proposes the construction of a freight tunnel, containing both a railway line and road connection, linking the Eastern Freeway to the western side of the city, possibly the redeveloped Port of Melbourne.

The Government must ensure infrastructure, such as an East-West Link, takes into account the needs of the community many decades in the future. One of the reasons for the Victorian economy's resilience in recent years has been the State's transport infrastructure.

The importance of new infrastructure, like an East-West Link, in maintaining development in the economy should not be underestimated.

Freight movement between Melbourne's eastern and western suburbs is expected to increase considerably in the future, largely due to:

- Strong growth in resident numbers and business activity in Melbourne's south-eastern and western suburbs; and
- The planned revitalisation of the Port of Melbourne.

The Victorian Government's decision to commission an East-West Link needs assessment recognises the importance of this issue.

An East-West Link will help reduce traffic congestion on the West Gate Bridge and Monash Freeway and reduce the time spent moving goods between the city's eastern and western suburbs, both of which will be enormously beneficial to Victorian industry.

Greater coordination with the Commonwealth

Ai Group urges the Victorian Government to support the Federal Government's plan to coordinate infrastructure planning through a new statutory body called *Infrastructure Australia*.

Infrastructure Australia will report directly to State and Federal Infrastructure Ministers through the COAG.

This new process, while dependant on how well COAG operates, should lead to better investment in transport, water, energy and telecommunications and must be supported by Victoria.

The Victorian Government should also seek to design a solution to the Murray Darling Basin via the National Water Initiative, or its successor.



Taxation and federal-state relations

The Victorian Government must commit to refreshing the Australian federation to deliver better outcomes, to clarify responsibilities, improve accountability and to make the public sector more efficient. This process of renewing the federation should include a reassessment of intergovernmental financial relations to better align revenues and responsibilities and to improve accountability. Genuine reshaping of intergovernmental financial relations would also create considerable scope to improve the pattern of state and territory taxation.

Ai Group recognises the leading role the Victorian Government has played in recent years in the reform of state taxes and in the National Reform Agenda. We urge a continuation and an extension of this leadership in the context of the potential for improvement and the opportunities opened for intergovernmental cooperation by the election of a new Commonwealth Government.

Intergovernmental relations

Across a very wide range of governmental responsibilities, the Australian federation is performing well below its potential. For many, the federation has become a barrier to progress rather than a means by which there can be appropriate allocation of responsibilities between central, state and local governments and a source of policy experimentation and innovation.

Ai Group urges a reassessment of the workings of the federation to improve the allocation of responsibilities, the accountability and efficiency of government, and outcomes.

Ai Group urges a reinvigoration of the Victorian-initiated National Reform Agenda (NRA). This agenda, which is coordinated through the Council of Australian Governments (COAG), needs to be placed on a more dynamic foundation. This might involve providing incentives that impact both on the design and the timely implementation of measures. There is considerable potential for real progress to be made in regulatory reform; infrastructure development, planning and coordination, preventative health and education & training.

Ai Group has proposed a rolling reassessment of the allocation of responsibilities between jurisdictions. This should be conducted against clear principles and have the objective of improving accountability and efficiency of Australian government.

A key part of this rolling review should be reconsideration of intergovernmental financial arrangements. A structure that permits a closer alignment of revenue and responsibilities between the levels of government is required. This structure needs to be flexible enough to accommodate a new pattern of responsibilities and adjustments to the allocation of responsibilities over time. Ai Group has proposed a process similar to the National

Competition Policy approach where an independent body is charged with conducting the initial review; in assessing & reporting on progress in implementing a reform program; and in making recommendations about the allocation of incentives that reflect the costs & benefits of adjustments.

Taxation

Ai Group recognises the inroads Victoria has made over recent years in improving its pattern of taxation. Victoria has moved ahead of the pack in removing the range of stamp duties that were subject to the Intergovernmental Agreement at the time of the introduction of the GST. Victoria has also made changes to land and payroll tax that have reduced inefficiencies and stimulated business competitiveness.

While Ai Group would welcome further changes along these lines, given the current structure of intergovernmental finances, there are diminishing opportunities for improvements to the pattern of taxation imposed on Victorians and Victorian businesses. We therefore propose that the opportunities for larger-scale reform of the pattern of taxation be widened through the reshaping of Australia's intergovernmental financial arrangements as outlined above.

The Victorian government could again take a leadership role in an assessment of the range of alternative approaches to intergovernmental financial arrangements that would:

- Lift the potential the states and territories have to remove the most damaging of the taxes they currently levy; and
- Improve the balance between responsibilities and revenue raising;

Alongside this ambitious agenda, Victoria should also pursue a vastly accelerated program of harmonisation of tax bases across jurisdictions and across alternative levies on similar tax bases. These programs could be incorporated into the National Reform Agenda.

