Ai GROUP SUBMISSION

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Submission to the Commonwealth Government's 2014-15 Budget

Contents

About Australian Industry Group

The Australian Industry Group (Ai Group) is a peak industry association in Australia which along with its affiliates represents the interests of more than 60,000 businesses in an expanding range of sectors including: manufacturing; engineering; construction; automotive; food; transport; information technology; telecommunications; call centres; labour hire; printing; defence; mining equipment and supplies; airlines; and other industries. The businesses which we represent employ more than 1 million people. Ai Group members operate small, medium and large businesses across a range of industries. Ai Group is closely affiliated with more than 50 other employer groups in Australia alone and directly manages a number of those organisations.

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Executive summary

The substantial fiscal policy challenge over the rest of this decade is to move federal, state and territory budgets out of structural deficit positions and to rebuild the fiscal wriggle room that helped insulate Australia from the severity of the global financial crisis. For this to be achieved we need to contain the growth of public expenditure; extract better value from the public expenditures we do make; and upgrade our taxation arrangements so they raise the requisite amount revenue while doing as little damage as possible.

There are two other key policy challenges complicate this task.

Firstly, it is critical that the path to fiscal consolidation does not worsen the current patch of slow growth in the economy. Ai Group's close liaison with a broad cross section of the business community suggests clearly that the economy is very unlikely to be in a position to withstand big aggregate spending cuts or tax increases in 2014-15 without provoking slower growth and lower revenue collections.

This is, essentially, a short-term challenge and is about the timing of measures and their near-term impact rather than their extent over the remainder of the decade (which is the appropriate timeframe to plan for a fiscal consolidation of the magnitude that is required).

Secondly, the central structural challenge facing the economy is for it to become more balanced and to diversify away from the recently increased exposures to commodity prices and demand for resource and energy commodities in a handful of countries. This will require not just a lift in aggregate growth but also, as the Governor of the Reserve Bank has pointed out, a development direction that sees a particular lift in the trade-exposed sectors of the economy that have been squeezed by the high exchange rates that have prevailed over recent years.[1] For this to occur we need to lift productivity to restore the competitiveness of Australian businesses, particularly in the non-mining, trade-exposed sectors of the economy.

This submission emphasises the importance of measures to enhance the growth and productivity improvement needed for the longer term strength, balance and resilience of the broader economy. In particular we advocate retaining, expanding or introducing a

[1] Reserve Bank of Australia Governor Glenn Stevens, *Remarks to Citi's 5th Annual Australian & New Zealand Investment Conference*; Sydney, 29 October 2013.

number of initiatives to boost our workforce skills, our business capabilities and our capacity to innovate.

This concentration of developing the ingredients of growth is complemented by a range of measures in infrastructure, taxation, energy and environment and the defence sector. We do not include in this submission another important range of non-budgetary policy areas that are also critical to improved productivity and competitiveness. These include improving workplace relations to remove inflexibilities and undertaking measures to reduce the stifling red and green tape burdens on Australian businesses.

The orientation in this submission on building the economy does not detract from the seriousness of the task of fiscal consolidation. Indeed, it is clearly true that there is a substantial fiscal challenge for the rest of this decade that will not be easy to address. Nevertheless, a key element in meeting this challenge is to build a productive and competitive economy that is also more balanced and resilient. Growing the size and strength of the economy will also grow the tax base while building a more balanced and resilient economy will reduce the volatility of revenue collections which have become increasingly vulnerable to fluctuations in global commodity markets.

Thus, notwithstanding the extent of the fiscal challenge, there is no reason that with appropriate management, we cannot also meet Australia's growth and productivity challenges while navigating a course that is conducive to recovery over the next year or so from the slow patch we are currently experiencing.

Summary of Specific Recommendations

Ai Group takes the view that the transformational processes at work in Australia need to be complemented with investments in the longer-term drivers of business productivity.

In ***skills, education and training*** we recommend:

- Continuing to encourage industry participation in **skills policy** formulation;
- Retaining the National Workforce Development Fund (NWDF) or similar enterprise based co-contribution fund to upskill existing workers;
- Providing an additional 3% funding to the annual VET budget to 2025 to support the attainment of COAG determined targets;
- Ensuring an ongoing commitment to monitor and improve quality in the VET sector including endorsing revised and implement Standards for RTOs, as developed by the National Skills Standards Council and ensure the national regulator, ASQA, is adequately resourced;
- Piloting demand-side **apprenticeship** reform models through 'Gateway for the Trades' (formerly Alternative Trade Pathways pilot);
- Strengthening group training arrangements for apprenticeships by ensuring continuation of Joint group Training Funding;
- Implementing a genuine national approach to apprenticeships by establishing a National Apprenticeship commission or similar entity;
- Providing the National Foundation Skills Strategy with an adequate budget, and a national awareness campaign needs to be developed and implemented in consultation with industry and other key stakeholders;
- Significantly expanding funding allocation for **English literacy programmes** like WELL to provide Language, Literacy and Numeracy skills program access for existing workers;
- Implementing funding reforms to facilitate the achievement of a world-class **school education system**;

- Developing and funding major initiatives to lift literacy and numeracy achievement in parallel with the anticipated efforts and activity under the National Foundation Skills Strategy;

- Reviewing policy for VET in schools across all jurisdictions;

- Supporting major initiatives in the school sector and in teacher education to lift Science, Technology, Engineering and Maths (STEM) subject participation;

- Supporting a range of measures designed to improve the capability of the teaching profession;

- Investigating the leadership and management skills required to drive innovation and productivity, particularly in light of the Asian century and the emerging digital economy;

- Supporting the development of practical tools and new methods for a new leadership and management development model particularly for SMEs;

- Looking at measures aimed at improving the quality and industry relevance of **higher education** including the need for close monitoring of the alignment of student demand to industry need, the impact on skill shortages, the impact on the VET sector and whether quality arrangements can be established and maintained;

- Further developing the linkages between higher education institutes and industry in order to improve the relevance to industry of tertiary skills, and to facilitate knowledge transfer and foster innovation between higher education and industry;

- Facilitating greater incorporation of core skills for work into tertiary courses and the development work-integrated-learning and professional cadetships/internships; and

We make the following recommendations to ***lift business innovation and capability:***

- We commend the Government's announcement of Strategic Growth Action Agendas aimed at lifting industry competiveness and capabilities. We would encourage the Government to ensure this program is adequately funded so fulfill its worthy objectives;

- We stress the importance of collaborative links between research institutions and industry as an important means of lifting the pace of innovation by Australian businesses. In particular, we support ongoing funding to Cooperative Research Centres Program and Industry Innovation Precincts;

- We strongly urge the Government to maintain its level of commitments to proven Enterprise Connect program provides ongoing crucial strategic advice to Australian businesses;

- Ai Group supports the Government's decision to maintain the core digital economy programs managed within the Communications portfolio, and in particular the Digital Business Kits and Digital Careers programs to take advantage of high speed broadband;

- We support the ongoing simplification of the process for businesses seeking environmental approvals; and

- Ai Group applauds the announcement that the Government will commit to holding two regulation "Repeal Days" a year and would encourage the Government first focuses on removing those regulations that are proving to be obstacles to business.

In the areas of ***environment and energy policy*** we recommend:

- The Government needs to ensure the regulatory and policy development structure is resourced adequately to advance its existing expansive reform agenda;

- We emphasise the importance of providing certainty to industry on Emissions Reduction Fund funding availability;

- We encourage the Government to remove Energy Efficiency Opportunities burdensome reporting obligations following the removal of funding; and

- We encourage the Government to consider maintaining funding levels of the Australian Renewable Energy Agency, which has the potential to lower the costs of future energy options.

Our priorities for ***taxation*** are:

- Ai Group supports the Government's proposed, nothing-off-the-table review of Australia's taxation arrangements and recognises that the timing of this review will extend well beyond the timeframe for the 2014-15 Budget; and

- However, the Government should consider changes to taxation to assist in the major policy directions proposed in this Submission including targeted tax incentives for business spending on workforce training and on innovation and investment in capital equipment.

Immigration:

- Increase the migration planning level for 2014-15 from 190,000 to 220,000, with a sharper focus on lifting the proportion of the program devoted to skilled migration.

Defence Industry:

The Ai Group submission offers strong support for the Coalition Government's commitment to no further cuts to the Defence spending and, over the next decade, an increase of the budget to 2% of GDP, up from the current 70-year low of 1.59% of GDP.

Over recent years, Australia's defence industry has witnessed savage cuts to Defence spending (e.g. $5.4 billion cut in the 2012-13 Defence Budget) leading to cancelled major equipment projects, lower levels of sustainment of equipment for the Australian Defence Force and reductions in essential training for the troops.

We propose:

- Provision of proper funding to Defence. This will enable the ADF to meet its many operational responsibilities overseas, including its role in border protection; and

- Restore confidence to Australia's defence industry to enable it to maintain and improve its workforce skills and invest wisely in infrastructure essential for the security of the nation, including securing the future of Australian naval shipbuilding and committing to the Future Submarine Program, Joint Strike Fighter Program and new armoured vehicle capabilities.

