AUSTRALIAN INDUSTRY GROUP

Ai Group Submission to the 2011-12 Budget

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Executive Summary

The 2011-12 Budget confronts a complex array of competing short, medium and longer-term forces.

Despite the strength of mineral prices and investment in the mining-related projects, the patchy performance across the private sector is currently translating into slower aggregate growth than anticipated in the Mid-Year Economic and Fiscal Outlook (MYEFO) and in the Reserve Bank's November Statement on Monetary Policy.

A range of data including Ai Group's measures of performance in the manufacturing, services and construction sectors and our 2011 Business Prospects Report, point to continued patchiness over coming months as caution on the part of consumers and businesses, together with the disruptive impacts of the structural pressures on non-mining trade exposed sectors associated with the minerals boom continue to drag on aggregate activity.

However it is difficult to see the current caution on the part of consumers and businesses continuing through 2011-12, particularly in view of the growth in income associated with solid employment growth and high minerals prices.

Notwithstanding the fiscal tightening measures announced by the Prime Minister on 27 January, Ai Group anticipates that the extra labour commitment and call on material resources required in the flood and cyclone recovery and rebuilding efforts will add to organic growth in private sector demand as incomes grow and caution retreats. As a result, Ai Group's expectation is that, even though the economy currently remains patchy, we are facing the prospect that pressures on labour markets, skills shortages and underlying inflation will accumulate over the course of 2011-12.

The benefits and good fortune of having an economy approaching full employment and boosted by high export earnings from strong minerals prices should not be underestimated. However, on top of the immediate challenges of recovery and rebuilding in flood and cyclone-affected areas, Australia also faces fundamental challenges of a medium and longer-term nature. These include challenges to:

- Reignite productivity growth which has fallen alarmingly over the past decade;
- Equip ourselves to manage the ageing population by boosting productivity and participation;
- Retain a balanced and diversified economy that avoids becoming excessively exposed to mineral commodity exports to a handful of countries; and
- Best manage the bipartisan commitment to reduce Australia's greenhouse gas emissions.

To address these challenges, there is a need to:

- Increase efforts across all layers of education and training to lift the general and specialised skills of the existing workforce and of new entrants;
- Improve the level of investment in Australia's infrastructure and the processes of project prioritisation and selection; and
- Stimulate the business capability development and innovation that is so important to generating and disseminating sources of productivity improvement across the economy and that is required to put Australia on a low-emissions growth trajectory.

Building capabilities and encouraging innovation are particularly important for the sectors such as manufacturing, tourism, education and agriculture challenged by the strength of the dollar, the higher interest rates and the shortages of skilled labour associated with the minerals boom. Emphasis should be given to these sectors in programs aimed at building business capabilities and encouraging innovation.

These pressures on sectors such as manufacturing also heighten the importance of addressing important shortcomings in a number of policy areas. These include:

- Improving the workings of anti-dumping arrangements to allow rapid assessment of claims and more effective defence against detrimental dumping of goods at below-cost in Australian markets;
- Introducing and enforcing effective procurement arrangements to ensure full and fair access by Australian businesses in major domestic projects;
- Restoring business confidence in the Government's commitment to the Defence White paper and the Defence Capability Plan.

In an economy that is testing the limits of its capacity there is little spare to build new capacity and invest in developing skills, capabilities and productivity without taking away from resources in use elsewhere. We need capacity to build capacity.

Against this background, Ai Group's Budget submission proposes a framework to guide the reprioritisation necessary to enable us to meet current priorities and to make meaningful contributions to addressing our medium and longer-term challenges and we put forward programs and measures to build capacity and productivity.

Framework for the Budget

Ai Group expects the deficits in 2010-11 and 2011-12 to exceed the levels anticipated in the MYEFO due in part to the slower pace of activity than anticipated a few months ago and in part to the loss of revenue and extra spending associated with severe weather events.

We nevertheless anticipate that the substantial fiscal consolidation following the response to the Global Financial Crisis will continue – taking pressure off inflation and interest rates and pulling the Budget back towards surplus in 2012-13. After including the spending and tax measures announced on 27 January, an increase in the underlying cash balance in 2011-12 in the order of the 2.2% of GDP anticipated in the MYEFO, remains broadly appropriate in view of the march of the economy towards full employment.

Raising additional tax revenue, while lifting public sector capacity to finance new programs, would detract from the fragile recovery in private sector demand magnified by productivity-sapping deadweight losses on the broader economy. Any new measures and programs should, therefore, be financed by reducing existing spending.

Ai Group supports investing greater effort and resources into capacity expansion and productivity growth and we propose a number of initiatives to these ends. This will call for reductions in spending elsewhere and all efforts should be made to make way for a substantial reprioritisation of funding. Given that the priorities of the budget need to be on raising capacity and productivity, programs aimed at supporting these objectives should be excluded from general reductions in existing programs.

Policies to Boost Productivity and Capacity

Education, Training and Skills (see **Fact Sheet 1** for further details)

- Ai Group proposes a total overhaul of the national approach to workforce development that includes lifting funding to make up for the $660 million annual shortfall in current levels of funding for the Vocational Education and Training sector and overhauling the governance and effectiveness of the workforce training sector to lift quality and build coherence. Ai Group proposes the implementation of a national workforce development strategy under the guidance of a national workforce development agency charged with:

  - Ongoing development of national workforce development strategies;
  - Building on and expanding workforce development funding models to lift performance;
  - Improving the quality of skilling;
  - Establishing and servicing the National Standards Council;
  - Establishing a National Apprenticeship Commission which will upgrade and give coherence to apprenticeship arrangements;
  - Establishing a National Workforce Foundation Skills Fund aimed at lifting literacy and numeracy skills across the existing workforce and among new entrants;
  - Giving renewed focus to the critical area of the development of management skills;
  - Developing and implementing a national broadband skills strategy to ensure full advantage is taken of the opportunities of a national high-speed broadband network;
  - Ensuring that workforce development programs give emphasis to innovation-related skills; and
  - Complementing improved workforce development capabilities with more comprehensive and connected careers advice.

- Ai Group also proposes a set of measures to empower individuals to make better choices about their education and training decisions and to plan and keep track of their education, skilling and allied activities.

- Ai Group proposes a comprehensive re-engineering of apprenticeship arrangements to improve and streamline the disparate arrangements across the country; to lift retention; and to better link with secondary education.

- Ai Group proposes a range of measures aimed at improving the quality and industry relevance of higher education including by bringing the capabilities of the tertiary teaching profession to world-leading levels; improving the job-readiness of graduates and further developing links between the sector and industry. Ai Group also advocates increasing incentives to boost the number of students entering maths, science and engineering disciplines.

Infrastructure (see **Fact Sheet 2** for further details)

- While infrastructure investment has picked up in the past few years, Australia still suffers from an infrastructure deficit that accumulated from the 1980s and over the 1990s. With the economy on the road to full employment, Ai Group does not see an immediate capacity for major additional infrastructure projects over the next year or two. There is however, an immediate opportunity and indeed a need, to build on the start that has been made by the creation of Infrastructure Australia to improve the transparency and sophistication of processes of assessment, prioritisation and selection of major projects and to contribute to the development of alternative financing models. Ai Group advocates a nationally led upgrading of these processes across all levels of Government.

- To further inform and stimulate community discussion on strategies to address urban congestion, we also propose that the 2011-12 Budget fund three studies: a managed motorways study; a public transport pricing study and a congestion charging study. Each of these studies should draw on and cooperate with agencies across the Federation.

- To assist in building and disseminating the information about the full potential of a national, high-speed broadband network, Ai Group proposes a Broadband Flagship program to be coordinated by the Department of Broadband, Communications and the Digital Economy in cooperation with business and other agencies. The objectives of the project are to alert businesses in particular of the potential for innovation and productivity gains with ubiquitous high-speed broadband.

Innovation and R&D (see **Fact Sheet 3** for further details)

- The Government's proposal to change the research and development tax incentive with effect from 1 July 2010 has serious flaws that will undermine the effectiveness of the tax incentive. The Board of Taxation should be asked to assess the proposed changes in light of both the Government's explicit objectives (including revenue neutrality) and the claims from across a broad spectrum of the business community that the proposed changes will substantially erode the effectiveness of the tax concession. The Government should abandon its proposal to change the law with retrospective effect.

- Extending and strengthening the place of innovation capabilities within Enterprise Connect.

- Support the creation of an Australia-led regional innovation network linking businesses and researchers in the Asia Pacific region.

Building Business Capabilities (see **Fact Sheet 4** for further details)

- Ai Group proposes a substantial expansion of the successful Enterprise Connect program and the facilitation deeper engagement between businesses and advisers including in the development of management training, workforce development, e-business, innovation and collaboration.

- In the critical area of exporting, the Government should provide additional support for the Export Market Development Grants (EMDG) Scheme which is so essential to build businesses capabilities in exporting. There should also be appropriate funding for the Department of Foreign Affairs and Trade and Austrade for the development of trade policy and its implementation.

- Ai Group proposes a number of initiatives to build capabilities in energy efficiency. Ai Group recommends the creation of a CSIRO National Research Flagship for Industrial Innovation in Energy Efficiency. Ai Group also proposes a Commonwealth-led program for the development and dissemination of detailed advice on best practice in energy efficiency technologies. Existing provision of efficiency information by governments and agencies tends to be high-level and lacking in specificity. There is a clear need for much more detailed practical information.

- There is also a need for more active Government involvement in equipping and informing business of the need to incorporate climate change adaptation into its longer-term planning.

Workplace Relations

- Workplace relations play a central role in overall productivity performance and are also pivotal in the drive to lift workforce participation. While there is not currently an appetite for major improvements to workplace relations, in some areas it is evident that the *Fair Work Act* is impeding companies in maintaining flexible and productive operations. The following amendments are needed:

  - Reinstating the former prohibition on enterprise agreement clauses which restrict the engagement of on-hire employees and contractors;
  - Modifying the transfer of business laws to remove the current major barriers to outsourcing and restructuring;
  - Introducing a standard, legislated Individual Flexibility Term for enterprise agreements to prevent unions blocking access to genuine flexibility arrangements.

