



**NEVER WASTE A CRISIS:
REBUILDING QUEENSLAND'S POST
NATURAL-DISASTER ECONOMY**

MAY 2011

Priorities for 2011/12 Queensland State Budget
Australian Industry Group

Executive Summary

The past 12 months have been amongst the most turbulent periods in living memory for Queensland industry. Whilst the resources sector has continued to expand strongly, many trade-exposed businesses, particularly manufacturers, have faced the challenges of a surging currency, interest rate increases, cheaper global prices for goods and services, high levels of consumer caution and a flat housing market. Additionally, across the broader economy, the tightening labour market is developing into a barrier to growth and adding to general wage pressures.

Over the summer of 2010-11 Queensland experienced its worst period of sustained natural disasters in over a century, with widespread floods and Cyclone Yasi. Affecting more than 90 per cent of Queensland, these events resulted in a tragic loss of life and impacted many Queenslanders whose homes and places of work were damaged or destroyed. Economic impacts included the decrease in coal production, loss of agricultural output, impairment of and disruption to manufacturing businesses, and a sharp decline in tourist arrivals.

Despite the destructive impact of these events, they have also created a once in a generation opportunity. Decisions taken now have the capacity to pave the way for a stronger, more resilient, more innovative and more diversified Queensland economy. Alternatively, a poorly managed recovery and rebuilding effort could leave us with a Queensland that simply resembles the status quo, or worse, leads to a less productive economy and more risk prone community.

So how do our policy-makers deliver the post-natural disaster economy Queenslanders want and deserve? In short, the crisis Queensland experienced over the summer just past is one that should not be wasted. It should be seized upon as a State-shaping event. Properly responded to, and directed by a clear vision for Queensland's future, this crisis has the potential to launch our state strongly into its next phase of economic expansion, which will bring improvements to living standards and most importantly an even more robust environment for Queensland industry.

This submission is broken into two parts, one focusing on the recovery, the other more broadly on delivering a stronger, more robust and resilient economy. The reconstruction of Queensland's economy must be strategic and targeted: critical infrastructure must be reinstated and future-proofed with a forward pipeline of major projects maintained; affected SMEs, which play a critical role in the economy, should be supported, both through immediate financial assistance to address critical cash-flow issues and through reduced business operating costs; and declining productivity must be addressed through increased investments in innovation and other capacity-building initiatives.

More broadly, we must acknowledge that Queensland is overly reliant upon mining, agriculture and tourism – a virtual ‘three-trick pony’ economy. In having acknowledged this, our policy-makers need to also understand that this represents a significant and unnecessarily acute risk exposure for the economy and our community, and then

seek to redress it through specific decisions. Queensland’s reliance on mining, tourism and agriculture is understandable given our abundance of resources and our geography, but we do not want to simply be Asia’s farm and quarry, and a place holiday-makers consider visiting. By investing in a diversified and balanced economy, policy-makers can significantly reduce the risk of future weather-related shocks, which are set to increase with the onset of climate change. Policy decisions made in the next 12 months need to focus not only on rebuilding but also on critical skilling requirements, infrastructure investments that build capacity, and clever initiatives that help local industry and suppliers compete in the supply chain of major capital projects.

A penultimate point to consider is that while there is an understandably sharp focus and sense of urgency about the rebuilding of Queensland, over time the exigency of this will recede and it is imperative that the State’s medium and longer term challenges are not overlooked. In short, policy-makers face the prospect of competing headwinds over the short-term; on the one hand to respond quickly to the immediate demands for the restoration of critical infrastructure; on the other, not to lose sight of the need to reshape the Queensland economy.

Further, policy-makers ought not fall into the trap of failing to deal with ever-increasing government outlays. There are very serious fiscal risks associated with allowing large structural imbalances to occur in the Budget settings at a time of crisis. Therefore a program of forensic analysis to identify spending cuts, followed by consideration of those most appropriate, and then relentless implementation of such a program, would be well-advised.

As we have now entered into the final 12 months before an election, Industry would like to see our elected representatives work constructively to advance the proposals and recommendations contained in this submission. To do so would be to position

Delivering the post natural disaster economy we want

- Drive the diversification needed to maintain sustainable economic growth
- Ensure a forward pipeline of strategic targeted infrastructure investment
- Reduce government spending to underpin a strong fiscal position
- Reduce the costs of doing business
- Build business capacity to normalise innovation and deliver business efficiencies
- Increase participation and skills in anticipation of industry needs
- Support recovery of flood and cyclone affected SMEs
- Support local industry participation in major projects
- Develop a program of further asset sales

Queensland strongly for the future and provide the most robust footing upon which our ongoing prosperity and standard of living can continue to be advanced.