- There is particular scope to harmonise payroll taxes both between states and territories and between the three major imposts on payroll: payroll tax itself, workers compensation premiums and employer contributions to superannuation.



Business costs

In today's economic climate, intensifying global competitive pressures, skills shortages, the drought and a growing focus on energy-efficient production are all adding to the costs of business. In facing these challenges, Victorian industry looks to the Government for assurance that other business costs are being minimised.

To date, the Victorian Government has expressed a strong commitment to reducing business costs, a stance welcomed by industry. Much more needs to be done, however, to ensure the costs of business are not holding back the competitiveness of local firms.

Business costs, such as payroll tax, also act as a barrier to attracting offshore investment.

Ai Group calls on the Victorian Government to continue its push to reduce business costs, with particular focus on the following areas:

WorkCover premiums

Ai Group advocates a 10 per cent reduction in average WorkCover premiums in 2008/09.

Strong financial results and falling workplace injury claims have allowed the Victorian WorkCover Authority to make four consecutive 10 per cent cuts to average premium rates.

In the 2006-07 financial year, the VWA posted a \$1.2 billion net profit and saw workplace injury claims fall from 12.19 to 11.32 per 1,000 workers.

Ai Group believes these strong results give the Victorian Government scope to make a further 10 per cent reduction in average WorkCover premiums in 2008-09. The Government should also commit to annually assessing the scope for additional cuts to premiums and provide support for the VWA's plan to reduce the cost of operating the scheme.

The Victorian Government should also take a leading role in pushing towards harmonisation of WorkCover premiums across states.

Payroll tax

Ai Group proposes an additional 0.25 per cent cut in the payroll tax rate from July 2008.

While, Ai Group commends the Victorian Government for steadily lowering the payroll tax rate since assuming office, it has been our long-standing view that the rate should be cut to 4.75 per cent.

With Victorian economic growth expected to strengthen over the coming two years, Ai Group believes the time is right for the payroll tax rate to be lowered further.

Regulatory burden

Ai Group encourages the Victorian Government to continue implementing reforms that will reduce the regulatory burden placed on businesses.

The fundamental elements of these reforms, which have to a great extent already been adopted by the Victorian Government, should be:

- The measurement of compliance costs burdens;
- The refinement of these measures over time;
- Clear commitments to reduce burdens; and
- Transparent and effective accountabilities for achieving targets at both the political and agency levels.

Reforms are also needed to improve the effectiveness of regulation, particularly in the areas of:

- Harmonisation between states on workers compensation arrangements and in occupational health and safety; and
- The application process for all government grants, with a greater focus on performance outcomes.

Ai Group strongly commends Victoria for being at the forefront of attempts to reduce the administrative and compliance burden on business.

Under the *Reducing the Regulatory Burden* initiative, the Victorian Government has committed to reduce the administrative burden of State regulation as at 1 July 2006 by:

- 15 per cent over three years; and
- 25 per cent over five years.

It is important that the Victorian Government adheres to these commitments, providing a strong example for other state governments to follow.



Exports

Victorian firms are increasingly discovering that overseas markets can provide exciting opportunities for expansion and business success. Furthermore, the failure of firms to explore sales opportunities in global markets can place their long-term survival at risk. The Victorian Government must explore measures that raise the state's overall level of exports, as well as the frequency with which firms engage in overseas markets.

Ai Group continually receives feedback from small and medium-sized firms concerning the difficulty of both entering, and becoming entrenched in export markets. Many fear that shifting their focus towards global customers may jeopardise their position in domestic markets.

Ai Group believes the Government can help support new and prospective Victorian exporters by implementing the following proposals:

A post-market support initiative

The Victorian Government should consider establishing a post-market support initiative.

The initiative could be similar to that run in New South Wales, and would complement existing programs such as First Step Exporter program and the Trade Fairs and Missions program.

The initiative would provide exporters with the resources to adequately follow-up on market visits and successfully convert potential business into sustainable business.

Under the initiative proposed by Ai Group, financial grants capped at \$5,000 per company, would be provided to help cover the costs incurred in market visits. The grants would be provided on a dollar-for-dollar, matching basis.

The Victorian Government should also commit to funding the Next Step Exporter Program (NSEP) for the next five years.

Ai Group believes the NSEP has proven to be a very effective vehicle for converting emerging exporters into sustainable exporters.