For **infrastructure**:

- Ai Group supports the Abbott Government's commitment to building vital infrastructure;

- We encourage the Government to carefully consider and where appropriate act on the recommendations made by the current Productivity Commission inquiry into the Public Infrastructure costs;

- We welcome the Government's commitment to ensuring Infrastructure Australia undertakes thorough cost-benefit analysis of all its infrastructure spend;

- We encourage the new Government to ensure that all decision making on infrastructure spending is transparent;

- We also encourage the Government to partner with private sector where appropriate to build and/or operate infrastructure; and

- Finally, we ask the Government to reconsider the onerous tendering requirements it places on construction firms.

The Economic Context

In 2014, Australia faces yet another year of lacklustre economic performance following 2013's disappointing year of below-trend growth and rising unemployment. But the defining feature of 2014 in contrast to recent years will be our slide down the ladder table of economic performance. Both private and official forecasters see 2014 as the year the recovery in major advanced economies will finally gain traction, yet Australia is set for another year of soft growth and rising unemployment.

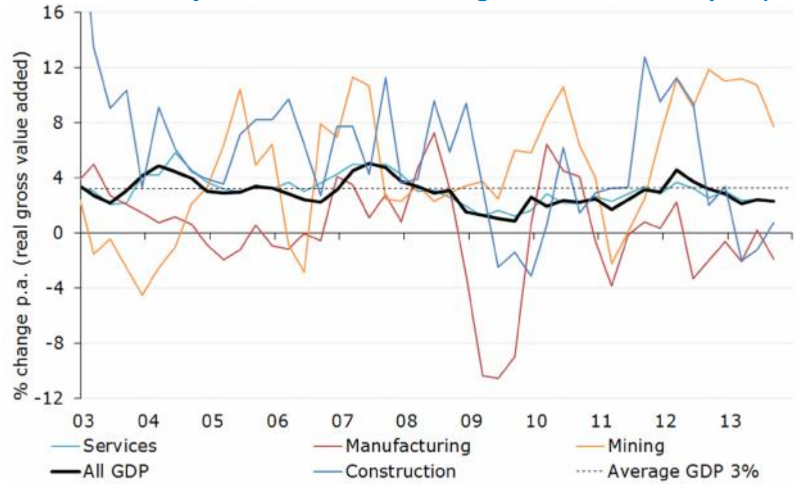
The International Monetary Fund's World Economic Update in January forecast world output will grow by 3.7% in 2014 and 3.9% in 2015, up from 3.0% growth seen in 2013. Leading the way will be an upswing in the United States, but Europe will also contribute to global growth as the area finally emerges from several years of recession. Emerging Asian economies will continue to grow, albeit at a slower pace. China, our largest trading partner, is forecast to grow by 7.5% in 2014, which is slower than recent years though still firm.

In 2013, Australia experienced a year of rising unemployment and below-trend growth as the resources sector transitioned away from investment towards extraction, and the non-mining economy remained soft as the high dollar weighed. The most recent ABS data showed the Australian economy grew by 2.3% over the year in real terms, well below the commonly-held view of trend growth sitting at 3% annual growth. Three sectors – mining, finance and health – showed strong growth in value-added output through 2013. On the other hand, the manufacturing industry, together with construction and professional services, has been especially weak recording flat or declining growth in recent years (Chart 1).

The transition toward resource production meant the sector contributed to growth through export earnings rather than driving engineering investment as mining has in recent years. But export earnings were also hit in nominal terms by falls in commodity prices, and the country's terms of trade, which hit national income. The shift away from investment also meant the resources sector no longer required large construction workforce to build new mines and this, together with softness in the non-mining economy, contributed to a rise in the unemployment rate to 5.8% in December 2013.

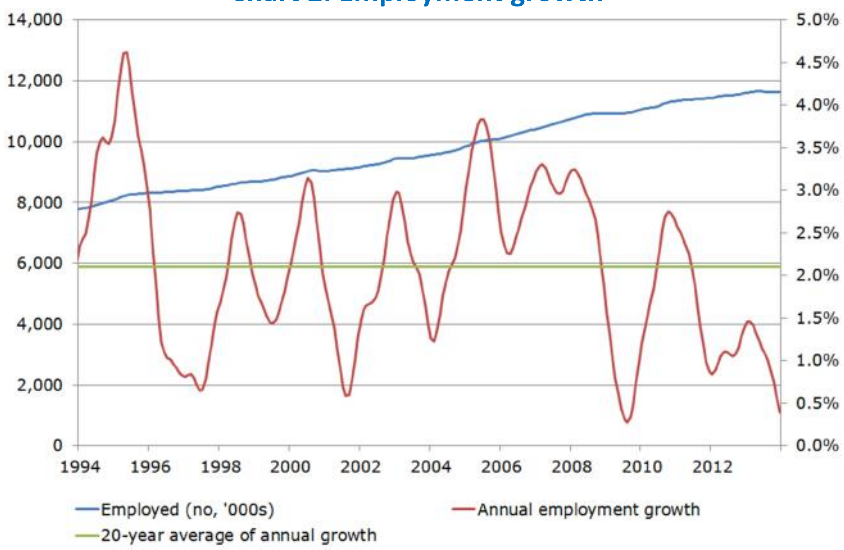
Uncertainty surrounding the labour market worked to dampen consumer confidence and the post-election rise seen after September was short-lived. Household spending in recent years has been soft as a prolonged period of below-average employment growth has weighed on sentiment (Chart 2). It has been apparent for some time that conditions in the broader economy are holding back key non-mining sectors which are in no position to compensate for the end of the boom in mining. Recovery in these sectors now holds the key to a pick-up in employment growth, a strengthening of the general economy and a recovery in revenue collections and the budgetary outlook.

Chart 1: GDP and major industries, annual growth in real output (% p.a.)



Source: ABS, *National Accounts*. Sep 2013.

Chart 2: Employment growth



Source: ABS, *Labour Force*. December 2013.

However, the forecasts presented in both the Government's Mid-Year Economic and Fiscal Outlook in December and the Reserve Bank's November Statement of Monetary Policy both predict below-trend growth for 2014 of 2.5%, well below the commonly-held view of trend growth of around 3% per annum.

Business investment is forecast to fall in both the current and the following financial years and moderate growth in household spending is anticipated due to ongoing slow employment growth. Despite an overall subdued picture, there are bright spots - chiefly historically low interest rates supporting asset prices and dwelling investment activity. The depreciation in the currency should also provide some support to non-mining sectors.

The Australian Industry Group's own data is in line with these forecasts. In our *2014 Business Prospects* publication, we surveyed 241 CEOs drawn from a wide cross-section of businesses around the country. They expect business conditions in 2014 to be only modestly better than in 2013 than those they experienced 2013.

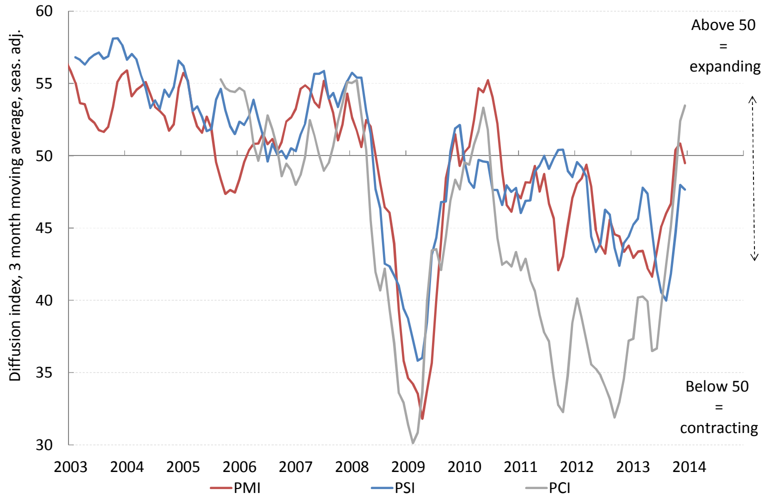
The CEOs cited slow demand across the economy as the main concern for growth in 2014, while wage pressures and the inflexibility of industrial relations have re-emerged as key potential impediments to business growth. More encouragingly, the survey has found an apparent improvement in the ability of manufacturing businesses to compete at a higher Australian dollar range compared to 2011, both in export markets and against import competition.

At a sectoral level, Ai Group's data fits within this picture of some strength in construction and services while manufacturing appears set for tepid growth. Ai Group's monthly indices monitoring business conditions in the manufacturing, services and construction sectors (respectively the **Australian PMI®**; the **Australian PSI®** and the **Australian PCI®**) point to softness across large sectors of the economy for the year ahead.

The latest **Australian PMI®** showed contraction in the manufacturing sector for a second straight month at 47.6 in December 2013, where a figure below 50 signifies contraction. The index sat below 50 for most of the past year, apart from two months of renewed confidence among business following the September federal election. However, the election boost to confidence has dissipated and the subsequent mid-December announcement by GM Holden it would cease local production also likely to have dampened confidence. The forward looking sub-sector indices like new orders and employments also sit below 50 but have strengthened over the year.

The latest seasonally adjusted **Australian PSI®** fell by 2.8 points to 46.1 points in December, its lowest level since August. The **Australian PSI®** has been indicating contraction since February 2012, the longest run of continuous contraction since this data series commenced in 2003. Like the **Australian PMI®**, the decline in the **Australian PSI®** in December reversed an improvement seen over the previous three months following the election. In both surveys, respondents indicated the earlier improvement in confidence never translated into a solid improvement in demand and activity.