Queensland economy and industry 2010-11

The past year has been challenging for Queensland industry. Whilst there were clear indications of continued recovery from the deepest global recession in a generation, this recovery has been gradual and very uneven.

A multi-speed economy, driven by a rapidly expanding resources sector, is evidenced by data indicating that through 2009–10 the mining industry's growth rate has been four times that of the manufacturing sector and 12 times that of the construction industry.

Figure 1 : Growth rates of selected Australian industries 2009- 10 (Industry Gross Value Added)

Mining	Manufacturing	Construction	Retail Trade	ICT
6.0%	1.5%	0.5%	1.9%	1.2%

The surging currency has had major implications for trade-exposed Queensland businesses in export or domestic markets, largely impacting on manufacturing, a sector increasingly struggling due to intense competition from cheap imports.

Increases in the official cash rate through 2009-10 (a total of 175 bps added to the cash rate from October 2009 through November 2010) have also constrained industries that are now under sustained exchange-rate pressures. These two macro-economic forces (the currency and the cash rate) are both linked to the strong performance of the resources sector, which is also causing skill shortages amongst in-demand specialist trades. In short, the second phase of the mining boom has had the effect of raising business borrowing costs, reducing investment in non-resources sectors, placing intense pressure on other exporters and those who supply domestic markets, and dampening consumer spending.

The job market has also been robust with continued strong rises in wages and input costs, combined with low selling costs, which have seen a narrowing of manufacturing margins.

Recent natural disasters have also significantly impacted industry. The Federal government has estimated flood impacts on Queensland industry (excluding transport, mining, agriculture and tourism) at \$500 million. Across coal and agricultural industries alone, the Federal government estimated production to have been reduced by around \$8 billion. Cyclone Yasi is expected to have caused more

than \$1 billion in losses to tourism, agriculture and industry in Far North Queensland. These losses have been felt throughout the economy including impacting local supply chains.

The floods were credited with causing the largest fall in consumer confidence in eight months in January (Westpac-MI consumer confidence index dropped from 111 in December 2010 to 104.6 in January 2011), however the reconstruction, including a projected \$10 billion infrastructure and housing construction boom between April 2011 and 2013¹, is likely to exacerbate skills shortages already evident in the resources sector.

Ai Group's own survey of inundated Queensland industrial premises showed that for affected businesses, an average of 15-17 working days were lost, depending on the size of the enterprise.

The effects of flooding have also added to already weak conditions in the construction industry, with the Ai Group Australian Performance of Construction Index (Australian PCI®), falling 3.6 points to 40.2 in January - the eighth consecutive month the index has been below the 50-point level delineating expansion and contraction. This improved somewhat in February when the PCI registered 44.6, an increase of 4.4 points from January, in part reflecting an easing in weather related disruptions. However the decline worsened 5.2 points in March to 39.4, driven by steeper falls in activity, new orders and employment. This represented the weakest reading on the overall state of the construction industry in two years. This is, however, likely to be reversed as reconstruction gets underway during mid-2011.

Estimates suggest an overall Queensland Gross State Product (GSP) impact of between 1 – 1.5 percentage points with a likely loss of 0.5 percentage points for national Gross Domestic Product (GDP) for 2010/11. The Commonwealth Treasury says GDP impacts will be concentrated in Q1 2011 and recovery impacts will show in later quarters. Headline inflation was 1.6 per cent in the March quarter 2011 and 3.3 per cent over the year; the last time headline inflation was 1.5 per cent or above was June 2008. While this outcome was above market expectations, economists generally expected the headline CPI to grow strongly this quarter due to recent flooding and Cyclone Yasi.

Ai Group consultation with businesses affected by the floods, detailed in Part 1, also provides some important evidence of the impacts, including:

- Loss of critical infrastructure: lengthy closures of business premises, inadequate and unreliable energy supplies and transport infrastructure (rail and road).
- Human capital: dislocated and traumatised staff, as well as labour availability to be somewhat lower in the immediate crisis period.

¹ IBIS World, 2011, p.5, Queensland Floods – the economic impact.