- The regulatory burden on business also needs to be addressed. For example, the Paid Parental Leave Scheme will impose substantial administrative obligations upon employers from 1 July 2011. Ai Group supports the scheme but the necessary funding needs to be made available in the 2011-12 Budget for an employer education program carried out by respected industry organisations such as Ai Group.

Taxation and Transfer Reforms

- Ai Group is a firm advocate of taxation reform across all jurisdictions and will actively engage in the Taxation Forum to be held later this year. Our priorities in taxation include:

    - Reducing the company tax rate to 25%;
    - Streamlining the taxation of business income for businesses of all sizes;
    - Re-modelling personal income tax and transfer arrangements to reduce barriers to workforce participation and to improve incentives for saving and investing;
    - Initiation by the Commonwealth of discussions with the states and territories over a re-design of Australia's intergovernmental financial relations to facilitate:
        - The removal of the range of inefficient taxes on goods and services levied by state and territory governments; and
        - Removing conveyance duties and other turnover taxes and levies on residential and commercial property;
    - Harmonising and making more efficient remaining state tax bases.

Defence (see **Fact Sheet 5** for further details)

- Recent Government announcements have undermined business confidence in the commitment to the Defence White Paper and the Defence Capability Plan. Firm indications in this commitment are needed. This should be complemented by an expansion of the Skilling Australia's Defence Industry (SADI) program.

Migration (see **Fact Sheet 6** for further details)

- The planning for the 2011-12 immigration program needs to take fully into account the intensifying skill shortages forecast for the middle of this decade.

    - The immigration program planning levels should be at least set at the same levels determined in 2008 of 190,300.
    - The Government should reduce the English language cut-off entry level to the independent skilled component of the program from International English Language Testing System 6 (IELTS) to IELTS 5 and change the scale to begin awarding 5 points at IELTS 6.
    - Consideration should be given to introducing a sliding scale for language requirements in the Points Test based on occupational language needs.
    - There should be no further tightening of eligibility under the 457 program.

The State of the Economy

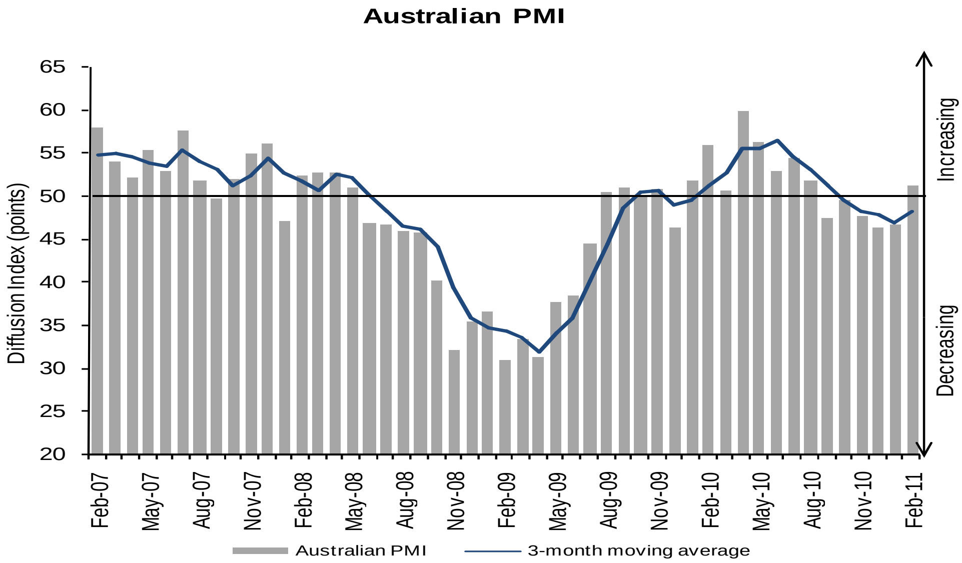
Current Economic Conditions

The Australian economy is making the transition from being dependent on government fiscal stimulus during the global financial crisis to its more traditional reliance on private domestic demand for growth as the fiscal stimulus is withdrawn. Further, after a temporary setback, commodity prices and demand from emerging economies is driving a resurgent minerals sector that is boosting current and prospective domestic incomes. The strength of mineral prices and investment in the minerals sector have heightened the value of the Australian dollar and prompted the Reserve Bank to raise the cash rate to a point where market rates are currently somewhat above their longer-term averages.

Australian businesses and households generally remain cautious in the face of these factors. Investment plans outside of the mining sector are mixed at best, the residential real estate market is flat and, while employment levels have recovered strongly post GFC and consumer confidence is not low, these fundamentals are not translating into consumer demand which remains weak.

Even before the disruptive impacts of severe flooding and Cyclone Yasi, Australia's economic growth was disappointing amid the tepid performance of business outside of the mining sector. The patchy economic conditions experienced outside of the mining sector in 2010 and in the early part of 2011 are shown in the findings of Ai Group's performance indices for the manufacturing, services and construction sectors (i.e. the Australian PMI®, Australian PSI ®and Australian PCI®, respectively).

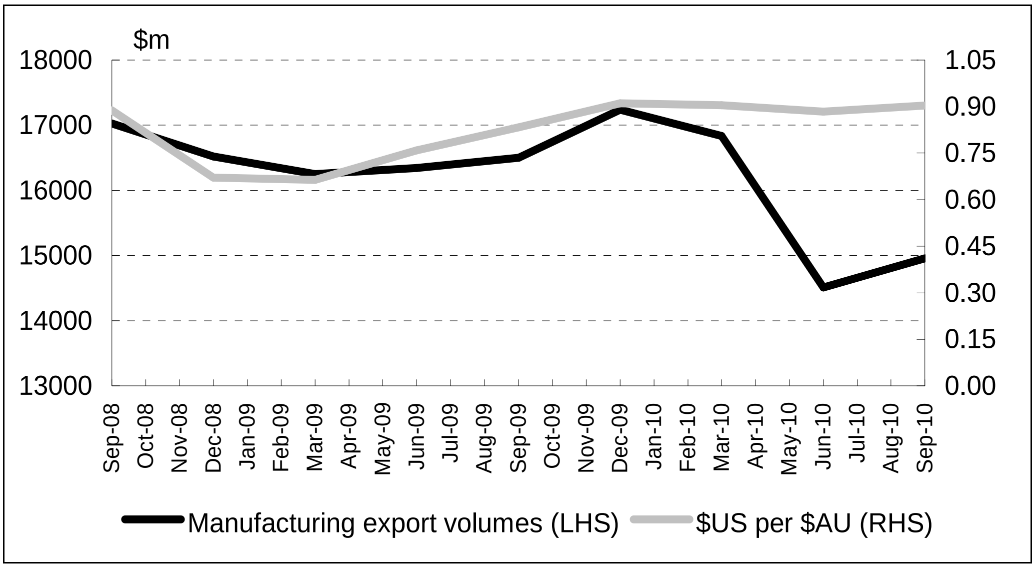
Chart: Australian PMI®
February 2007 to February 2011



In February 2011, the seasonally adjusted Australian PMI® indicated a mild rise in manufacturing activity but was the first reading above the 50-point level separating expansion from contraction since August 2010. The strong Australian dollar, intense overseas competition, slack domestic demand, higher interest rates and shortage of appropriately skilled workers have been regularly cited as the major influences that inhibited manufacturers over this period.

One of the factors underpinning the lacklustre performance of the manufacturing industry has been the growing pressure associated with an appreciating exchange rate. This has impacted on competitiveness and exports and is illustrated in the chart below, which shows the decline in manufacturing export volumes during 2010 as the Australian dollar approached parity with the US dollar.

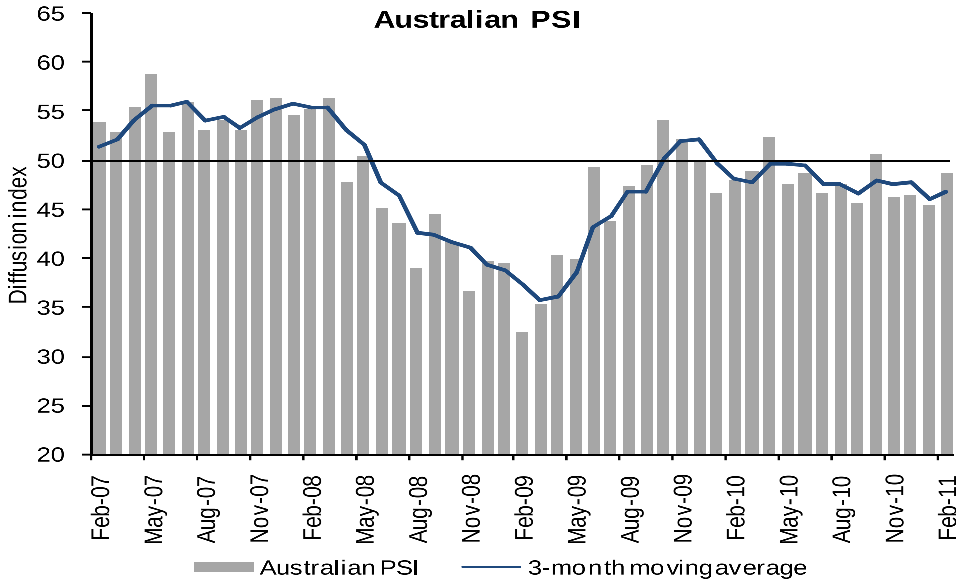
Chart: Manufacturing export volumes and $US exchange rate



Source: ABS.