Chart 3: Australian PMI®, PSI® and PCI



Source: Ai Group

Consistent with the positive outlook for dwelling investment, the seasonally adjusted Australian Industry Group/Housing Industry Association Australian Performance of Construction Index **(Australian PCI®)** registered 50.8 in December 2013, indicating a third consecutive month of expansion for the national construction industry. While the **Australian PCI®** sat above the critical 50 points level, it was 4.4 points lower than the previous month, signalling a moderation in the industry's rate of growth.

Weighing on total industry activity in December was weaker engineering construction activity, which moved back into negative territory after two consecutive months of growth. House building remained the strongest performing sector. The pace of expansion in commercial construction and apartment construction activity moderated in the month, but both remained above 50 points.

The Fiscal Challenge and its Context

The substantial fiscal policy challenge over the rest of this decade is to move federal, state and territory budgets out of structural deficit positions and rebuild the fiscal wriggle room that helped insulate Australia from the severity of the global financial crisis. For this to be achieved we need to contain the growth of public expenditure; extract better value from the public expenditures we do make; and upgrade our taxation arrangements so they raise the requisite amount revenue while doing as little damage as possible.

The current phase of sub-par GDP growth and weak labour market performance outlined above presents an important, though essentially short-term, challenge to the task of fiscal consolidation. It is especially critical that the path to fiscal consolidation does not worsen the current patch of slow growth in the economy and that, more proactively, that it builds rather than detracts from longer-term productivity growth.

The economy does not look ready to withstand big cuts in aggregate spending or tax increases in 2014-15 without provoking slower growth and lower revenue collections. Fortunately, Australia’s fiscal position is still in good enough shape to allow a little breathing space before a longer-term fiscal consolidation and the emphasis in assessing the 2014-15 Budget should be on the credibility of savings measures that grow over and beyond the forward estimates rather than on the anticipated bottom-line outcome for the 2014-15 year.

While smaller than anticipated fiscal inroads in the near-term may disappoint some, there should be plenty of out-year savings ideas generated by the Commission of Audit and the Government itself. The budget narrative should be of a Government taking a credible, steady as she goes approach to fiscal consolidation with too rapid consolidation and unachievable surplus targets relegated to the past.

Beyond the issue of timing of aggregate consolidation, the budget also needs to support higher productivity growth and the development of the more balanced growth path needed to reduce our increased exposures to prices and demand for resource and energy commodity exports.

As Reserve Bank Governor Glenn Stevens said in October, more balanced growth involves expansion in some of the trade-exposed sectors that have been squeezed by the high exchange rate.[2] The recent depreciation of the currency is welcome, but domestic competitiveness remains hampered by rises in the cost of key inputs – particularly energy; a legacy of low productivity growth over more than a decade and, more recently, strongly rising unit labour costs. The combination of these factors has seen Australia become a high-cost economy.

It is this background that is fueling a national re-focus on productivity growth, fuelled by the concern with finding long-term sources of competitive advantage and sources of employment and income growth to make up for the decline in mining investment and commodity prices.

It would be clearly be counter-productive to cuts program and tax expenditures that add more in sustainable productivity gains than the costs involved in continuing them. Moreover, in some areas it may well make good sense to lift expenditure (or decrease effective tax rates) in order to strengthen the economy and help build performance and tax revenues over the next few years.

In this regard three particular areas warrant specific mention: workforce skills; business capabilities and innovation.

Lifting the skill base of our working-age population remains a central challenge, particularly as the labour market continues to require increased skill levels. Our apprenticeship system needs carefully targeted changes. Institution-only pathways and provider-driven solutions will only serve to further increase dissatisfaction and alienate employers further from vital apprenticeship arrangements. The government has the opportunity to reconfigure the proliferation of apprenticeship-related services that clutter an already crowded landscape.

With an estimated 4.2 million working Australians having insufficient literacy and numeracy skills to function effectively in the modern economy, cutting any programs in this area would be short sighted. There is solid evidence that increasing the literacy level of a country by 1% leads to a 2.5% rise in labour productivity and a 1.5% increase in GDP per capita. Indeed, on this basis, the Workplace Language and Literacy program that targets our languishing literacy and numeracy levels should receive a higher funding allocation. Similarly, the National Workforce Development Fund is an example of a

[2] Reserve Bank of Australia Governor Glenn Stevens, *Remarks to Citi's 5th Annual Australian & New Zealand Investment Conference*; Sydney, 29 October 2013.

successful co-investment fund that provides targeted skill development across the economy.

In the area of developing business capabilities, there are also very good reasons to maintain or even increase spending. The very successful Enterprise Connect program is a case in point. Originally established under the Howard Government as the Australian Industries Productivity Centres program, Enterprise Connect, delivers tailored advice to small and medium-sized businesses through a highly-skilled cohort of business advisers and facilitators drawn from industry. Research underway at the present time suggests the Enterprise Connect program has a positive and sustained impact on the performance of participating businesses in comparison to non-participating businesses.

There is also very good scope for returns from well-targeted programs that accelerate the development of Australia's "digital economy" capabilities. Digital capabilities are of growing importance for many industries due to innovations in technologies, economic pressure on existing business models, and the rollout of high-speed broadband and mobile infrastructure. Australia's ability to foster these capabilities among Australian businesses will be an increasing determinant of our global competitiveness.

As the World Economic Forum recently noted, with most major countries having committed to substantial high-speed infrastructure investments, Governments now need to set strategies and facilitate targeted investments in the digital capabilities of industries that capitalise on their country's competitive advantage. Failure to invest will see Australia fall behind other countries that reap greater productivity benefits from their infrastructure investments.

Programs that will help underwrite a step-up in Australia's innovation performance provide another example where public expenditure can deliver a substantial return to taxpayers. The research and development tax incentive is a case in point as it has a very strong policy rationale behind it. Similarly, programs that help break down the well-entrenched chasm between business and the publicly-funded research sector offer the potential for Australia-wide returns well in excess of outlays.

We also put forward proposals in other policy areas that governments need to make to lift productivity and competitiveness. These include measures in the areas of:

- Industrial Relations;
- Environment and Energy Policy;

- Taxation;
- Immigration;
- Defence, and,
- Infrastructure.

The orientation in this submission on building the economy does not detract from the seriousness of the task of fiscal consolidation. Indeed, it is clearly true that there is a substantial fiscal challenge for the rest of this decade that will not be easy to address. A key element in meeting this challenge is to build a productive and competitive economy that is also more balanced and resilient. Growing the size and strength of the economy will also grow the tax base and building a more balanced and resilient economy will reduce the volatility of revenue collections and their vulnerability to fluctuations in global commodity markets.

Thus, notwithstanding the extent of the fiscal challenge, there is no reason that with appropriate management, that we cannot also meet Australia's productivity challenges while navigating a course that is conducive to recovery over the next year or so from the slow patch we are currently experiencing.

These include the need to substantially upgrade Australia's infrastructure. Over the next year or so greater infrastructure investment could also assist in boosting the economy from the current slump in aggregate activity. Boosting infrastructure investment also has a critical role to play in lifting the pace of productivity improvement.

Can progress be made of all of this front as well as repairing fiscal position simultaneously? Or will we have to sacrifice some of these priorities in order to hasten the recovery of our public finances? Ai Group believes we can make good progress on each front: it is not beyond us to walk and chew gum at the same time.

Fortunately, the infrastructure upgrade need not challenge the restoration of a strong budget position as much as many fear. Indeed, if the emphasis is given to the most appropriate areas, lifting investment in infrastructure will play a role in raising productivity and, by accelerating the growth of the tax base, in improving the longer-term budget outlook.

Where it makes sense, capital for new and improved infrastructure can be provided by selling existing public assets. There is, on the other side of the market, a substantial pool of superannuation funds ready for investment – particularly in brownfields infrastructure.

Nor should public borrowing to invest in infrastructure be ruled out. It can also make sense when costs associated with building new assets, including interest, are more than covered by the benefits. The logic of this strategy could be made more apparent by careful differentiation in the public accounts between funds invested in long-lived assets and those absorbed in meeting recurrent costs. Properly managed, Australia should be able to meet the infrastructure challenge while the necessary steps are taken in relation to recurrent expenditure and taxation to put our public finances on a more secure footing.

Skills, Education and Training

Key points

Ai Groups stresses the importance for the Government to:

- continue to encourage industry participation in **skills policy** formulation;
- retain the National Workforce Development Fund (NWDF) or similar enterprise based co-contribution fund to upskill existing workers;
- to provide an additional 3% funding to the annual VET budget to 2025 to support the attainment of COAG determined targets;
- ensure an ongoing commitment to monitor and improve quality in the VET sector including endorsing revised and implement Standards for RTOs, as developed by the National Skills Standards Council and ensure the national regulator, ASQA, is adequately resourced;
- pilot demand-side **apprenticeship** reform models through 'Gateway for the Trades' (formerly Alternative Trade Pathways pilot);
- strengthen group training arrangements for apprenticeships by ensuring continuation of Joint group Training Funding;
- implement a genuine national approach to apprenticeships by establishing a National Apprenticeship commission or similar entity;
- provide the National Foundation Skills Strategy with an adequate budget, and a national awareness campaign needs to be developed and implemented in consultation with industry and other key stakeholders;
- significantly expand funding allocation for **English literacy programmes** like WELL to provide Language, Literacy and Numeracy skills program access for existing workers;
- the Government progress the implementation of funding reform to facilitate the achievement of a world-class **school education system**;
- the Government develop and fund major initiatives to lift literacy and numeracy achievement in parallel with the anticipated efforts and activity under the National

Foundation Skills Strategy;

- Ai Group supports a review of policy for VET in schools across all jurisdictions;
- to support major initiatives in the school sector and in teacher education to lift Science, Technology, Engineering and Maths (STEM) subject participation;
- to support a range of measures designed to improve the capability of the teaching profession;
- to investigate the leadership and management skills required to drive innovation and productivity, particularly in light of the Asian century and the emerging digital economy;
- to support the development of practical tools and new methods for a new leadership and management development model particularly for SMEs;
- look at measures aimed at improving the quality and industry relevance of **higher education** including the need for close monitoring of the alignment of student demand to industry need, the impact on skill shortages, the impact on the VET sector and whether quality arrangements can be established and maintained;
- There should be further development of the linkages between higher education institutes and industry in order to improve the relevance to industry of tertiary skills, and to facilitate knowledge transfer and foster innovation between higher education and industry;
- The government facilitates greater incorporation of core skills for work into tertiary courses and the development work-integrated-learning and professional cadetships/internships; and
- We also ask the Government to recommit to COAG agreement between states and federal government to harmonise occupational licensing across jurisdictions.