Expansion of the Trade Fairs and Missions program

Ai Group supports the expansion of the Trade Fairs and Missions program to include market research and R&D missions.

Such tours would allow firms to benchmark their firm to world competitive standards, by observing best practice in action. They would also aid the exchange of ideas and information with peers in foreign industries.

Ai Group also encourages the Victorian Government to:

- Consider missions that cover many industries linked by a common theme (such as security or design); and
- Support missions that are dedicated to accessing global supply chains.
- Consider utilising the Australian/Victorian diaspora.
 - Many Australians are involved with overseas companies and large projects, often with exceptional understanding of the supply chain within the company and its purchasing needs.

Establishment of an export unit

The Victorian Government should establish an export unit as a central point of contact.

The export unit would ensure that Victorian Government services are delivered in a coordinated and cost effective manner and enable companies to take advantage of all programs, regardless of industry.

To maximize the benefits of a central network, regular network meetings with Ai Group and Austrade could be maintained to discuss respective export promotion programs which can then be coordinated for all of industry.



Exports (continued)

Simplified application processes for export programs

Ai Group proposes a simplified application process to programs such as the First Step Exporter and Collaborative Marketing Grant.

Many exporters do not apply for these forms of assistance due to the time-consuming nature of the application process.

The process should be simplified and the processing time reduced, to encourage more firms to access these grants.

Support for export market development and tendering

The Victorian Government should consider a program which assists companies taking active steps to develop in markets, particularly where tenders are being undertaken.

Many companies choose to have teams in the overseas destination, preparing documents, becoming known to the organisation, seeking the tender and gaining a better understanding of the local market.

On occasions, this requires numerous tenders to be supplied over a period of time, to ensure the Victorian company becomes known in the market.

Support for these initiatives may come from the Federal Government, but where those programs are unavailable the Victorian Government could provide support where companies are already making considerable investment.



Skills and training

The future competitiveness of Victoria will, in large measure, be determined by the extent to which businesses are able to attract skilled workers and upskill and reskill their existing workforces. Ai Group continues to stress the need to re-orient both the training system and the funding mechanisms to better meet the needs of business, to skill new entrants and to broaden and deepen existing workers' skills.

Recent OECD figures indicate that Australia is falling behind the OECD leaders in terms of financial investment in education.

Further, the Centre for the Economics of Education and Training has predicted:

- A shortfall of 240,000 qualified people over the next decade if supply remains at its current level; and that
- The resource base for vocational education and training (VET) will need to expand by 5 per cent over the next decade to avoid this predicted shortfall.

Ai Group strongly believes this underinvestment must be addressed and the relatively lower attainment levels of the workforce must be improved. This will require a concerted effort in both entry-level training and also in the broadening and deepening of the skills of the existing workforce.

The new Federal Government has made education and skilling a key priority for its term in Government. They are expected to focus particularly on:

- The upskilling of the existing workforce,
- Increasing the number of training places,
- The commitment to trade schools; and
- The allocation of funds to structured workplace learning.

In broad terms, Ai Group would like to see these initiatives supported at the state level. A practical demonstration would be for Victoria to support the integration of the local Australian Technical Colleges into the Victorian schools and technical and further education network to provide an integrated range of specialist trade facilities to bolster entry-level training.

Ai Group would like to see the Victorian Government focus its efforts on the following areas of education and training:

- **Work towards a new federalism for skilling** to ensure that allocated funding is utilised effectively and efficiently; that the quality of training delivery is raised; that there is real portability of skills; that duplication is removed and synergies between the various strands of training delivery are achieved; and that industry's needs for skills are well understood and delivered on.
- **Increase engagement and attainment levels of Victorian secondary school students.** It is proposed that current levels should be lifted to the point where 85 per cent of young people leaving school will have completed either Year 12 or commenced a Certificate III qualification, and that this increases to 90 per cent by 2015. Access Economics estimates that boosting the proportion of young people completing school or an apprenticeship to 90 per cent would boost annual GDP by 1.1 per cent by 2040, representing an extra \$500 a year per Australian.
- **Increase funding for the pre-school, school and vocational education and training sectors** to at least meet that of the OECD leaders. A particular target for additional expenditure should be VET in schools; funding should be linked to demand and the programs should be fully funded so that there are no tuition costs for these students.
- **Continue to lead reform of the training system including;** accelerate apprenticeship reform; overhaul funding arrangements; and build linkages between formal and other forms of learning. The Government could also consider subjects to encourage lean thinking and innovation.