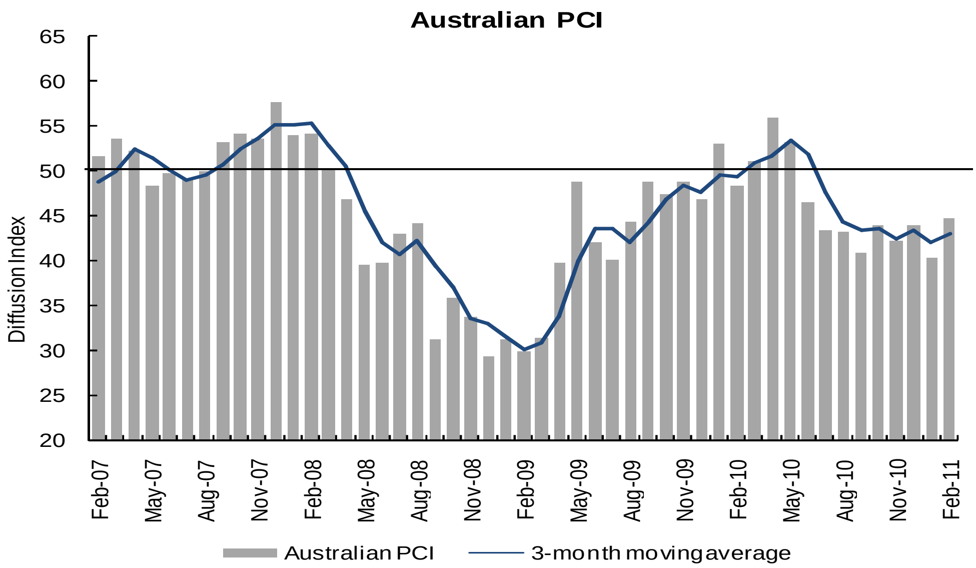
Ai Group's measure of performance in the services sector, the Australian PSI®, pointed to contractions in the services sector in ten months over the course of 2010 and into the early months of 2011 as caution on the part of households and businesses inhibited spending and activity.

Chart: Australian PSI®
February 2007 to February 2011



Ai Group's measure of construction sector performance, the Australian PCI®, for February 2011 revealed that the construction sector has contracted for a ninth consecutive month (see chart below). There was an improvement in the first half of 2010 followed by a subsequent contraction over the second half of the year and continuing into 2011.

Chart: Australian PCI®
February 2007 to February 2011



The further decline in the construction sector's performance coincided with numerous reports of difficult market conditions, intense competition to secure new contracts and a dwindling level of work from school building projects.

Residential builders also cited the negative impact on activity from recent interest rate rises and weak demand from first home buyers.

The Outlook for 2011-12

While current conditions are patchy across significant sections of the economy and the immediate outlook is subject to the disruptive impacts of recent extreme weather, Ai Group expects conditions to pick up over the course of 2011-12 as private sector demand improves and as recovery and rebuilding activity, particularly in Queensland, gathers pace.

Even though the stimulatory effects of rebuilding efforts will be offset to some extent by the flood levy and the deferral of spending in a number of areas, our expectation is that overall levels of activity over the course of the 2011-12 year will see further growth in demand for labour and bring us closer to overall capacity levels where inflationary pressures could re-emerge.

Despite this macroeconomic outlook, we anticipate that a number of trade-exposed sectors will continue to battle the headwinds associated with the mining boom's impact on the level of the dollar and pressures on labour markets and interest rates. Sectors such as manufacturing, tourism, education and agriculture will find the going tough in these conditions and are not likely to be major contributors to growth over the course of 2011-12.

Other sectors outside of the mining sector but less exposed to international trade and the strength of the dollar, appear likely to pick up over the course of 2011-12 as incomes, consumer sentiment and business confidence rise and fuel a more solid pace of growth in domestic demand than we are currently experiencing.

The mining sector appears set to continue its powerhouse performance with strong prices and ongoing investment and output growth.

There are both global and domestic sources of risk to this outlook. On the domestic front there is the upside risk of a faster-than-anticipated rebound in private demand pushing up inflationary expectations and interest rates. The largest downside risk appears to be a continuation of caution on the part of consumers and businesses to the extent that private demand fails to make up for the substantial withdrawal of fiscal stimulus.

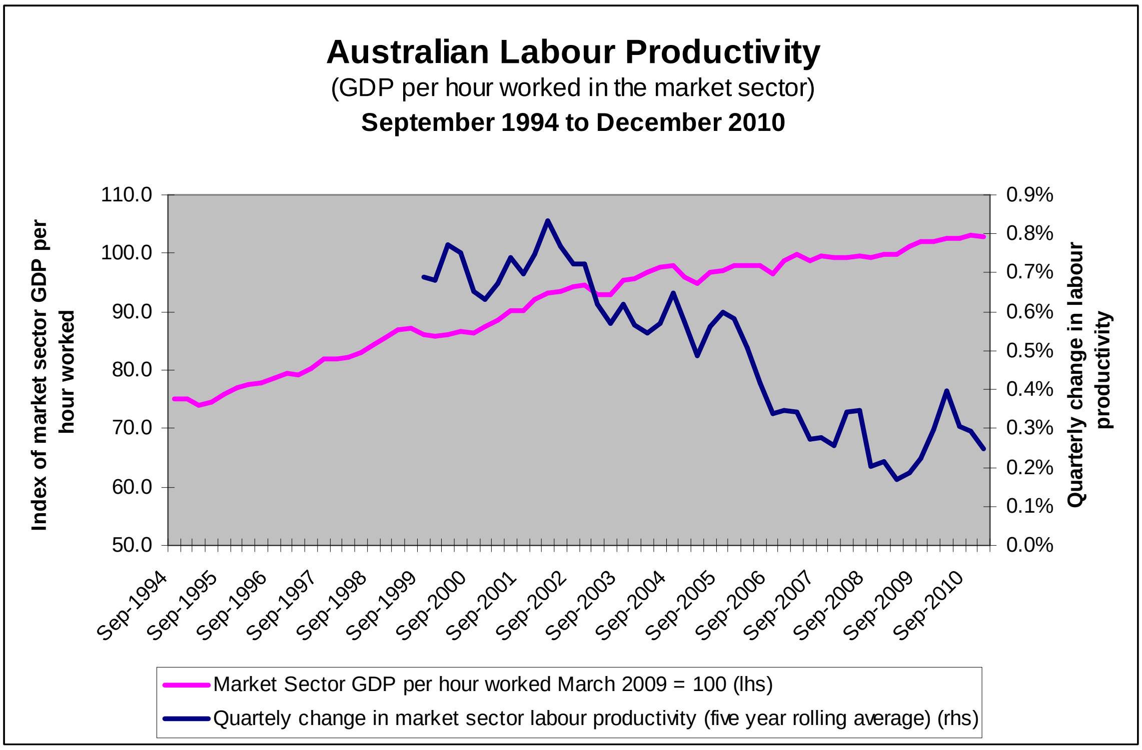
On the global front key risks revolve around the management of sovereign debt particularly in Europe; a setback to the emerging recovery in the US and Australia's heightened vulnerability to disruptions to the strong emerging-economies' demand for mineral commodities.

Economic Fundamentals

Australia's relative economic performance has been strong over recent decades. However, while it has been masked by solid workforce growth, the relatively strong performance of the economy in the face of the GFC and the strength of demand for Australian minerals commodities, since the early years of this century we have seen a marked decline in productivity, a considerable loss of international competitiveness and accumulating pressures on trade exposed industries outside of the mining sector.

The great productivity slump

As illustrated in the chart below, Australia's productivity performance has slowed markedly in recent years.



Source: ABS, National Accounts.

While a part of this decline has been due to the surge in longer-term investment activity in mining and mining-related construction projects (so that inputs have expanded ahead of the growth in associated output), the drop in productivity is widespread across the economy and reflects a number of factors.

- The gains in productivity over the mid to late 1990s were preceded by a range of big-picture, economic changes including the float of the dollar, the deregulation of financial markets, trade policy changes and labour market reforms, all of which after a period of adjustment added to labour productivity. Since the mid 1990s there has not been the same degree or scale of reform and this source of added productivity has tapered off;

- As employment has grown and substantial inroads have been made into the level of unemployment and long-term unemployment, many lower skilled and less capable people have entered and re-entered the workforce slowing the average growth in output per hour worked;

- Over the course of the 1980s and 1990s, the new “fiscal responsibility” saw substantial reductions in emphasis on capital works budgets and a comparative underinvestment in infrastructure. These chickens have come home to roost and productive performance in recent years has been adversely impacted by the state of our transport infrastructure in particular. While there has been a turnaround in the level of infrastructure investment in recent years, a considerable infrastructure gap remains.

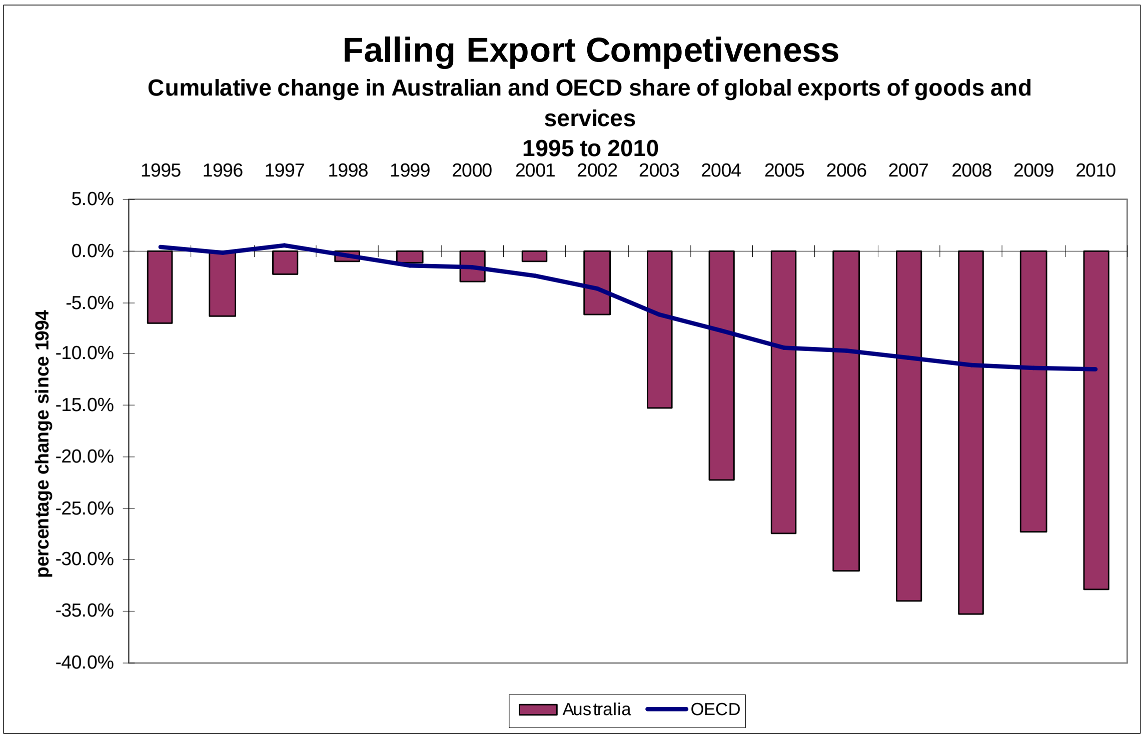
The seriousness of this decline in productivity has been masked by solid workforce growth, the relatively strong performance of the economy in the face of the GFC and the strength of demand for Australian minerals commodities.