Industry leadership

One of the great strengths and internationally admired aspects of the Australian training system is the role of industry. The training system exists to meet the needs of industry and the broader economy by assisting individuals to acquire skills in this context. The importance of the role of industry must not be continually eroded; rather it must be strengthened to allow Australia to optimise the human capital of our working age population.

Industry does have a clear role through industry skills councils in the development and maintenance of training packages. This is one of the key pillars of our training system and must remain. Industry, however, needs to have a strong and direct voice in the policy setting process. Currently this occurs in a fragmented way through the National Skills Standards Council, the Australian Workforce and Productivity Agency and various other committees and councils. Industry's commitment and involvement in this arena is vital. Not only should industry have a direct role in establishing the policy settings for the training system it should also have a direct voice to both Commonwealth and State ministers. It is possible, however, to streamline or improve some of the existing mechanisms.

Recommendations:

- Commitment to further three year funding of Industry Skills Councils
- Develop mechanism for industry to have direct voice into policy process at the senior level

1. Vocational Education and Training Sector

a. Investment

Investment of public funds in the training sector generally provides for two different cohorts: *individuals* seeking qualifications, often initial qualification and usually through public access arrangements; and, *enterprises* seeking a funding contribution to upskill existing workers. Both funding strands are of great importance to building our human capital.

In recent years we have seen the establishment and growth of the *National Workforce Development Fund* (NWDF). This fund has been highly successful in engaging enterprises to upskill their existing workforce through a co-contribution model. Furthermore, the fund has seen the purchasing power and ensuing choice of provider firmly placed in the hands of enterprises. This has led to a lift in both the quality and confidence of training outcomes under such arrangements. The NWDF has seen a cost efficient, targeted and customised growth in accredited skill development for existing workers. This model should be continued.

Investment models that focus upon individuals are more complex. The success of introduction of demand-driven funding by different jurisdictions has been variable. Unfortunately, we have witnessed excessive enrolments occur in course areas that contain limited employment prospects. Whilst the policy shift away from supply-driven funding approaches is supported, we need to be judicious in this public spend. A more managed model that prevents wasteful spikes in enrolments in areas of low priority can mitigate wasteful public expenditure.

However, the method of purchasing training does not overcome the issue that in order for the training sector to be sufficiently responsive to industry it needs to be properly resourced. For too long the training sector has been the poor cousin of the higher education and school sectors. For some time the level of funding for the VET sector has been inadequate in its own right and in comparison with the higher education and schooling sectors[3]. *Australian Workforce Futures* noted that VET funding per hour fell by 14% between 2006 and 2010 which contributed to the call for an additional 3% funding per year to 2025 to meet the projected need for enrolment growth.[4] Industry will not be able to meet its need for the amount of qualifications required if the current levels of VET funding continue. This is especially the case given the increasing need for higher levels of qualifications.

Finally, we also ask the Government to recommit to COAG agreement between states and federal government to harmonise occupational licensing across jurisdictions.

Recommendation:

- Continue National Workforce Development Fund (NWDF) or similar enterprise based co-contribution fund to upskill existing workers.
- The Commonwealth Government provide an additional 3% to the annual VET budget to 2025 to support the attainment of COAG determined targets.

b. Quality

Ai Group considers that there are ongoing and serious issues confronting the national VET system in terms of quality. A high quality VET system must be underpinned by

[3] *Investment in Vocational Education and Training (VET)*, A Report to the Board of Skills Australia, Peter Noonan et al., May 2010.
[4] As reported *in Australia's skills and workforce development needs, Discussion Paper, July 2012*, Australian Workforce and Productivity Agency, page 73.

standards and regulation that can assure high quality training and assessment services. Ai Group supports improved regulation of the standards that will lead to consistent and enforceable regulatory approaches within the Australian Skills Quality Authority and by all VET regulators. Ai Group supports the proposed revised VET standards for regulation. Furthermore, we consider that consistently high performing quality providers should be 'rewarded' with a lighter touch regulatory approach, a model that will only work within the context of the revised standards.

As well as standards and regulation there are additional quality measures that require consideration. The Quality Measure work, led by the industry skills councils, in conjunction with the National Skills Standards Council and the Commonwealth government has the potential to provide the additional and essential piece of the quality arrangements required around industry expectations of product and delivery.

Recommendation:

- Endorse revised and implement Standards for RTOs, as developed by the National Skills Standards Council;
- Ensure the national regulator, ASQA, is adequately resourced.

2. Apprenticeship Reform

Apprenticeships are the flagship of the Australian training system. Apprenticeships are highly valued by industry as the best way to train skilled tradespeople for the future. The combination of structured training and workplace learning in the context of employment provide apprentices with the theory and practical skills that make qualified tradespeople. However, reform to the Australian Apprenticeship system is required.

Reform that preserves the integrity of the apprenticeship system and is sustainable must be driven by the demand-side, i.e., industry. Chief among reforms is the need to refocus apprenticeships on the core relationship between the apprentice and the employer. Administrative and support mechanisms, requirements of the supply-side must not get in the way of these reforms. Many issues require attention including facilitating genuine user-choice, overcoming national inconsistency, finally implementing competency-based progression, lifting completion rates and improving school pathways to apprenticeships.

Ai Group proposes *(see attached model)* that we drive genuine demand-side reform of the apprenticeship system utilising group training organisations[5] as the preferred platform. The central feature of this new approach is to aggregate critical mass on the demand-side of the apprenticeship system – a significant reform in and of itself. The current apprenticeship arrangements are sub-optimal primarily because they are driven around the needs of RTOs and other service providers to apprenticeships.

The 'Gateway to a Trade' funding (formerly Alternative Apprenticeship Pathways) should be utilised to support this reform initiative- enabling an improved system that genuinely repositions the apprenticeship model on the demand-side of the equation – that is in industry for industry.

Additionally, consideration should be given to establishing genuine national apprenticeship arrangements. Australian apprenticeships are Australian in name only and the lack of a genuine national system is a frustration to employers, especially those that operate on a national basis or in multiple states. Forging national arrangements would see the removal of duplication of service provision, the streamlining of administrative requirements and unnecessary confusion. A National Apprenticeship Commission will be required to undertake this important task.

Recommendations:

- Pilot demand-side apprenticeship reform models through 'Gateway for the Trades' (formerly Alternative Trade Pathways pilot);
- Strengthen group training arrangements by ensuring continuation of Joint group Training Funding; and
- Implement a genuine national approach to apprenticeships by establishing a National Apprenticeship commission or similar entity.

3. Workplace Literacy and Numeracy

Our research tells us the situation regarding the low levels of workplace literacy and numeracy is a major concern to employers. It has a negative impact on productivity, labour mobility and the capacity of the economy to achieve the higher levels of skills

[5] The current group training model would need to expand to accommodate the full requirements of the new proposed model. The GTO model is currently the only demand-side platform currently available, and to establish another set of entities is undesirable. However, not all group training companies would chose to participate, not would employers be required to enter these new arrangements.

needed for the increasingly knowledge-based economy. There remains an urgent need to address the language, literacy and numeracy needs of the Australian workforce. In addition to the well-known results of the Adult Literacy and Life Skills Survey (ALLS) and the more recent Programme for the International Assessment of Adult Competencies (PIAAC) study, research undertaken by the Ai Group demonstrates that 93% of surveyed employers reported that low levels of literacy and numeracy were having an impact on their business.[6] The Ai Group, and increasingly employers, see a strong connection between improving workplace literacy and numeracy and lifting Australia's productivity performance.

While the National Foundation Skills Strategy for Adults has formally commenced there is no activity to date on the workforce literacy and numeracy component.[7] It is essential that the strategy is appropriately funded, industry is consulted about implementation and that activity commence.

In terms of programmatic responses there is a clear need for additional funding to expand the WELL program to reach the significant sections of Australian industry that need assistance. The 2012 – 2013 budget provided $28.8m for 12,500 places and the 2013 – 2014 Budget estimate is for 14,700 places.[8] The evaluation of the WELL program reported that over the last five years the WELL program reached 72,000 employees and 530 Indigenous Employment program participants.[9]

The WELL program needs to expand considerably with over 4 million workers currently experiencing low levels of literacy and numeracy. It would be appropriate to establish targets and a budget within the context of the National Foundation Skills Strategy.