Environment and energy

The demands on Victoria's finite energy, land and water resources have continued to grow in recent years, reflecting a rising population and expanding industry sectors. In addition, persistent drought conditions and a growing momentum towards environmentally sustainable practices have brought into question the way natural resources are used in Victoria.

To overcome these demands, the Government must nurture research into methods of reducing use of resources, energy consumption and waste.

Industry recognises that minimising waste, recycling, reducing inefficient energy use and adopting more environmentally sustainable production techniques will be enormously beneficial to Victoria's environment.

It also sees the commercial opportunities available to innovative Victorian businesses that are able to develop more environmentally sustainable business practices.

Ai Group calls on the Victorian Government to assist industry to meet its environmental challenges in the following ways:

Environment grants scheme for SMEs

Ai Group believes the Victorian Government should look to develop a small grants scheme, designed particularly for SMEs.

The environment grants scheme could be provided through the Victorian industry agility initiative proposed in the 'Innovation' section of this submission.

Interested SMEs could have their business audited to identify solutions to lowering greenhouse gases. This would be achieved through assessments of resource usage, including energy and water.

Funding for the implementation of these solutions could then be provided by the Victorian Government on a cost-shared basis. In many cases, the solutions identified by the audit might be no more than simple changes to operational procedures.

Ai Group's research has identified that many SMEs have a poor understanding of the sources of greenhouse gases in their businesses and means to lower emissions.

The environment grants scheme will buffer SMEs from the impact of higher energy charges as a result of the implementation of an emissions trading scheme.

As well, the costs of undertaking an initial audit of their operations can be quite costly, although in the long-term, the investment will contribute to lower costs for business and improved productivity.

Increased support for waste reduction

Ai Group urges the Victorian Government to optimise existing facilities for management of Prescribed Industrial Waste in order to reduce costs to the community.

There is also a role for the Victorian Government to support companies which are looking to reduce the generation of waste, as this will ultimately benefit the entire community.

The Victorian Government must ensure that the hypothecated funds from the substantial increase to the Landfill Levy go back into the specific management of Prescribed Industrial Waste.

Funding, not only through the sustainability covenant Ai Group has with the EPA, but also for introduction of projects, should be considered. Sustainability covenant funding is limited and not intended for capital infrastructure.

Where companies can show that investment will reduce prescribed waste, the Victorian Government should be willing to support the initiative with funding assistance.

Action is currently not being taken, particularly by SMEs, where there are competing cost drivers. Generous government incentives would be important in reducing such waste.



Water

The Victorian community is facing challenges from the persistent drought and the implementation of the Government's program of enhanced infrastructure for the delivery of potable water interconnection of the water grid. Ai Group believes the following water-related initiatives need consideration by the Victorian Government.

Water price determination

The Victorian Government must ensure that the Essential Services Commission (ESC) considers the full impacts on industry when determining the price of water.

In addition to the purchase price of input water, the ESC must also consider the related trade waste costs of treatment and discharge, which give a clearer picture of the cost of water to industry

Ai Group requests the Victorian Government consult with industry prior to the development of water trading arrangements, as well as in regards to long-term water entitlements for large water users.

Water pricing must also be equitable. All sections of the community – business, households, farmers – should contribute to the increased costs of water production, generation and facilitation.

Funding for water reduction

The Victorian Government should dedicate funding for assistance in large-scale reductions of potable water use.

Evidence from water management action plans (waterMAPs) by industry confirms that many opportunities for large-scale reductions in potable water use are not cost effective at the site. Yet the savings may be very important to water infrastructure investment.

The Victorian Government should dedicate a specific fund to provide the financial assistance to cover the difference between an agreed payback period (for example, three years) and the actual project cost.

This would bring forward the accelerated delivery of projects in industry that will cause significant reductions in potable water usage. This arrangement would support projects where the principal beneficiary of the project is not the host site in industry.

Lower expenditure on water manufactured through the proposed desalination plant will mean a lower cost to the community.

Establishment of an independent water agency

Ai Group believes that there should be an independent agency to make decisions about water usage in the Victorian water infrastructure in the future.

We recognise that the Government has accelerated the interconnection of Victoria's water infrastructure and has proposed additional sources of water, including desalination; a connection from the north of Victoria to Sugarloaf Reservoir; and a Bendigo-Ballarat Super Pipe.

Ai Group believes it is essential that the new agency source water from the cheapest of the options available from the traditional catchment (lowest cost) to the desalination plant (most expensive).

The new agency should have the equivalent responsibility in water management of VENcorp (Victorian Energy Networks Corporation) and NEMMCO (National Electricity Market Management Company) on the energy sector. These organisations have responsibility for system planning, market operation and transmission planning.

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