The importance of productivity is intensifying with its role in future growth potential becoming more important. Another major source of economic growth – increased workforce participation as a percentage of the total population – is fading in the face of the gathering demographic storm unleashed by growing life expectancies and the collapse of the birth rate over the past few decades. While some further gains can be made in participation of people of workforce age, an inexorable shrinkage of the workforce as a proportion of the total population is in train.

Competitive performance

Australia’s competitive position has deteriorated markedly over the past decade in the face of the twin influences of the rise of new competitors (most notably China) and as the strength of the dollar has undercut domestic producers in export and local markets.

The export story is particularly telling and is summarised in the Chart below drawn from OECD data. The OECD’s share of global goods and services trade has fallen some 11% over the past 15 years as new competitors have emerged to challenge developed countries’ share of (growing) export markets. For Australia, however, the loss of market share over the same period is approaching one third. The strong dollar is the major difference while weaker productivity growth in Australia has exacerbated the decline in competiveness.



Source: OECD.

Competitive performance in the domestic market has also declined due to the rise of the dollar and falling productivity. These impacts have been intensified by the rise in "dumping" of below-cost goods in the domestic market and by an erosion of market share in large-scale development projects – particularly in the resources sector. Dumping is a major source of concern for domestic manufacturers as is the lack of access to significant resource-project contracts as modularisation of projects and lack of monitoring of fair access arrangements in local procurement guidelines is taking its toll.

The multispeed economy

The dynamics of the minerals boom and its impacts on the broader economy are now firmly entrenched in the national economic debate with three broad categories making up a multi-speed economy.

The minerals sector is growing strongly on the back of high prices and, as recent investments come on line this will be complemented by export volume growth. With the underlying causes of growth well entrenched in China and India and in train in a range of other countries, many are predicting an ongoing strength of demand for materials related to the industrialisation/urbanisation process – particularly coal and iron ore. The outlook – though never assured - is very favourable for the minerals sector and industries linked closely to it.

Economy-wide income growth and linkages to the minerals sector provide important stimulus to broad sections of the economy. Thus the outlook for non-traded goods and services is solid when the post-GFC bout of caution on the part of consumers and businesses eventually subsides.

The outlook for trade-exposed industries where mining sector linkages are relatively minor presents more difficult challenges. The strength of the dollar, labour shortages and interest rates that are high in relation to conditions in these sectors, collectively pose a formidable barrier to success. These industries include manufacturing, tourism, education services to foreign students and agriculture. In the manufacturing sector the position is compounded by the reduction in global prices associated with the industrialisation of emerging economies.

While not wanting to detract from the strength of the minerals sector or of the overall economy, a clear and definite policy response is warranted to ensure that Australia maintains a diverse economic base and is less exposed to the risks of overreliance on exports of a handful of commodities to a relatively narrow range of countries. These include:

- Policies that encourage aggregate economy-wide growth, including through strong immigration can assist in alleviating the internal sectoral pressures of the multi-speed economy.

- Policies to build productivity are particularly important for industries whose competitive position has been eroded by the heightened value of the currency.

- There is, further, strong potential for policies that build business capabilities in areas such as exporting, workforce management, strategic management. Policies that strengthen innovation by Australian businesses also have strong potential. If well-designed, an orientation in these programs towards businesses in trade exposed industries can lift aggregate economic performance and reduce the costs involved in the restructuring that is underway in trade exposed industries.

- An effective and WTO-compliant anti-dumping regime is vital additional policy armoury in an increasingly competitive world.

- Effective procurement arrangements that ensure that local producers are given full and fair access to compete for major projects are also an important element of broader national economic policy.

FACT SHEET 1

Education, Training and Skills

Investing in education and training, particularly in training that is linked to and reflects the needs of the workplace, is central to the efforts that Australia needs to make to meet our economic and broader social objectives. To these ends improvements and reforms can be undertaken across all elements of our education and training arrangements.

New Frontiers for Productivity: Workforce Development

Australia is currently experiencing skills shortages across the economy, including in many of our key industry sectors. These shortages are threatening the progress of many of our major infrastructure projects and will slow the rebuilding of flood and cyclone damaged regional economies.

Skill shortages are an immediate concern to industry and they are expected to intensify. Australia needs an additional 240,000 skilled workers over the next five years to meet the needs of an economy on the brink of unprecedented growth[1]. This estimate takes into account the skilled migration program which remains an important contributor to Australia's skill levels and which must be factored into a consideration of Australia's workforce development environment.

Skills shortages are being experienced across the economy and across the full range of skills. Of particular concern is the inadequacy of our workforce's foundation skills. Approximately 46% of Australia's working age population (7 million adults) has literacy scores below the minimum required to function fully in life and work. In terms of numeracy it was 53% or 7.9 million below the required level.[2] In excess of four million of these people are currently employed in the Australian workforce. The latest survey revealed that Australian levels have shown little improvement since the previous survey – 10 years ago. Literacy levels have a direct link to productivity levels[3].

A failure to develop these skills will result in decreased productivity and profitability. Other non-technical skill areas are also in shortage and those skills related to innovation are often overlooked. The Australian innovation system consistently underperforms on most measures of collaboration and networking. Information technology, marketing and business skills are the most frequent skills used for innovation. The largest shortage of skills required for innovation was in the trades.[4]

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[1] Skills Australia (2010), Australian Workforce Futures, Commonwealth of Australia

[2] Adult Literacy and Lifeskills Survey at http://www.abs.gov.au/ausstats/abs

[3] Canadian research undertaken as part of an OECD study indicates that a 1% increase in the national literacy score is associated with 2.5% higher labour productivity and an associated increase in GDP per capita. The recent Commonwealth Budget referred to the Productivity Commission estimate that increases in literacy and numeracy together with improvements in early childhood education and higher educational attainment could raise aggregate labour productivity by 1.2% in 2030.[3]

[4] Australian Innovation System Report 2010, Department of Innovation, Industry, Science and Research, Commonwealth of Australia

The approach to workforce development in Australia needs to be reformed, not re-jigged. Stalled productivity, skills shortages, demographic shifts reducing the future numbers of new workers and ongoing pressure on workforce participation rates, the new skills demands which will flow from the national sustainability and technology policies and outdated management practices are all deeply concerning challenges. There's no point continuing to roll out one-off programs; they're a short term fix to a long term problem. What's needed is a new approach.

The Australian skilling system is underfunded – by in the vicinity of $660m per annum. However, the problem will not be fixed simply by increasing funding. Nor will it be fixed just by focusing on skills. We need, instead, to move to a workforce development model focused on industry need and industry engagement, including improved and more effective financial engagement from industry.

Industry is deeply concerned about the impact of the move to a system driven by individual demand, as being rolled out through the Bradley reforms. Without proper oversight and management the public investment in skilling will be applied to skills which may not be needed and not be utilised by Australian industry. The result will be endemic waste in a financially constrained environment and this policy has the potential to contribute to a worsening of skills shortages. There needs to be a rebalancing of this direction so that enterprise and industry demand is considered together with individual demand.

While there are many positive elements of the current system, they are obscured by the fragmented nature of the arrangements. The policies, initiatives, funding and research activities focused on workforce development need to be consolidated in a national workforce development strategy. This requires a dedicated agency that will facilitate the development of the national workforce strategy and provide the focus to drive policy development and effective implementation.

Industry needs to have a key role in shaping the national workforce development system. Industry's voice in the national training system, and more recently the tertiary sector, has been progressively diminished in recent years. The results of this are plain to see and the only way to effectively address the skills shortages and skills development challenges is to draw on the advice and experience of employers who coordinate and harness the efforts of the workforce.

A national workforce development agency

The national workforce development agency would have the following features and would:

- Be an independent entity governed by industry;

- Demonstrate industry leadership and be highly collaborative working closely with key stakeholders, including Skills Australia and industry skills councils;
- Be a high profile organisation and the recognised authority by industry and enterprises for advice, policy and 'industry-stream' funding;
- Generate and co-ordinate industry demand for skills development;
- Deliver an authoritative policy capability to industry and government which would underpin decision making and be the source of up to date advice to industry;
- Provide the dissemination point for industry solutions and initiatives;
- Engage industry experts in workforce development who have a deep knowledge of how industry and enterprises work and who would form a multi-disciplinary team working cooperatively across industry and with government and other stakeholders. They would work to develop the policy and practice needed to work through the productivity, skills, management and innovation challenges;
- Demonstrate cost neutrality as it would be funded through the re-assignment of existing funds designed to support industry skills and productivity development. It would also work with industry, especially industry skills councils, to promote and develop co-funding arrangements.

Skills Australia currently provides a high level strategic advice to the Commonwealth Minister across all aspects of the training system, including workforce development. This agency would work with Skills Australia's advice, as it relates to workforce development and progress implementation and drive reform.

What the national workforce development agency would focus on

The functions of the agency should encompass:

1. The Development of National Strategies

    - Development of a National Skills Shortages Strategy and Implementation Plan - immediate priority;
    - Formulation of a National Workforce Development Strategy and Implementation Plan - a medium term perspective;
    - The National Workforce Development Strategy will focus on skilling issues associated with key components of the workforce including; new entrants via the apprenticeship system; the particular skilling and re-skilling needs of the existing workforce; foundation skills for existing workers; skilling of the mature age workforce; and a renewed focus on the particular needs of management.

2. Funding of Workplace Development Initiatives

- Administer, build on and expand the workforce development funding models, such as the Enterprise-Based Productivity Places Program and the Critical Skills Investment Fund

3. Improved Skilling Quality

- Inclusion of the new National Standards Council within the auspices of the Workforce Development Agency. The National Standards Council is the key policy body for the training, and subsequent workforce development system, and therefore, requires strong industry leadership and oversight.