It would also be appropriate to target manufacturing workers within the automotive industry for WELL assistance. Many of these employees will need to retrain to find alternative employment and low levels of literacy and numeracy will be a barrier in this process. The employer funding contribution should be waived in these particular circumstances for targeted WELL programs delivered to these employees until 2017.

In addition, further programs need to be considered to provide additional workplace options and meet industry needs. The Ai Group *National Workplace Literacy Project*

[6] *Getting it Right: Foundation Skills for the Workforce*, Australian Industry Group, October 2013.
[7] *National Foundation Skills Strategy for Adults*, Standing Council on Tertiary Education Skills and Employment, September 2012.
[8] DICCSRTE 2013, Budget Statements 2013 – 2014, page 103.
[9] *Strengthening Foundation Skills in the Workforce*, Final Report, 22 February 2012, Third Horizon.

demonstrated the value of short, sharp programs targeting small numbers of employees requiring intensive assistance.[10] The WELL programs need to be supplemented with this option or made more flexible to incorporate such approaches.

The notion of Workplace Champions was espoused in the National Foundation Strategy to promote an environment that encourages employees to seek assistance.[11] Ai Group is prepared to be involved in this approach and with supporting funding would establish such a network.

Recommendations

- The National Foundation Skills Strategy needs to be provided with an adequate budget and a national awareness campaign needs to be developed and implemented in consultation with industry and other key stakeholders.
- The funding allocation for WELL be significantly expanded to provide LLN access for existing workers.
- Targeted WELL assistance needs to be provided to manufacturing workers within the automotive industry needing to retrain in the face of major company closures.
- The Government commence discussions with industry and other appropriate stakeholders about the development of further workplace LLN program options.
- The Government engage with industry and provide funding support for the establishment and implementation of a Workplace Champions network.

4. School Sector Reform

A world class economy needs the support of a world class education system. All the international indicators reveal that we do not have this. Particular areas of concern are the lack of work-readiness and foundation skills of school leavers, the decline of the STEM skills very much needed for the new economy and considerable employer unease about the quality of VET in Schools arrangements.

[10] *National Workforce Literacy Project, Final Project Report*, January 2012, Australian Industry Group.
[11] *National Foundation Skills Strategy for Adults*, Standing Council on Tertiary Education Skills and Employment, September 2012.

a. *Resourcing*

To have a high skill economy Australia must have a high performing school system. Ai Group supports the aspiration for Australia to have world-class education system grounded on a needs- based funding model. It is of significant concern that Australia's international schooling ranking has been declining over the past decade and we have now been overtaken by many of the systems in our regions - including Hong Kong, Shanghai, South Korea and Singapore. Such countries are investing heavily in their schooling systems and are seeing the human capital of future generations as fundamental to securing future economic growth. Significantly expanded resourcing and a sustained reform process with multi-jurisdictional commitment with staged and transparent measurement will be the only way to achieve this ambition.

Recommendation

- The Government progress the implementation of funding reform to facilitate the achievement of a world-class education system.

b. *Literacy and Numeracy*

There are increasing concerns from industry about the adequacy of the literacy and numeracy levels of young people entering the workforce from school. Despite increased expenditure on school education and increases in the achievement of senior secondary certificates there has been no improvement in average literacy and numeracy levels across age groups.

Ai Group is concerned that school students exit school without meeting a set benchmark in literacy or numeracy. There are no national exit standards for literacy and associated with the award of senior secondary certificates. Only South Australia links the achievement of its senior secondary certificate to level three descriptors of the Australian Core Skills Framework.[12]

The *2008 Melbourne Declaration* articulated the central educational goals government and schools need to attain, and specified literacy and numeracy as essential foundations for learning. Yet Australia does not feature favourably in relevant international comparisons of data, showing deteriorating reading literacy of 15 year olds over the past decade in the OECD Programme for International Student Assessment (PISA).[13] The Australian Council of Education Research noted that an unacceptable proportion of 15

[12] *Policy Circular, Literacy and Numeracy*, SACE Board of SA, February 2010.
[13] Media Release, 7 December 2010, *PISA identifies challenges for Australian education*.

year olds are at serious risk of not achieving literacy levels sufficient for them to effectively participate in the workforce.

The state of maths and science in schools has deteriorated to a ‘dangerous level’ according to a review commissioned by the Vice-Chancellor’s of Australia’s eight research-intensive universities. The number of students undertaking advanced maths at secondary school fell by 27% between 1995 and 2007. The 2011 Trends in International Mathematics and Science Study (TIMSS) indicates that Australia’s performance in mathematics and science has stagnated over the past 16 years.[14]

There is an opportunity to address these issues in the context of the announced review of the National Curriculum.

Recommendation

- The Government develop and fund major initiatives to lift literacy and numeracy achievement in parallel with the anticipated efforts and activity under the National Foundation Skills Strategy.

c. *VET in Schools*

VET in schools can play a role in helping young people transition to work. However, the role of VET in schools within senior secondary certificates has become fragmented and in many instances quality is being severely compromised. In addition, recent research has cast doubt on the capacity of VET in Schools programs to assist young people to make the transition to employment.[15] Employers need to be confident that all students have completed training with quality skill outcomes, as defined by the accredited course or training package, no matter where or how they are trained, including through VET in Schools arrangements. This is fundamental to an effective and quality functioning training system. The persistence of concerns about a range of VET in Schools issues indicates the need for a review of the arrangements, especially from the transition to employment perspective.

Recommendation

- Ai Group supports a review of policy for VET in Schools across all jurisdictions.

[14] Sue Thomson et al., *Highlights from TIMSS and PIRLS 2011 from Australia’s perspective*, ACER, 2012.
[15] Kira Clarke, *Entry to vocations: the efficacy of VET in Schools*, NCVER research Report, 2012.

d. *Science, Technology, Engineering and Maths (STEM)*

There have been numerous reports that the number of students participating in science and mathematics at a Year 12 level (senior secondary certificates) has dropped. Furthermore, despite successive government attempts over the last decade to increase student participation in science, technology, engineering and mathematics (STEM), the proportion of students commencing in STEM has flat-lined at around 10% or less[16]. Consequently, despite current young people being high level consumers of technology it appears that they are not increasing their ambitions to be the creators and innovators of tomorrow.

Ai Group is concerned that declining interest in science, technology, engineering and maths courses in senior secondary certificates poses an immense challenge to current skills shortages in engineering professions and trades and to securing Australia's future manufacturing skills base, as these subjects often serve as prerequisites to most trades and university science and engineering courses.

Recommendation

The Government support major initiatives in the school sector and in teacher education to lift STEM subject participation.

Lifting the Capability of the Teaching Profession

The role that education plays in underpinning productivity and economic performance is crucial. For example, a country able to attain literacy scores 1% higher that the international average will achieve levels of labour productivity and GDP per capita that are 2.5% and 1.55% higher respectively than those of other countries.[17]

The former approach of a singular pathway into the teaching profession is no longer sustainable. All professions, including teaching, need to embrace multiple entry points for acceptance into professional practice. This not only reflects the modern workforce and the increasingly mobile labour force, it also recognises the multiple careers an individual will increasingly pursue over the course of their working life.

Even though we support broadening the entry pathways into the teaching profession and diversifying the potential applicants, the issue of quality remains crucial. It is

[16] *Australia's skills and workforce development needs*, Discussion Paper, Australian Workforce and Productivity Agency, July 2012.
[17] Education Outlook – OECD 2009

concerning, for example, that the ATAR scores for Victorian undergraduate teaching courses have declined to 67.53 from a peak of 75.26 over the past decade. There is also a pressing need to attract more candidates into the teaching profession with higher degrees of proficiency in maths and science. This decline in ATAR entry scores reflects the difficulty in recruiting quality applicants into the teaching profession and indeed reflects the broader societal perspective on the status of teaching/teachers especially compared to other leading nations.

A weakness in Australian schooling systems has been the low key approach taken to continuous professional development (CPD) for all teachers. As a nation we have embraced the mantra of life-long-learning yet we do not systemically embed this notion within some of our key professions. The teaching profession needs and deserves an innovative model for CPD. This model needs to mirror best practice lifelong learning principles.

Recommendation

The Commonwealth Government support a range of measures designed to improve the capability of the teaching profession.

Lifting Australia's productivity through organisational leadership

There is a raft of new issues and trends in the external business environment that are impacting on companies, whether in terms of risks or opportunities or both. This increasing complexity and ambiguity in Australian workplaces is posing a challenge for those in leadership positions. Global, economic, political and social power is shifting towards the emerging world, especially Asia. By 2020, Asia is expected to have more middle class consumers than the rest of the world combined.[18] In addition, technology is changing the way companies do business. New forms of doing business have arisen which are transforming the business landscape; outsourcing, offshoring, supply chain integration and alliances. Added to this, the pace of change has accelerated in many industries with product life cycles shortening. Change is rapid and constant. In Australia, the perception of management practices, relative to other countries has been dropping in recent years, with Australia's ranking falling from 8th in 2009 to 14th in 2013.[19]

[18] Homi Kharas, (2010) *The Emerging Middle Class in Developing Countries*, Working Paper No. 285, OECD Development Centre
[19] World Economic Forum (2013); International Institute of Management Development.