- Loss of agricultural produce and inputs.
- Disruption to the supply of coal and steel inputs and associated delays and problems throughout the production supply chain.

Economic outlook 2011-12

The coming year will be a critical one for Queensland industry and the state's economy.

Whilst a slow start to the year is expected as the impacts of natural disasters continue to be felt, particularly through Q1 and into Q2, subsequent quarters will see an upswing in activity as the combined effects of the resources boom and the reconstruction efforts kick-in.

Projects under the Queensland Government's infrastructure investments, major coal developments in the Surat and Bowen Basin, LNG Pipelines – Surat Basin to Gladstone, and LNG Plants – Gladstone, Coal Seam Gas (Methane) – Bowen Basin, Hard Rock Mining (West of Townsville and Mt Isa), Coal Mining (Galilee Basin), sewerage treatment and water pipelines across Queensland and maintenance, servicing and replacement of equipment, combined with the reconstruction, will increase competition for scarce resources towards the end of the year.

Whilst coal mining, the emerging LNG industry and government infrastructure investment appear to present strong growth opportunities, a failure to encourage and stimulate local participation in supply chains for these projects will see an exacerbation of the existing unevenness of the recovery. This will in turn hamper growth in the manufacturing and engineering sectors, increasing the State economy's reliance on resources, tourism and agriculture.

Natural disaster impacts on Queensland industry

- Industry (excluding transport, mining, agriculture & tourism) - \$500m
- Transport sector - \$470m
- Coal (lost production) and agriculture (loss of stock and crops) - \$8b
- Tourism – lost bookings - \$500m

At a glance – the trends

- Multi-speed economy nationally
- Over-reliance on resources agriculture and tourism
- \$AUD – sustained period tracking at around parity with the \$USD
- Increasing competition from cheap imports
- Declining productivity
- Increasing competition for scarce skills driven by resources and reconstruction
- Major non-resource infrastructure pipeline coming to an end

Sectoral Outlook

Manufacturing

- Manufacturing sector activity will remain weak in 2011. Nominal sales are forecast to rise 3.1% in 2011 and employment is expected to decline by 1.2% (although the pace of decline is smaller than in 2010).
- Capital investment is anticipated to decline 28.4% in 2011 as manufacturers remain tentative about investing for the future as they are cautious about the economic outlook. The availability and cost of credit also remains a constraint on investment plans.
- R&D expenditure is forecast to decline 0.7% in 2011, potentially putting at risk the relative productivity and cost competitiveness of Australian manufacturers.
- Export earnings in 2011 are forecast to be largely unchanged from 2010, rising by a mere 0.2%. Exports could be restrained further in 2011 should the Australian dollar remain near parity relative to the US dollar for an extended period, as 64.4% of respondents said that a USD/AUD exchange rate of between 80 and 100 cents was already making exports uncompetitive.
- Selling prices are anticipated to rise 4.7% in 2011. However, non-labour costs and wages are also expected to rise significantly.
- From a business strategy perspective, 20% of manufacturing CEOs report that improving sales of current product/service lines is the key business strategy that will be implemented over 2011.
- For the manufacturing sector potential impediments to growth in 2011 include: cheap imports; lack of demand (suggesting manufacturers are some way from full capacity); a high exchange rate; and skills shortages.

Services

- Services sector (nominal) sales are forecast to expand by a significant 12.5% in 2011 with employment to expand by a solid 6.4%.
- Capital investment is forecast to decline in 2011 by approximately 2.5%.
- Services export earnings are expected to accelerate by 9.3% despite an elevated exchange rate; R&D expenditure is set to drop by 4.7% in 2011; and selling prices to grow by a solid 3.6%.
- The services sector is expected to increase its investment in skills by 6.3% in 2011.
- From a business strategy perspective, a majority of services sector business CEOs indicate that improving sales from current product/service lines is a critical strategy they plan to implement over 2011.
- For the services sector potential impediments to growth in 2011 include skills shortages and a lack of demand. Government regulatory burden is also mentioned amongst respondents from the services sector.