- The overall quality of skilling delivered by the vocational education and training sector is not sufficiently high to lead to the development of the skills needed for Australian companies to be globally competitive. The significant public investment in skills development can be better leveraged to drive quality by requiring that demonstrated training excellence is a pre-condition of eligibility for tranches of public funding.

  Ai Group proposes:

  - Development and application of an industry-endorsed performance rating system to registered training organisations (RTOs) to provide transparent, credible ratings that differentiate the relative performance of training providers. Only those RTOs in receipt of the highest rating will be eligible to access Commonwealth and/or State and Territory training funds* allocated to existing worker training.
  - Support and appropriate resourcing for the establishment a truly National VET Regulator that is able to implement and enforce appropriate quality and compliance standards for the training system from its commencement.
  - Mandating the publication of data on RTO performance, including Australian Quality Training Framework audit reports, to provide information on which consumers of training can make decisions, as a condition of the receipt of public training funds.*

    *The proposals to link funding to training excellence applies to the funds allocated to contestable funding – not initially to the 70%-80% allocated to entry-level training, foundation skills development and other components of the general profile delivery and administration.

4. Establishment and auspicing of a National Apprenticeship Commission

A new National Apprenticeship Commission would:

- o Progress the approved recommendations from the Expert Apprenticeship Panel Report: *A Shared Responsibility – Apprenticeships for the 21st Century*.
- o Have the express purpose of delivering a reformed high quality Australian Apprenticeship system that:
    - forges nationally consistent apprenticeships
    - removes duplication of service provision
    - streamlines administrative requirements

  Ensure that arrangements and programs meet both current and future economic and occupational needs, including addressing foundation skill requirements.

- The next and subsequent Commonwealth-State funding agreements must include specific reference that all jurisdictions support and actively contribute to apprenticeship reform, including ceding apprenticeship regulatory and administrative arrangements where necessary.

- The Workforce Development Agency would have responsibility for implementation of proposed new arrangements that relate to employer incentives, as identified by the Expert Apprenticeship panel.

5. Establishment and administration of a National Workforce Foundation Skills Fund

    - The National Workforce Foundation Skills Fund which will be used to:
        - o develop a national workforce and numeracy and literacy strategy through which will be established a 10 year long term blueprint to identify and address long-term goals that will profoundly shift the capacity of learners and the workforce and significantly impact our nation's future
        - o establish a Workforce Foundation Skills Fund to assist employers to provide workplace literacy projects for their employees based on workplace requirements. This Fund will include but be broader than the WELL program.

6. Renewed Focus on Management Skills

    - Take a fresh look at Australian management needs and develop a new national approach to management skills development.

    Australian managers, as identified in *Management Matters,*[5] need to give more attention to building their people management skills and the relationships within their organisations and this is also

[5] Green, Roy: Management Matters

consistent with the characteristics of high performing workplaces. Governments need to explicitly support Australian company moves to become high performing workplaces by supporting management and leadership development.

In the first instance, and to highlight the need for the development of these business capabilities, Ai Group proposes the Government commission a national study of management capabilities which recognises the dramatic changes in the capability requirements of managers since the Karpin Taskforce's report of 1995 particularly around innovation, globalisation and sustainability.

In addition Ai Group proposes the further development of the Enterprise Connect initiative to include a particular focus on workforce development solutions. In addition to the business diagnostic services, companies would have access to specialist workforce skills development advisors who would work with them to:

- Provide advice to enterprises to link workforce skills development to broader business strategies with an appropriate emphasis on sustainability
- Develop tools to assist return on investment in workforce skills development
- Undertake an initial analysis of skills needs
- Develop strategies to encourage and support employee participation in workforce skills development
- Assist in the development of enterprise and individual learning plans
- Provide advice to support the building of the internal skilling capacity of enterprises
- Assist the enterprise to access relevant programs and services offered by training providers
- Develop tools to assess and monitor implementation and outcomes, including the productivity dividend and skills utilisation levels.

This work would be undertaken under the auspices of the Workforce Development Agency.

7. NBN Skills Strategy

    - Develop a NBN Transformative Skills Initiative – to assist enterprises and individuals prepare for and reap the benefit of the transformative potential of the NBN

8. Focus on Innovation

    - Innovation - foster and develop a strong approach to innovation within the context of workforce development initiatives.

Other Education and Training Proposals

Empowering Individuals

For individuals to be able to better choose between options and benefit from skills development they need information and advice which clearly explains the benefits, including in terms of return on investment, which will flow from maintaining and building their skills.

While the establishment of the myskills web site will go part way to achieving this end, it is also important that information and industry-focused lifelong careers advice is readily available. Individuals also need a straightforward means through which to plan and keep track of their education, skilling and allied activities and an efficient and consistent method of doing this would contribute to the more efficient development of skills and support an increase in workforce participation rates by assisting people to move back into the workforce and to reskill to move to new skill areas.

Ai Group proposes:

- The development of good industry-based information on which individuals can base decisions about the skilling options available to them. The costs and benefits of skilling, particularly as they relate to upskilling and re-skilling, need to be well communicated.

- As individuals increasingly take control and customise their own life-long learning, an appropriate range of tools and tracking mechanisms will need to be provided. These include a unique student identifier, skills passports and e-portfolios that can capture both formal and less formal forms of skilling.

Careers advice

Since the dismantling of the Careers Advice Australia (CAA) network, Ai Group has questioned the relevance and strength of engagement of careers advice provided for within National Partnership agreements. CAA had industry at its centre and as a consequence, high levels of industry engagement, particularly at the school – business interface, were developed. Without the national focus this has dissipated.

Never before has the provision of industry/employment related careers advice been so important. The introduction of individual-based entitlement funding models in the tertiary sector relies on the provision of robust and timely information. This information must be about employment, occupations and industry. Current careers advisory arrangements, such as they are, are not able to deliver this information in a coordinated, strategic and timely manner.

Higher education

Ai Group proposes the following measures aimed at improving the quality and industry relevance of higher education:

- The Government should commit to and resource a national strategy to lift the capability of the tertiary teaching profession.

- Build skills quality through the appropriate resourcing of the Tertiary Education Quality and Standards Agency (TEQSA). This is a key step in improving the regulation and quality of the post-school education and training sector, Ai Group supports the establishment of TEQSA and its eventual merger with the National VET Regulator.

- Further develop the linkages between higher education institutes and industry in order to improve the relevance to industry of tertiary skills development, and to facilitate knowledge transfer and foster innovation. Ai Group proposes the Government allocate funding to facilitate ongoing reform of course content in partnership with industry.

- To improve the job readiness of graduates, Ai Group proposes the provision of funding support to facilitate greater incorporation of employability skills into tertiary courses, including through the increased requirement to include work-integrated-learning in appropriate courses.

- To increase the number of students entering maths, science and engineering disciplines, Ai Group proposes the introduction of incentives for students to undertake courses in these disciplines to counter the anticipated further reduction in enrolment in these courses in the context of changes to higher education funding arrangements.

Infrastructure

Infrastructure is an essential underpinning to the productivity and capability ambitions outlined in this submission and Australia needs to

- develop a clear framework for planning to meet present needs and support future directions;
- maintain and reinforce a rational and transparent process to identify the highest-value infrastructure options;
- direct adequate and appropriate investment towards those options;
- ensure timely delivery; and
- ensure efficient use of the resulting assets.

Sound infrastructure policy nationwide is needed to accommodate population growth and to ensure adequate amenity and opportunity for Australia's existing population. Important steps have been taken towards these goals, particularly through the work of Infrastructure Australia, but also through the Commonwealth's growing emphasis on strategic urban planning and a National Urban Policy.

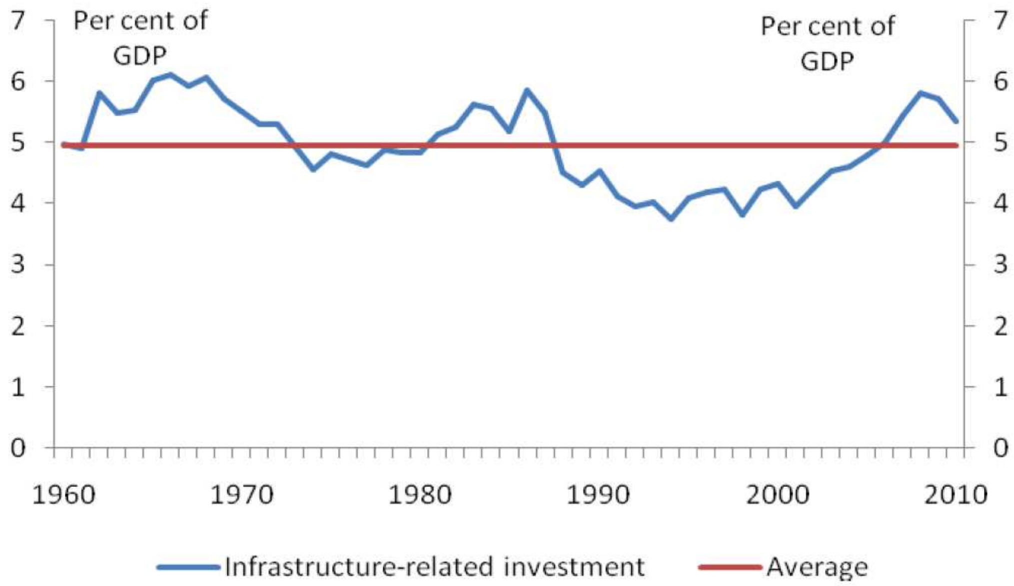
However, a strong and sustained commitment is needed. The governance arrangements around the Building Australia Fund were a welcome advance on previous practice, particularly the requirement that money from the BAF could only flow to projects endorsed by Infrastructure Australia. Substantive adherence to this practice even outside BAF funding decisions will be important to maintain high quality in future public infrastructure investment.

The initial endowment of the BAF was rapidly exhausted during the response to the global financial crisis, and while the Budget is expected to return to surplus over the next several years, there is unlikely to be fiscal capacity to replenish the BAF in this period. Yet the need for sound infrastructure is ongoing and long-term, and does not respect the vagaries of the budget or the business cycle.