Increasing evidence, from both academic research and business surveys indicate that workplaces with more effective leaders and management capability are more productive, profitable and innovative. High-level management and leadership practices are vital to high performing workplaces, as the decisions that shape the productivity performance of organisations are ultimately the responsibility of their leaders.

Ai Group is concerned that limited policy attention has been devoted to the role of leadership and management skills in driving productivity. There has been little attention to this area since the recommendations of the Karpin Report of 1995.[20]

Ai Group recommends that the Federal Government commission a major industry-led study into leadership and management in the context of the digital economy and Asian globalization. The purpose of the study would be to develop a more contemporary business approach to management and leadership development within this emerging context. This study would look broadly at leadership and management within a clear business strategy for Asian operations and a vision of how they fit within a more global business, not simply management education or training. The study would also be tasked with developing practical tools and new methods that support this leadership and management development model, particularly for SMEs.

Recommendations:

- The Government investigate the leadership and management skills required to drive innovation and productivity, particularly in light of the Asian century and the emerging digital economy.
- The Government support the development of practical tools and new methods for a new leadership and management development model particularly for SMEs.

5. Higher Education

The higher education sector is critical to Australia’s future. Universities educate our leaders and workers of the future. They can facilitate new ideas which provide opportunities for industry innovation and therefore productivity.

[20] Commonwealth of Australia (1995), *Enterprising Nation: Renewing Australia's managers to meet the challenges of the Asia-Pacific century*, Report of the Industry Task Force on Leadership and Management Skills.

Higher education produces workers with the advanced knowledge and skills required in the labour market. The skills learnt through higher education not only provide benefits for Australia's productivity, but they benefit the individual in terms of improved employment prospects with higher salaries, and thereby contribute to overall economic, social and cultural well-being. The Productivity Commission highlights international studies showing that an additional year of education can raise the level of productivity in industry by 3 to 6 percent for a country like Australia.[21]

Ai Group supports the recent introduction of demand driven funding but has identified that it is important to monitor how this reform progresses and whether increased student demand aligns with industry demand. To date the increase in student places has revealed expansion across the full range of disciplines,[22] this includes the Science, Technology, Engineering and Mathematics (STEM) disciplines and the development of employability skills, which have been the subject of considerable recent concern.[23][24][25] Improved enrolments in STEM disciplines seem to be the result of good fortune rather than good planning. It is essential that industry's need for these skills generated by higher education are not lost in a system entirely dependent on student demand. As mismatches between educational supply and work-force demands can severely risk business productivity and contribute to skills wastage and skills shortages.

The recent growth in university places is likely to include students who would typically become vocational education and training (VET) students. It is important to monitor the impact of this new growth on the VET sector and its supply of graduates to the workforce. In addition, there is the issue of providing effective pathways between the VET and higher education sectors. There is a need for those with initial vocational qualifications to acquire higher-level higher education qualifications as they advance in the workforce. To date these arrangements have been ad hoc and localised. The introduction of demand driven funding in higher education provides a new impetus to establish pathways from vocational education and training to higher education, particularly in areas of skills shortage.

[21] Productivity Commission (2007), *Potential Benefits of the National Reform Agenda*, Research Paper, Canberra.

[22] Conor King and Richard James, *Creating a demand-driven system*, in Tertiary Education Policy in Australia, Simon Marginson (Ed), Centre for the Study of Higher Education, University of Melbourne, July 2013.

[23] See for example *Science, Technology, Engineering and Mathematics in the National Interest: A Strategic Approach*, Office of the Chief Scientist, July 2013 and *Lifting our Science, Technology, Engineering and Maths (STEM) Skills*, Australian Industry Group, March 2013.

[24] Sydney Morning Herald, *Employers unhappy with literacy and numeracy skills*, 27 Feb 2013.

[25] West Australian, *Graduates lack literacy skills*, 28 February 2013

Research into graduate employability skills found there to be a perception that employability skills are under-developed.[26] Many industry representatives are satisfied with the technical or discipline-specific skills of graduates, but believe that students don't have the ability to intelligently apply that knowledge in work settings.

Work-integrated learning (WIL) is an important way of ensuring that students can apply their knowledge and skills, develop employability skills and build professional networks in industry. They are an important higher education curriculum innovation, based on the notion that graduates will develop graduate attributes and employability skills and therefore will be better prepared for work or professional practice if they have opportunities to integrate theoretical knowledge with practice.

To improve the job readiness of graduates, Ai Group proposes the provision of funding to facilitate greater incorporation of 'core skills for work' into tertiary courses. Ai Group further supports an increase in the requirement to include work-integrated-learning in appropriate professional courses and the development of professional cadetships/internships.

Recommendations

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

- There is a need for close monitoring of the alignment of student demand to industry need, the impact on skill shortages, the impact on the VET sector and whether quality arrangements can be established and maintained.

- There should be further development of the linkages between higher education institutes and industry in order to improve the relevance to industry of tertiary skills, and to facilitate knowledge transfer and foster innovation between higher education and industry.

- The government facilitates greater incorporation of core skills for work into tertiary courses and the development work-integrated-learning and professional cadetships/internships.

[26] Precision Consultancy (2007) *Graduate employability skills: Prepared for the Business, Industry and Higher Education Collaboration Council.* Canberra: Department of Education, Science and Training (DEST) 2007

Policies to Lift Business Innovation and Capability

Key policy recommendations:

- We commend the Government's announcement of Strategic Growth Action Agendas aimed at lifting industry competiveness and capabilities. We would encourage the Government to ensure this program is adequately funded so fulfill its worthy objectives;
- We stress the importance of collaborative links between research institutions and industry as an important means of lifting the pace of innovation by Australian businesses. In particular, we support ongoing funding to Cooperative Research Centres Program and Industry Innovation Precincts;
- We strongly urge the Government to maintain its level of commitments to proven Enterprise Connect program provides ongoing crucial strategic advice to Australian businesses;
- Ai Group supports the Government's decision to maintain the core digital economy programs managed within the Communications portfolio, and in particular the Digital Business Kits and Digital Careers programs to take advantage of high speed broadband;
- We support the ongoing simplification of the process for businesses seeking environmental approvals.
- Ai Group applauds the announcement that the Government will commit to holding two regulation "Repeal Days" a year and would encourage the Government first focuses on removing those regulations that are proving to be obstacles to business.

Boosting innovation, investment and productivity in Australian businesses must be an economic priority, particularly in the non-mining sectors.

Australia needs an ambitious, holistic innovation policy framework that maximises Australia's competitive strengths and ties together individual measures that are coordinated, cost-effective and targeted.

Ai Groups stresses the importance that industry programs, such as the one currently being designed for the automotive sector, need to be coherent and co-ordinated and fit within overall framework, where clearly identified goal are laid out for industry. Policies should not be ad hoc bandages with no clear objective. Ai Group understands the fiscal pressures facing the Government but stresses that any savings identified in industry space be redirected towards proven policies known to boost the productive capacity of Australian industries especially manufacturing. This will help Australia transition to a more balanced growth path and away from an economy reliant on the resource sector.

Strategic Growth Action Agendas

We support the Government's policy to develop and implement strategic industry Action Agendas plans in conjunction with industry, including making manufacturing and its subsectors the first priority for an Action Agenda given the major transitions underway in the sector. Action Agendas are also needed in sectors that are critical to Australia's growth prospects and global competitive advantage. These are can be found in the high value-add industries including, but not confined to:

- Information and communications technology and services
- Electronics
- Bio-Technology
- Food production
- Health and education services.

At present, no funding has been committed to support the development of Action Agendas. The financial status of the Strategic Growth Action Agendas should be clarified to enable the initiative to reach its full potential and ensure buy-in from industry. Funding should be confirmed to enable the Department of Industry to undertake research and strategic planning as well and to advise on and assist industry growth plans.

Improving collaboration between industry and research institutions

Ai Group supports collaborative links as an important means of lifting the pace of innovation by Australian businesses. Collaboration and networking have been cited as consistent weaknesses in Australian innovation when compared with other OECD countries, with just 4.6% of innovation-active businesses collaborate with universities and 8.9% with publicly funded research agencies and programs.[27]

The Commonwealth invests in two programs that act as crucial bridges linking business and industry. Funding for these measures should be retained:

Cooperative Research Centres Program[28] (CRC)

Ai Group supports the retention of the Cooperative Research Centres (CRC) Program. Innovation and research and development are often prohibitively expensive for many businesses, particularly small and medium enterprises. SMEs often lack familiarity with the research community. By aggregating the financial and in-kind contributions of participants, and by giving individual businesses privileged access to Australia's finest researchers and institutions, CRC's reduce the costs to industry of participating in R&D projects and ensure that businesses are directed to the research organization best suited to their needs.

The broader benefits of an effective CRC are felt in an accelerated pace of innovation amongst individual companies and the diffusion of new knowledge to the wider sector. There are also benefits to the Australian economy, with a 2012 study estimating that CRCs have spun out technologies, products and processes making an annual contribution of $278 million to the economy.[29]

Industry Innovation Precincts

Industry Innovation Precincts are a relatively new initiative designed to improve collaboration and technology and knowledge transfer between industry participants and research institutions. Two precincts have been established in the food manufacturing and manufacturing areas with up to ten envisaged. The first two precincts are taking shape and have attracted interest from industry and research organisations keen to participate. They have the potential to complement the CRC program by accelerating the dissemination of new knowledge generated within new and existing CRC's and anticipates that they will play an important future role in improving Australia's innovation performance.