Australia has underspent on infrastructure for much of the last two decades, and despite recent increases there is much ground to be made up (see Chart below).

Finding the necessary funding will require both innovation and flexibility. All options should be explored. Well-structured public-private partnerships can lower the risks faced by private investors while reducing upfront costs to the public purse. Privatisation of existing public assets can unlock substantial sums for reinvestment in new infrastructure. Many superannuation funds are willing investors in infrastructure and there is scope to build opportunities for and remove barriers inhibiting their fuller participation.

Chart Infrastructure Spending 1960 to 2010



Source: ABS cat no 5204.0.

It is also reasonable for governments to borrow to invest in productivity-enhancing, intergenerational projects with attractive cost-benefit profiles. This will require addressing community concerns with government borrowing and suspicion, in some cases well-founded, about project prioritisation and selection. One approach could be for government-issued infrastructure bonds to be available only for projects approved by an independent body. Such bonds could both overcome an indiscriminate aversion to public borrowing, and provide attractive long-dated investment options for superannuation funds.

The choice of funding method will depend on many factors, including the extent to which project benefits are private or public, the availability of private capital, and the state of public balance sheets. Whatever the method, substantial investment is needed and it must be made.

A second constraint is the risk that additional investment in infrastructure would bring forward inflationary and interest rate pressures by adding to the demand for labour and other inputs. While this is certainly likely to be a constraint over the next year or so (and it underlines the folly of the slump in infrastructure investment over the period from the second half of the 1980s when there was much more capacity in the labour market), there are considerable lead times involved as projects work through feasibility and other preliminary stages before adding substantially to aggregate demand.

In the meantime there is plenty of work to be done to improve the quality of planning, prioritisation and project selection and in refining approaches to financing. There is, further, scope for developing innovative solutions that allow for project-specific offshore sourcing of infrastructure capacity. This would ease pressures on labour markets and lift the capacity of the economy.

Congestion

One area of particular importance for infrastructure policy is urban transport congestion, which imposes serious and growing economic, environmental and quality-of-life costs. Addressing congestion is a crucial opportunity to raise both productivity and amenity, ensuring that a growing population does not intensify the waste of time, money and resources when commuters and goods are stuck in traffic.

There are at least three elements to an effective strategy on transport congestion:

- *Better management and utilisation of existing infrastructure*. The sunk investment in current road networks and other transport infrastructure is immense, and opportunities to make better use of these assets may be relatively affordable and immediate. These could include more active management of road systems, better provision of real-time information about transport options and network conditions, optimisation of public transport schedules and modal integration, and so on.

- *Investment in new transport infrastructure*. While much more can be wrung out of existing assets, growing cities and changing patterns of settlement and activity will inevitably require substantial new transport infrastructure. Public transport is an important part of the picture, though options pursued must be genuinely efficient; also important will be enhanced road connections between new hubs, as cities shift towards multiple activity districts.

- *Pricing reform*. More rational transport pricing – whether targeting congestion and road damage or reworking public transport subsidies – has the potential to encourage better use of transport systems and better decision making in transport and urban policy, while providing a revenue stream to help fund the investments needed to provide alternatives and address inequities. Unless congestion is targeted directly through pricing, new infrastructure investments risk simply inducing more traffic.

State and local authorities have traditionally dominated this space, but the Commonwealth can play a valuable role in coordinating better practice and helping fund strong projects. It has already begun to expand its role in urban transport with its contributions toward urban road and rail projects and the National Urban Policy currently under development. Infrastructure Australia's work will continue to play a key role in identifying further projects and improving funding decisions. These efforts should continue.

However, while congestion pricing has been widely recommended, including by the Henry Review, it shows little sign of imminent implementation. The potential is great, but there are substantial technical complexities, project risks, and community concerns about cost, privacy and equity. The result so far has been minimal activity from governments. Much more investigation and public debate is needed before congestion pricing can plausibly be implemented. What the Commonwealth can and should be doing, however, is to lay the groundwork that will turn congestion pricing from an abstract possibility into a real option for medium-term decision. To that end, there are several measures that could be funded in the 2011-12 Budget:

- *Managed motorways study*. Managed motorways use techniques like variable speed limits, priority allocation of road space and ramp access control to achieve more efficient utilisation of existing infrastructure. Several states have proposed projects in this area, with Infrastructure Australia assessing Queensland's proposal as ready for inclusion in the pipeline of projects for serious consideration. A national approach could help raise the quality of all proposals. To this end the Commonwealth should fund a study of the range of available and forthcoming systems and technologies for managed motorways, develop criteria for assessing suitable locations and a list of the best opportunities, and explore the scope for standardisation and interoperability for managed motorway systems nationwide to reduce implementation costs.
- *Public transport pricing study*. A more rationally priced transportation system would likely involve more dynamic pricing for public transport and potentially higher charges at peak times. It is also possible that road congestion pricing may improve the viability of public transport sufficiently to allow reductions to operating subsidies. However, implementation of pricing changes and new ticketing systems is highly complex, contested and risky. A Commonwealth-funded study should canvas the options for reform of public transport funding and pricing, particularly in the context of congestion pricing. It should also examine the suitability of current and forthcoming Australian ticketing systems for more dynamic pricing.
- *Congestion charging study*. If well-implemented, charging for road congestion could greatly improve the efficiency and amenity of Australia's city transport networks, with substantial economic benefits. However the greatest benefits are contingent on the most ambitious and dynamic systems, which carry significant project risk. The Commonwealth should:
    - examine relevant congestion and road use pricing systems worldwide, assessing their maturity and suitability for Australian conditions;
    - assess the best locations in major cities for potential future implementation;
    - develop standards for interoperability between systems, both to lower costs and avoid barriers to a seamless national economy;

- o develop principles for implementation and operation of congestion pricing systems, addressing community concerns including privacy and equity;
- o study the potential impacts of congestion pricing on relevant demographic and geographic groups in major cities, the transport options available to them, and their attitudes to congestion pricing proposals.

These studies should involve maximal cooperation, coordination and communication between the Commonwealth and States, since the latter have much of the relevant expertise and will be most directly involved in implementing any eventual policy.

Broadband Infrastructure

The successful rollout of the National Broadband Network is vital to protect an immense public investment and to provide the core of Australia's future information infrastructure. Many risks are involved, and while the NBNCo corporate plan indicates that these are being guarded against, close scrutiny will be required from the company, the markets and the Government as the rollout progresses. However, unlocking the full value of this investment is not just about building infrastructure, but also about building capacity to use that infrastructure effectively.

There is useful work being done by the Government on broadband applications in healthcare, education and parts of the 'digital economy', but the broader business sector has not been sufficiently considered to date. There is a lack of well-integrated and up-to-date information on the potential economic and business benefits of ubiquitous high speed broadband. The broader productivity agenda has had little to no substantive focus on broadband.

What information exists is not well framed in terms of business language, needs and concerns. Businesses themselves frequently don't know enough about the uses of broadband and ICT to recognise opportunities.

These gaps need to be filled if business is to take full advantage of broadband to boost productivity, growth and innovation – and for business in Regional Australia, to potentially erase some of the disadvantages of distance. Industry and government should collaborate in a Broadband Flagship program that addresses these gaps. This should find, describe and help seize the opportunities that broadband presents for business to raise productivity and boost the bottom line.

A Broadband Flagship program should be coordinated by the Department of Broadband, Communications and the Digital Economy in collaboration with industry partners and the Department of Industry, Innovation, Science and Research. It could have three components:

Phase One: Generating Knowledge on Broadband and Productivity. This element would draw together different strands of existing knowledge, research and expertise on the benefits available to business and the economy from smarter and fuller use of broadband. It could also highlight scope for, or even conduct, additional research on key aspects where existing knowledge is inadequate. The method would be an interdisciplinary dialogue and research effort, similar to the CSIRO's Flagship research programs.

The goal should be to produce a comprehensive statement of the state of knowledge on business and broadband: the relevant applications; the benefits potentially available; known barriers to take-up and effective use, including skills requirements and shortages; experience with and evaluation of attempts to unlock those benefits; and a statement of relevant elements and gaps in existing Government policies and agendas, such as innovation, productivity and so on.

The process should be guided by industry, but bring together participants from multiple areas with distinct and useful expertise for a series of meetings and ongoing dialogue and research:

i. Business groups and individual businesses who might be customers for/users of broadband and related applications;
ii. Service providers who might be vendors of broadband or related applications;
iii. Academics studying business productivity and use of broadband and ICT;
iv. Relevant government departments – Treasury, DIISR, DBCDE, possibly State industry departments.

Phase Two: Feeding Back from the Trenches. This element would involve on-the-ground assessment of business and broadband, conducted separately from but simultaneous with Phase One. How much do different sectors and sizes of business tend to know about broadband? How do opportunities vary? And what barriers do they face to their efforts to take advantage? Methods could involve surveys, embedding researchers at individual firms, or strong opportunities for feedback and discussion with small groups of businesses at workshops and other events. The results should flow back up to the interdisciplinary group and inform further work and policy.

Phase Three: Translating Broadband for Business. This element would take the Phase One research and use the outcomes of Phase Two to translate it for businesses of all sizes and levels of engagement, using clear business language and relating opportunities and risks to bottom-line issues. This should include developing a suite of case studies that highlight instructive instances of success by diverse businesses in exploiting various applications of broadband.

Once developed, this information would be rolled out to business through reports, fact sheets, events, seminars, newsletters and general outreach from business organisations and relevant Government departments. As with information provision in contexts like OH&S, IR and environment, industry organisations with a wide membership and strong reputation are very well placed to deliver this sort of education campaign in an authoritative and effective manner. Ai Group's existing Member Reference Groups for Telecommunications and Software, and our forthcoming seminar on business improvement in a broadband economy, are models for what can be done on a larger scale in a Flagship Program.

FACT SHEET 3

Innovation and Research and Development

Innovation is central to the recovery of Australia's productivity growth and is a key strategy in ensuring the ongoing diversity and balance of the economy.

Research and Development Tax Incentive

The Australian Government currently has a proposal to change, with retrospective effect, the nature of the formerly well-established tax incentive. While some changes are welcome, including the increased rate of incentive for smaller businesses and the improved access to the incentive for businesses in loss-making positions, Ai Group is deeply concerned that the overall effect of the changes to the tax incentive will reduce its reach and effectiveness. This is particularly important for the many manufacturing businesses who invest in experimental development (which is estimated by the Productivity Commission to make up two-thirds of business expenditure on research and development).

Ai Group recognises and supports the need for the authorities to monitor and upgrade the operation of the tax incentive to address areas of misuse. In this context we supported the revenue-neutral revamp of the tax incentive originally proposed by the Cutler Review. This revamp included the removal of the 175% tax incentive for certain incremental expenditure. However, our strong expectation is that the current proposals will significantly erode the reach and effectiveness of the tax incentive well beyond the stated intentions of the Government and in limiting the scope of eligible expenditure, will go well beyond revenue neutrality.

For over a year, Ai Group has called for the Board of Taxation to be asked to assess the proposed changes in light of both the Government's explicit objectives (including revenue neutrality) and the claims from across a broad spectrum of the business community, that the proposed changes will substantially erode the effectiveness of the tax concession. We maintain that this remains the appropriate course of action.

We oppose the current proposal to make the changes retrospective from June 2010.

Integration of Innovation in Skills and Business Capability Development

In this submission Ai Group proposes incorporation and strengthening of innovation within Enterprise Connect – the major national business capability development program and within the workforce development strategy that we propose. Giving greater weight to innovation in these areas should be aimed at improving businesses innovation readiness and their capabilities and raising the frequency and intensity of their links with research organisations and other businesses to lift innovation performance.

Support for a Regional Innovation Network

Australia's participation in international research and innovation networks can help provide opportunities for skills and knowledge exchange and forge new productive partnerships and trade and investment links.

A regional innovation network that brings together participants from rapidly growing countries in our region like China, India and Indonesia, will position Australia to develop opportunities associated with their strong growth prospects, their industrialisation, urbanisation and rising living standards.

A Review of International Best Practices of Programs to Promote Regional Innovation Systems conducted by the Inter-American Development Bank in 2009 identified 39 Regional Innovation System Programs - Australia was not identified as being involved in any of them.

Ai Group proposes that Australia take the lead in establishing a regional innovation network. Participating in such a network would allow Australian businesses and researchers to contribute to and share in the benefits of the surge in innovation and R&D that is occurring in the region. China, for example, continues to increase its spending on research and development and now accounts for 12 percent of global R&D spending. This spending is shifting from government-controlled research institutes to large and medium sized enterprises, which now account for 60 percent of total R&D spending.[6]

Existing International Regional Innovation System programs often utilise more than one policy tool to promote innovation in a region. Some of them link a broad range of policies, encompassing projects of collective research, technological services, sub-regional innovation stimulation and cooperation for clustering.[7] This broad approach would be ideal for an Australian- led Regional Innovation Network (RIN).

By adopting a broad approach, the RIN will assist interaction between public sector agencies, businesses, and private research organisations in the region.

The Department of Innovation, Industry, Science and Research is currently conducting a research project focussing on enhancing the capabilities and opportunities for Australian businesses to engage in international business collaborations for innovation. Ai Group proposes that this project, together with input from industry, guide the form of Government support for an Australian-led regional innovation network.

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[6] Orr, G. *Unleashing innovation in China*. January 2011. McKinsey Quarterly, McKinsey & Co.
[7] Regional Innovation Systems Review – Inter-American Development Bank 2009.

FACT SHEET 4

Building Business Capabilities

Enterprise Connect

As an initiative aimed at building capability, boosting productivity and increasing innovation in firms, Enterprise Connect has continued to make an impact on Australian SMEs.

The initiative has completed support for over 2,700 businesses since it commenced in 2007, with many more still engaged. The initiative has driven increased efficiencies, process improvements and cost reductions through a growing range of services.

As a partner organisation within Enterprise Connect, with 18 Business Advisers and R&D Facilitators, Ai Group has direct involvement with the services offered and feedback from members. The formal involvement of partner organisations in this initiative has proven to be a successful and effective method of accessing SMEs who can benefit from business support to build their capability.

Notwithstanding this, the initiative has found that SMEs at the lower end of the eligibility spectrum ($2m - $100m turnover in metropolitan areas) have been the dominant users of the services, as well as firms struggling to survive. Future vision for Enterprise Connect should include strategies to engage SMEs at the higher end of turnover eligibility, including more firms who are currently successful, but are looking to become even stronger, to grow and innovate. This will enable a greater emphasis on innovation in companies, over and above basic good business management.

Ai Group encourages the allocation of a substantial increase in the resources for the Enterprise Connect initiative to further build this business capability support, and with particular emphasis on the following:

Longer term business support in the form of coaching and mentoring

While acknowledging the usefulness of the current Business Adviser support of the businesses, and the follow-up specific purpose interventions by specialist providers, capability of Enterprise Connect clients would increase through longer, deeper relationships with Business Advisers.

Research of Enterprise Connect clients conducted in April 2010 by the Enterprise Connect Branch reported that 40% of clients cited lack of time and HR as the reasons that more recommendations from business reviews were not implemented. This suggests that the business reviews and any follow up activity for this proportion of clients may not have brought about desirable sustainable changes, designed to address HR and lack of time issues. Forty percent of clients also responded that their engagement with Enterprise Connect had not changed their long term potential.

It is more difficult to build the firm's capability through the current learning and mentoring service whose model does not focus on a single on-going trusted relationship which progresses over time towards written goals, and which manages the engagement of other support as required. Feedback to Ai Group from SMEs has indicated a preference for one relationship rather than a series of consultants coming into the business.

Any resources which support the ability of Business Advisers to build their time and commitment to those of their clients in need of longer, deeper on-going support is encouraged.

Structured programs to build management capabilities

Significant weaknesses have been regularly identified in SMEs around internal capabilities such as strategic planning, understanding business risk, financial management and an understanding of marketing. Within the Enterprise Connect initiative much greater effort is needed on management education of business owners and senior managers covering all areas of the business, in order that they are able to integrate improvements in different areas across the business. This learning will also drive greater innovation by business, since as innovation systems and strategies are embedded in firms, they in turn become the key to boost productivity, and ensure the firms remain systematically innovative.

Greater support to companies in e-business and customer interactive applications

SMEs, particularly if exporting, need to have world class online business applications in place, as well as being familiar with social media as an element of their marketing strategy. There needs to be greater effort put into improving IT literacy for application within businesses, and also to increasing the level of knowledge of the Business Advisers in this discipline.

Increase emphasis and coordination of research uptake through the program

A relatively low uptake by clients of the program's services which support R&D points to the need for increased resources to effectively design, manage, monitor and build activity in this area. The Enterprise Connect initiative needs to be a vehicle to stimulate innovation and technology in new areas, to change production processes and existing markets where advantageous. This includes facilitating more international links through global technology sourcing – a strategy recognised as vital to economies by the OECD.

Develop and adopt strategies/resources to attract more successful SMEs

Enterprise Connect needs to devote resources to attracting more businesses that are already well-run, not just struggling businesses. Building increased innovation into already successful businesses will have a greater positive impact on the economy.

Build and better utilise the industry sector based expertise of the program's Business Adviser cohort

Enterprise Connect Business Advisers not only have rich and relevant backgrounds, but have developed expertise in industry areas and business disciplines during their tenure with the Enterprise Connect initiative. Resources should be allocated in order that this expertise can be better harnessed, shared and utilised amongst the group of Business Advisers and used to support more sector based services to SMEs.

Create greater public awareness of the range of Enterprise Connect services

It is considered that more resources should be devoted, and further strategies identified to engage SMEs who are not involved with external networks, associations or groups, and as a result do not get exposed as easily to the services offered through the Enterprise Connect initiative.

Exporting and Development of Export Capabilities

Australian exporters remain at the forefront of the challenges presented by the strength of the Australian dollar. Outside the booming resources sector, Australian exporters are fighting hard to remain agile and internationally competitive in the face of continued global economic uncertainty.

With increased pressure from global competition at home and abroad, Australian industry knows that it must compete on productivity, price and quality. However, the current conditions are extremely challenging when attempting to develop opportunities in new export markets. For many companies, their ability to fund their own export development opportunities has been greatly constrained since the onset of the Global Economic Crisis.

For Australian exporters to be successful, Government needs to deliver domestic and foreign policy settings that support an internationally competitive and sustainable Australian export sector. This includes appropriate funding for the Department of Foreign Affairs and Trade, and Austrade, so that resources can be directed towards trade policy development and implementation, and appropriate funding for Customs to support a well-resourced and strong anti-dumping regime to address the growing trend of below cost imports unfairly challenging competitively-priced local goods and services.

In this context, the Government should provide enhanced support for the development of export markets and experience in global engagement. The Export Market Development Grants (EMDG) scheme is essential to industry's ability to actually capitalise on the market access gains delivered by free trade agreements and to develop opportunities in emerging markets.

Now more than ever, Government programs such as the Export Market Development Grants Scheme, TradeStart, Enterprise Connect and the Global Opportunities programs are crucial to assist Australian businesses explore the potential of entering new markets more successfully. Greater assistance is necessary to encourage industry to look beyond these shores – an extremely costly enterprise for SMEs – to develop and maintain contacts and credibility in new markets.

In the May 2011 Budget, it is imperative that existing support for exporters is not further diminished. The decision to cut $50 million in the May 2010 Budget from the EMDG program has negatively affected Australian exporters.

An annual allocation of around $200 million per year is the minimum program funding necessary to provide the necessary support and ultimately funding for the EMDG.

Year on year changes to the program have eroded Australian exporters confidence towards the Scheme. Going forward, it is vital that Government policy increases certainty for the EMDG scheme. Greater certainty must be provided through consistency of refund percentage and greater certainty around eligible expenses, beyond one budget cycle to the next.

The national network of TradeStart Export Advisors is essential in developing export capabilities among small and medium sized enterprises. We welcome the Government's decision (May 2010) to continue this very modest program, which has a huge impact and return on investment. Accordingly, funding should be expanded to returned to maximise opportunities for exporters.

The Government should closely consider the existing Budget commitments for these programs, which are fundamental to our members' success in their efforts to increase Australia's export performance.