[27] Australian Bureau of Statistics, *Innovation in Australian Business 2010-11*, August 2012.
[28] Disclaimer, Ai Group is an essential participant in the Manufacturing Industry Innovation Cooperative Research Centre currently being considered by the Commonwealth for funding starting 1st July 2014.
[29] Department of Industry, *Australia's Innovation System Report*.

The future of the Industry Innovation Precincts program is currently under review, with $26 million cut in the Mid-Year Economic and Financial Outlook (MYEFO) from the $238.4 million originally allocated to the program. Ai Group supports the retention of Industry Innovation program, and at a minimum, ongoing funding for precincts that have already been established. Withdrawal of funding would be destabilising for industry, particularly during a period where key industries such as manufacturing sector are undergoing substantial transition.

Enterprise Connect

Transitioning businesses and communities to competitive industries requires provision of effective and tailored support at both the enterprise and regional level. This is the focus of the Enterprise Connect service offering and Ai Group supports the retention of this valuable program.

Research shows that the Enterprise Connect program is having a positive and sustained impact on the performance of participating businesses, including in comparison to a control group of non-participating businesses, with 83% of Enterprise Connect clients have improved productivity or efficiency as a result of participation in the program.

The main elements of Enterprise Connect include:

Holistic Business Reviews for eligible participants and subsequent matched grant-based assistance to implement the priority recommendations determined from the Business Reviews.

The Researchers in Business stream(RiB) which funds specialist facilitators to connect businesses with researchers that have expertise relevant to the needs of the business, including product, process and marketing innovation. Businesses that have used the program rate the experience very highly as a way of lifting their productivity and improving their opportunities.

Innovative Regions Facilitators who work collaboratively with regional businesses, researchers, local governments and communities to build business capability and entrepreneurial capacity and stimulate regional economic development.

The delivery of Enterprise Connect through a highly skilled cohort of Business Advisers and Facilitators with real world business and business advisory experience, including through partnership with industry associations, is a key strength of the program and provides an effective model for direct government/business interaction to address business imperatives. It is also consistent with the Government's goal to second to the Industry Department more people with first-hand business experience and to increase the direct interaction of Departmental employees with Australian businesses.

A key strength of the Enterprise Connect and RiB program has been its agility in responding to the needs of business and research institutions. This has recently been impacted by revised grants approvals processes. Ai Group supports a streamlining of these processes to minimise any delays in confirmation of funding for RiB and Tailored Advisory Service matched grants.

Digital capabilities

Using digital technologies and services to improve profitability and productivity is a key opportunity for Australian businesses and an important determinant of Australia's overall competitiveness. However, evidence shows that many businesses are unprepared for the rollout of high-speed broadband infrastructure or are not well-positioned to take advantage of other digital services and technologies. For example, a recent Ai Group survey found that fewer than 50% of business respondents were confident they had the capability to take advantage of high-speed broadband.

Ai Group supports the Government's decision to maintain the core digital economy programs managed within the Communications portfolio, and in particular the Digital Business Kits and Digital Careers programs. These two targeted programs are the only direct federal government intervention to address digital capability gaps and involve modest funding allocations.

Regulatory arrangements and processes

Ai Group strongly endorses the Government's ambition to substantially reduce and simplify the Federal regulatory regime. Although robust and impartial regulation is essential to safeguard the community, business and the environment, Ai Group's members share the Government's belief that there is substantial scope for efficiencies. This belief has been expressed repeatedly in Ai Group's own research and is starkly evident when comparing Australia to economies overseas. The 2013 World Economic Forum *Global Competitive Index* ranked Australia 128th for the burden of government regulation, down from 96th last year and from 60th in 2010-11.

Ai Group applauds the announcement that the Government will commit to holding two regulation "Repeal Days" a year. These events will provide valuable opportunities to periodically re-examine the merits of pieces of regulation in the light of rapidly changing domestic and global circumstances. For that reason it’s vital that the Government first focuses on removing those regulations that are proving to be obstacles to business, and avoid being distracted by pieces of legislation that are no longer relevant or even in use.

To improve regulatory arrangements and processes, Ai Group proposes:

- Further support for the initiatives being pursued through COAG to improve regulatory processes and regulator practice with financial incentives for the states and territories to effectively implement initiatives adopted by COAG.

- The Government should proceed speedily to streamline the often cumbersome and redundant processes faced by companies seeking environmental approvals. Voluntarily devolving the bulk of the Commonwealth’s approval authority to state governments will simplify and clarify the processes and requirements faced by businesses seeking environmental approvals.

- Complementing the Government’s belief in coordinating and funding development of a common reporting process and system for all State and Commonwealth environment and energy regulation, involving information sharing between authorised agencies at all levels of government. Common definitions, common reporting systems, preferably national harmonization

- Introducing a process to allow businesses to “graduate” from and exit the Energy Efficiency Opportunities program.

- Not introducing a federal Container Deposit Scheme (CDS), as it is expensive to implement, ineffective in addressing the broader environmental impacts of packaging, and significantly increases the regulatory burden on the beverage industry in particular.

Energy & environment

Key policy recommendations:

- The Government needs to ensure the regulatory and policy development structure is resourced adequately to advance its existing expansive reform agenda;
- We emphasise the importance of providing certainty to industry on Emissions Reduction Fund funding availability;
- We would encourage the Government to remove Energy Efficiency Opportunities burdensome reporting obligations following the removal of funding.
- We would encourage the Government to consider maintaining funding levels of the Australian Renewable Energy Agency, which has the potential to lower the costs of future energy options.

Energy prices are a serious issue for Australian industry. Despite depressed wholesale electricity prices, the rise in network charges ensures that retail electricity prices remain very high; meanwhile, natural gas prices are rising dramatically as a result of the looming start of gas exports from Queensland. These prices represent a significant threat to the competitiveness of many businesses. There is an appropriate role for policy in keeping price rises to efficient levels and helping ensure that price rises do not translate into higher final costs.

There is an existing reform agenda for the electricity and gas markets and for transmission and distribution networks. There is also scope for further reform. Issues include a mechanism for energy users to sell demand reductions into the wholesale electricity market; encouragement of time of use pricing; rollout of smart metering; resourcing for regulators; use-it-or-lose-it approaches to gas tenements and contracted pipeline capacity; a national interest test for future gas export proposals; and more. The Government needs to ensure that the regulatory and policy development structure is resourced adequately to advance this agenda.

The Government's proposed Emissions Reduction Fund, while principally funded to reduce emissions, could potentially be of interest to businesses seeking to reduce their exposure to energy prices. Ai Group is engaging closely with the development of this policy. In the Budget context, we emphasise again the importance of providing certainty about ERF funding availability, including through a legislated appropriation rather than inclusion in annual Budget Bills.

It may be some time before the ERF is up and running at scale. In the meantime, we reiterate that the existing successful Clean Technology Program, which has supported emissions-efficient capital upgrades at a wide range of manufacturing businesses, should continue. There is a backlog of meritorious project proposals which deserve strong consideration.

In the Mid-Year Economic and Fiscal Outlook, the Government announced a savings measure to remove funding associated with the Energy Efficiency Opportunities Program. While EEO has been burdensome and duplicative for some businesses, removal of funding while retaining EEO reporting obligations does nothing to reduce burdens on business.

The work of the Australian Renewable Energy Agency has the potential to lower the costs of Australia’s future energy options. ARENA projects can also underpin new economic opportunities, as well as offering benefits to existing businesses – particularly remote and off-grid facilities. Consideration should be given to maintaining currently legislated funding levels.

Taxation

Key policy recommendations:

- Ai Group supports the Government's proposed, nothing-off-the-table review of Australia's taxation arrangements and recognises that the timing of this review will extend well beyond the timeframe for the 2014-15 Budget.
- However, the Government should consider changes to taxation to assist in the major policy directions proposed in this Submission including targeted tax incentives for business spending on workforce training and on innovation and investment in capital equipment.

Ai Group recognises the need for substantial improvements to Australia's taxation arrangements to reduce the economic burdens they impose on the community while raising sufficient revenue to meet community expectations.

The shortcomings in our taxation arrangements are fundamental.

- At the federal level, we have an over reliance on income taxes that deter investment, particularly inbound investment, and that impose a punitive burden on regular forms of saving. Further, its indirect taxes (including the GST) are under-exploited and are eroding in the face of changing consumption patterns.
- State and territory governments levy a range of highly inefficient taxes. These include the charges on property transfers; duties on insurance premiums; royalties on resource extraction; and the range of taxes on payrolls.
- The wide disparities between the spending responsibilities of the states and territories and their own-source revenue collections, leave them overly dependent on the federal government and over exposed to the tendency of central governments to intervene in areas of state and territory responsibility.
- The compliance burdens imposed on businesses and other taxpayers are unnecessarily high.

The Australian experience with tax reform over several decades highlights the importance of community-wide participation in discussions about the options for reform and the trade-offs involved before substantial changes can be proposed and accepted.

Against this background, Ai Group supports the Government's proposed, nothing-off-the-table review of Australia's taxation arrangements and recognises that the timing of this review will extend well beyond the timeframe for the 2014-15 Budget.

In the meantime, however, there is scope for changes to taxation to assist in the major policy directions proposed in this Submission. In particular consideration should be given to targeted tax incentives for business spending on workforce training; on innovation and investment in capital equipment in sectors of the economy that will assist in rebalancing the direction of economic growth as the mining investment boom slows.