Energy Efficiency and Adaptation to Climate Change

Energy efficiency

Energy efficiency is a key enabler for Australia – and especially industry – to manage rising energy prices and respond to any carbon constraint. Yet while energy efficiency is often said to be the low-hanging fruit of emissions reduction, it has proven to be a slower and more difficult fruit to pick than predicted. Ai Group's most recent survey of energy input costs and energy efficiency efforts identified that industry continues to be impacted by significantly rising energy input costs. Disturbingly, however, some 73 per cent of businesses surveyed have either made no energy efficiency improvements or experienced reductions in energy efficiency over the last 5 years, with a further 12 per cent reporting improvements of 5 per cent or less.

Over half of all companies surveyed (57 per cent) expect their energy efficiency will be unchanged over the next 2 years. Around 27 per cent envisage making marginal energy efficiency improvements and just 3 per cent of respondents expect to make significant energy efficiency improvements, with a similar number of respondents expecting deterioration in energy efficiency.

Analysis of the results identifies that neither the differing level of staff and investment resources available to respondents, nor the greater exposure of large companies to mandatory energy and efficiency reporting, appears to make a substantial difference to expectations. This serves to emphasise the importance of the provision of practical assistance to build understanding of energy efficiency opportunities beyond light bulb upgrades.

The difficulties of the former Home Insulation Program highlight the implementation risk that some forms of intervention face, but the need remains for substantial and well-considered government action to encourage and support worthwhile improvements in energy efficiency.

The national efficiency incentive recommended by the Prime Minister’s Task Group on Energy Efficiency has important potential benefits, particularly given the proliferation of similar schemes at the State level, but much further development lies ahead to ensure a sound measure that genuinely reduces confusion and compliance costs. Another important recommendation was reform to the national electricity market – broadly defined – to ensure that it does not reduce incentives for energy efficiency. This is a complex task that will require protracted effort involving all jurisdictions and stakeholders – but given the economic benefits, this reform should be a Commonwealth priority.

Progress is needed in streamlining the connection process for distributed generation, which currently slows or stops many worthwhile cogeneration projects. Much more work is also needed to ensure that the electricity market incentivises demand-side options (from paying customers to temporarily reduce their load, to more complex demand management, to investments in ongoing efficiencies) when they are cheaper than supply-side options like expanding generation capacity or network infrastructure.

Reforming the energy market and harmonising efficiency incentives between the States will take time. Building on discussions with the Energy Efficiency Council, Ai Group recommends two additional areas for more immediate Commonwealth action on industrial energy efficiency: encouraging innovation, and supporting adoption of existing technologies.

Innovation will be critical to enable Australian industry adjust to and thrive under higher energy prices and a potential carbon constraint. While pure research has an important role, on-site innovation and trialling of alternative technologies at industrial facilities of various sizes and sectors will be critical. While there has been significant investment in research into energy generating technologies, innovation investment in energy use has been substantially lower.

- Ai Group recommends establishing a well-funded CSIRO National Research Flagship for Industrial Innovation in Energy Efficiency, complementing existing programs in future manufacturing, light metals and energy.

Meanwhile, a great deal of existing technology and information is available that can help improve industrial energy efficiency today. Rising energy prices will increase the commercial necessity for companies to adopt existing energy efficiency technologies, but a range of barriers will continue to inhibit take-up. Government and industry can cooperate to address these barriers, particularly through detailed advice on best practice in energy efficiency technologies. Existing provision of efficiency information by governments tends to be high-level. What is needed is much more detailed information, drilling down to the level of techniques for optimising the performance of particular models of industrial equipment. This information exists at best-practice operations, and with moderate resources and productive industry-government collaboration it can be captured and made available to industry at large. It could also draw on the considerable amount of information collated in the upgrading of Australian / New Zealand Standard *Energy Audits* (AS/NZS3598).

Equipping businesses for climate change risks

Ai Group research also indicates that companies consider themselves poorly informed about strategies and approaches to managing climate change and greenhouse gas emission reduction.

Successful adaptation will necessitate action by industry to identify and respond to climate change threats at an early stage. Given that adaptive planning and decision-making within industry will primarily occur within the context of individual businesses or corporations, there is a need to better engage with business in understanding adaptation risks and in the identification of innovative and best practice adaptation strategies

- Ai Group advocates introduction of an Industry Adaptation Initiative focussing on development of pragmatic, broadly applicable approaches that will assist businesses undertake risk assessments. Such a program should incorporate:

  - Provision of information to industry on the practical implications to businesses and regions from the projected economic, social and environmental impacts of climate change
  - Practical assistance in the identification, assessment and implementation of innovative adaptation solutions including across supply chains
  - Trialling of adaptation solutions in priority sectors and regions.

A key objective is development of strategic resilience in industry through the identification and/or assessment of climate change adaptation initiatives and facilitate development of in-house expertise, including development of carbon management plans and internalisation of adaptation considerations.

Defence

The 2011-12 Defence budget is being framed at a time when many companies within Australia's defence industry, particularly SMEs, are hurting, and some badly. There are a range of reasons why this is so.

The Defence Incoming Government "Red Book" Brief, released by the Government on 28 October 2010, reported that the *Portfolio Budget Statement 2009 -10* foreshadowed 29 capability projects to be progressed – 15 First Pass approvals and 14 Second Pass approvals. Of these, Defence achieved approval of "(disappointingly)" only two of the 15 projected First pass approvals, and eight out of 14 Second pass projects.

On 17 December 2010, the Government released the revised, public Defence Capability Plan announcing the cancellation or postponement of 21 major equipment projects, or phases of projects.

The combination of both government announcements has caused consternation among Ai Group Defence Council members, all of whom had believed the essential program to equip and support the Australian Defence Force (ADF) announced by the Government in 2009 – including the Defence White Paper and Defence Capability Plan – would be met in accord with their foreshadowed budget and schedule.

Unfortunately, the perception that these fundamental policy plans are not proceeding as envisaged is causing a crisis of confidence for many within the defence sector. This needs to be addressed urgently by government, with the goal of reassuring our members that the policy of equipping the ADF will be fully implemented, in accord with earlier assurances, including on funding and schedule.

The Ai Group appreciates that there are limitations on the Government's ability to address some of these matters. However, more can be done to reduce skill shortages in the defence sector. The past year has seen scheduling delays and underspending on a number of major equipment projects, due principally to the inability of companies to retain experienced, highly skilled engineers and technicians, or to recruit new staff to replace them. Retaining skilled employees is critical to reducing risk in highly complex weapons systems acquisitions and systems integrations.

A solution to this problem is to expand the successful, low cost Skilling Australia's Defence Industry (SADI) program. This is not a plea for protection, but a policy prescription aimed at improving efficiency and boosting productivity within Australia's defence industry.

Over the past five years, the SADI program has enabled an array of defence companies, including SMEs, to address some of their skills shortages. However, the growing pressure from the mining and resources sectors for skilled workers, including high wages (reported to be $300,000 – plus for a welder per annum) being paid by major mining companies, is making it far more difficult for many defence companies to compete for scarce workers.

The most recent round of SADI funding closed prematurely on 2 July 2010. Submissions for that round were received from 74 companies, who sought funding for 472 training activities. Of these, 328 were eligible for funding, amounting to $7.8 million. In a Defence Budget of nearly $30 billion, such a low level of funding for such a critical priority is odd and needs to addressed, quickly. And, a further adjustment of the criteria for funding would assist a number of SMEs who missed out in the recent round.

Strengthened engagement with industry, including Defence capturing more quickly industry's ideas for boosting efficiency and improved work practices across major equipment acquisition and support programs, would provide a fillip to the $20 billion Strategic Reform Program, allowing reinvestment in SADI and other programs.

Consistent with the Gillard Government's goal to continue to develop a balanced, diversified, highly productive and vibrant national economy, the defence sector represents a solid platform upon which to help achieve this goal.

FACT SHEET 6

Immigration

Ai Group's view is that the current planning level for the 2010–11 Migration Program, which is set at 168,700 places (down from the originally-planned level of 190,300 in the previous year), remains significantly below what is required to avoid pressure on Australia's capacity and its attendant impact on costs and interest rates.

This view is based on clear evidence of re-emerging skill shortages which are set to intensify with the combination of our ageing population and labour demands influenced by the resources boom.

If we are to have the right skills at the right time and in the right place, lifting training and participation rates, of course, needs to be the first priority. However, studies of our future skills needs have demonstrated that there will be significant shortfalls of skilled labour in the coming years and we need to be willing to complement domestic labour supply with more skilled migrants.

We need the permanent migration program to remain focused on skill needs and we welcome the Government's emphasis in this regard. We also need to keep temporary programs, such as 457 visas, accessible to business and not further tightened. In this connection we welcome the proposal to streamline processes governing sponsored migration related to flood recovery and rebuilding.

In determining the policy settings for access to the migration program, the Government should also take into full account forecasts showing that our economy is in need of both skilled trades and tertiary qualified migrants. We believe the new Points Test for the independent skilled component of the program should recognise that different levels of English are required for different skills.

Additionally, the migration program has a role to play in addressing labour shortages that extend to unskilled and semi-skilled occupations.

The migration program should be set with an eye to two years out as this can be the length of time taken between application and arrival. The Australian economy is growing strongly, with unemployment set to fall further and the budget on track to return to surplus in 2012-13.

The economic forecast for 2011-12 is similar to the conditions prevailing when the 2008-09 planning levels were being considered ahead of the May 2008 Budget. At that time, the government set the planning levels for the migration program at 190,300. As the Minister at the time sated in a media release: this level was based on the need to *"help ease Australia's skills shortage and help fight inflation."*

We maintain that in setting the 2011-12 migration program levels the Government should be guided by the same judgements on skills demand and the impact on the economy which were made in 2008 when considering the 2008-09 program.

Ai Group proposes:

- The planning for the 2011-12 immigration program needs to take fully into account the intensifying skill shortages forecast for the middle of this decade.
- The immigration program planning levels should be at least set at the same levels determined in 2008 of 190,300.
- The Government should reduce the English language cut-off entry level to the independent skilled component of the program from International English Language Testing System 6 (IELTS) to IELTS 5 and change the scale to begin awarding 5 points at IELTS 6.
- Consideration should be given to introducing a sliding scale for language requirements in the Points Test based on occupational language needs.
- There should be no further tightening of eligibility under the 457 program.