Ai Group also urges the Government to reconsider the discriminatory proposal to deny larger businesses access to the Research and Development Tax Incentive. The arguments put forward in support of this proposal are highly questionable and the full implications of the proposal on the broader innovation system have not been adequately considered. A sensible approach would be to put aside this ad hoc proposal and consider changes to the R&D Tax Incentive more carefully in the context the broader examination of Australia's tax system.

Immigration

Key policy recommendations:

- Increase the migration planning level for 2014-15 from 190,000 to 220,000, with a sharper focus on lifting the proportion of the program devoted to skilled migration.

Ai Group recommends the Government's migration planning level be lifted from 190,000 to 220,000 for 2014-15. We believe the emphasis should continue to be on increasing the level of the skilled component of the migration intake. This proposed increase takes into account the proven benefits to the economy of a strong migration program. This is necessary in order to support positive growth in our population and especially in our adult workforce, due to relatively low rates of natural population growth.

This proposed increase takes into account the proven benefits to the economy of a strong migration program. This is necessary in order to support positive growth in our population and especially in our adult workforce, due to relatively low rates of natural population growth. A higher skilled migration intake is appropriate at present due to Australia's relatively low (albeit rising) unemployment rate; the deepening effects of our ageing workforce (with 9% of all Australian employees now aged 60 or over and 17% aged 55 or over); and persistent skills shortages in industries including mining services, engineering, infrastructure and health services.

With the upturn in national housing market activity, we expect the residential and commercial construction cycles will pick up significantly from 2014-15 which will in turn lead to further skilled trade shortages. This will be exacerbated by the flow of construction workers into the mining sector and reduced trades apprenticeship numbers in recent years. In particular, the flow of skilled workers into the mining industry from construction and industrial sectors will continue as mining moves from its current investment and expansion phase into a very strong period of growth in output and exports. These skills shortages and labour hire difficulties were further evidenced in recent Ai Group construction sector surveys. During the six months to September 2013, 67.7% of respondents reported either major or moderate difficulty in the recruitment of skilled labour 47.1% citing major or moderate difficulty

The Australian Industry Group also releases each month performance indices for the manufacturing, services and construction sectors. All three indices continue to show relatively high wages growth despite weak real labour demand, which suggests continuing skills shortages.

The skill shortages situation is even more serious in relation to occupations requiring Science, Technology, Engineering and Mathematics. The Australian Workforce and Productivity Agency has estimated that Australia will be 2.8 million short of the number of higher-skilled qualifications that industry will need by 2025. To be able to meet this need domestically, Australia will need to increase the provision of higher skilled qualifications by 3% every year until 2025.

A larger skilled migration program will be necessary to manage this situation and to assist in smoothing the path to future growth across the economy.

Defence

Key policy recommendations:

- Supports the provision of proper funding to Defence. This will enable the ADF to meet its operational responsibilities whilst offering Australia's defence industry an end to recent budget cuts and incentive to invest in vital infrastructure and skills.
- Offer certainty and stability on plans relating to major equipment acquisition and upgrade for the Australian Defence Force including the critical Future Submarine Program, Joint Strike Fighter Program and new armoured fighting vehicles for the Army.

The Coalition Government, in its pre-2013 Federal Election policy, announced that it would make no further cuts to Defence spending. This followed the previous Labor Government cutting $5.4 billion from the Defence Budget in 2012-13 leading to the cancellation of major equipment projects, such as the previously foreshadowed self-propelled gun for the Army; savage cuts to sustainment of critical Australian Defence Force (ADF) equipment; and, reductions in essential operational training for ADF personnel. These measures amounted to a further hit to Australian defence industry confidence, coming on top of the negative impact of the high dollar.

Whilst the 2013-14 Budget contained no further cuts to the Defence Budget, substantial damage had been done to investment by defence industry in downstream capabilities essential for supporting ADF equipment.

Over the next decade, the Coalition Government has committed to increase spending on Defence from its current level of 1.59% of GDP (the lowest level since 1938) to 2% of GDP.

The Coalition Government has undertaken to introduce a new Defence White Paper within 18 months from the Federal Election with costed, affordable ways to meet Australia's defence and national security objectives; release a new Defence Industry Policy Statement and Defence Capability Plan; and, undertake a first-principles review of the structure of the Department of Defence and reform the Defence Materiel Organisation and strengthen its relationship with Australian business. Each of the latter measures should identify substantial efficiency savings able to be re-invested in vital new equipment for the ADF.

The Ai Group has made a number of submissions to the National Commission of Audit being chaired by former Ai Group Defence Council National Executive member, Tony Shepherd. We have identified scope for reducing the cost of doing business whilst offering opportunities for proper re-investment in Defence.

The Ai Group Defence Council fully supports the Coalition Government's Defence Budget commitments which, over time, will offer greater certainty and stability for Australia's defence industry.

We propose:

- Providing proper funding to Defence. Doing so will enable the ADF to meet its many operational responsibilities, including border protection.
- Offering budget certainty on plans relating to acquiring major new equipment acquisition for the Australian Defence Force.
- Restoring confidence to Australian defence industry including through ongoing support for vital programs such as the Skilling Australian Defence Industry and Global Supply Chain activities.

Infrastructure expenditure

Key policy recommendations:

- Ai Group supports the Abbott Government's commitment to building vital infrastructure;
- We encourage the Government to carefully consider and where appropriate act on the recommendations made by the current Productivity Commission inquiry into the Public Infrastructure costs;
- We welcome the Government's commitment to ensuring Infrastructure Australia undertakes thorough cost-benefit analysis of all its infrastructure spend;
- We also encourage the Government to partner with private sector where appropriate to build and/or operate infrastructure; and
- Finally, we ask the Government to reconsider the onerous tendering requirements it places on construction firms.

Ai Group has long advocated for both state and federal governments to have a sharper focus on investment in infrastructure. As Reserve Bank of Australia Deputy Governor Philip Lowe highlighted in a speech in November, there is an urgent need to address physical infrastructure needs around the country which are either inhibiting industry from doing business or leading to excessive costs.[30] He stressed that living standards in Australia cannot continue to rise unless the country takes meaningful steps to address our weak productivity performance.

One of the most important steps is to build and improve the nation's roads, rail and ports. Only then will Australian business be able to compete successfully in international markets in the years ahead and benefit from being situated close to the fastest growing economies in the world. But despite the well-understood need for investment in Australia's physical capital, the current outlook for public infrastructure is tepid at best.

[30] Reserve Bank of Australia Deputy Governor Phil Lowe; *Productivity and Infrastructure*; Speech to the IARIW-UNSW Conference on Productivity Measurement, Drivers and Trends
Sydney - 26 November 2013

Ai Group has welcomed commitments by the Abbott Government to invest in the nation’s infrastructure. We also commend the Government for establishing the Productivity Commission’s inquiry into Public Infrastructure, and we would ask the Government act upon any recommendations it makes to remove barriers to investment.

We commend the Coalition for its promise that all federal infrastructure spending in excess of $100 million will be subject to Infrastructure Australia analysis. Sound and thorough cost benefit analysis will ensure the taxpayer gets value for money and that public will remain supportive of investing in infrastructure. We also propose the adoption of strict criteria for assessing individual investment projects and for there to be very thorough transparency of decision-making over infrastructure spending.

This will also ensure finance costs are minimized and that projects can go ahead at least cost. This rigour is required regardless of the form of financing but is particularly important if debt is used to finance new projects. One way to constrain the building of infrastructure assets that have a low-priority against broad national interest criteria would be to limit the use of debt financing to projects that were ranked highly under transparent benefit-cost comparisons.

Ai Group also supports measures to facilitate a greater role by the private sector in financing public infrastructure, as well as sensible strategies by government to use their balance sheets to fund investment in a fiscally responsible way. Some infrastructure can be built, owned and operated by the private sector. Where this is the best alternative, it should be pursued. For other infrastructure projects, construction risk is best assumed by governments but operation risks are best managed by the private sector. Where this is the best alternative it should be pursued.

It should be noted that private sector investment does not solve all problems. To the extent capital is sourced offshore, the same links to international financial markets and exposure to exchange rate volatility mentioned above in relation to public sector debt need to be considered. Further, some point out that the public sector can borrow at lower rates of interest than can most private businesses. To some extent this could be overcome by government guarantees but these raise additional problems and of course add to public sector (contingent) liabilities.

An important limitation to private sector involvement in infrastructure investment arises where there are high “spillover benefits” from infrastructure assets that cannot be captured efficiently by user charges. If these sorts of assets were provided only by the private sector, the amount of investment would be much less than the socially optimal level.

Public investment in such assets could be limited to those that could be funded with the excess of taxation over recurrent spending requirements (past and current). An important consideration is that taxes impose deadweight costs on the community and detract from current economic welfare. While taxes also detract from the economy's growth potential, the bulk of the costs fall on the taxpayers that actually bear the taxes. This does not align with intergenerational benefits that flow from these investments. It makes more sense to spread the funding of infrastructure across the generations that derive benefits.

Finally, governments across the country could also achieve better value for money for taxpayers if they changed tendering requirements to be more in line with private sector commercial projects. This would reduce unnecessary costs borne by construction companies to meet often excessive and onerous tendering requirements including extensive design work for projects they have more chance of losing than winning.