Construction

- Construction sector (nominal) sales are forecast to grow substantially by 12.9% in 2011 with employment rising 1.2% but capital investment to remain subdued in 2011.
- Exports in the construction sector are expected to lift by 10.5% over the year in 2011, R&D expenditure is expected to rise by 7.3%, and selling prices to rise by 6.2%.
- Wages are expected to rise by an average of 5.3% in 2011, the highest rate increase amongst the three sectors surveyed.
- Like the services sector, the construction sector is expected to increase its investment in skills, with training expenditure to increase by 5.7% in 2011 (again the highest amongst the three sectors surveyed).
- From a business strategy perspective, the most frequently cited plans for 2011 are to improve sales of current product and service lines (23% of CEO respondents), followed by investing in the current business and reducing costs (17% and 16%, respectively).
- For the construction sector potential impediments to growth in 2011 include a lack of demand (14% of CEO respondents); skills shortages (13%); wage pressures (10%); higher interest rates (9%) and government regulatory burden (including taxation) (8.6%).

Part 1: Queensland natural disasters

Events that faced Queensland in the first quarter of 2011 will shape business communities and the State's economy for decades to come. From 30th November 2010 prolonged and in some cases acute rainfall in eastern Australia resulted in severe flooding throughout Queensland, northern New South Wales and Victoria. In some cases the rainfall extended to late January 2011. One of Australia's worst natural disasters, the flooding caused unprecedented damage, and has been described as the most costly disaster in Australia's history. Indeed the Commonwealth Government says 'in economic terms, the January floods and Cyclone Yasi will likely be the largest natural disaster in our history. Together, they will likely reduce economic growth by around ½ a percentage point this financial year'.²

In Queensland, initially 75 per cent of the State was 'disaster declared' rising to 92 per cent following Cyclone Yasi, and later to 99 per cent, including 72 local government areas. Over 28,000 properties were inundated State-wide. In regional places such as Bundaberg, Rockhampton and Emerald there were severe impacts. In the south-east of the State, Toowoomba, the Lockyer Valley, Ipswich and Brisbane were heavily impacted including some of the State's key industrial areas at Goodna, Rocklea and Sumner Park.

The Local Government Association of Queensland has estimated that 70,000-90,000 kilometres of public roads were affected, (nearly 19,000 kilometres of State roads), with indications that road infrastructure will account for 80 per cent of the cost of rebuilding. Some 29 per cent of Queensland's rail infrastructure was also damaged.³

Category 5 Cyclone Yasi hit Far North Queensland (FNQ) on 2 February as the largest cyclone system to hit the Australian coast since 1918, and the first Category 5 cyclone to hit Queensland. It resulted in an estimated \$800m in recovery and reconstruction costs.

Flood Impacts

Whilst the forshadowed broader economic impacts of these events are outlined in the introduction, Queensland's prosperity into the future will rely on the ability of businesses across all sectors to quickly recover.

During January Ai Group used aerial mapping to identify and contact flood affected members so business impacts could be determined and areas of highest need quickly understood.

² Commonwealth Treasurer Wayne Swan, Ministerial Statement, 23 March 2011

³ Queensland Reconstruction Authority

A snapshot 200 businesses were surveyed in the most acutely inundated areas of South-East Queensland with information sought on inundation levels, insurance status, damage type (stock loss, plant and equipment loss, structural damage) and cost, staff impacts, expected trading recommencement, and major issues impacting recovery.

Of the 200 Queensland businesses surveyed, 69 had experienced some form of inundation, ranging from approximately 150mm-300mm at the lower end through to 4-5 metres of floodwater. Apart from stock and equipment loss, businesses initially found it difficult to estimate longer-term financial impacts on their individual enterprises. A follow-up survey has subsequently been completed of the same sample (5 weeks after the initial survey work) to check initial assumptions. Whilst more recent findings have yielded valuable information illustrating the hardships faced by impacted businesses, for some it will take considerable time for the scale of the full impacts to become clear.

Key issues emerging for inundated businesses included:

- stock and equipment loss / damage
- loss of critical data and documents (relating to payroll, accounts etc)
- long delay to return to production and no/limited cash-flow
- electricity supply, and cost and difficulty accessing generators
- insurance coverage uncertainty / lack of cover for flood / high insurance excess
- timeframes for replacing highly specialised equipment
- transport /freight and/or business isolation
- clean up costs – water and waste disposal
- clean up safety – including dealing with asbestos
- stand down of staff for period of non-production
- delay getting electrical contractors on-site to certify equipment safety
- staff personally impacted by flood
- lack of orders / demand.

Ai Group's research shows that of the inundated businesses in the most acutely affected areas, there has been an average direct damage bill of \$1.2 million. The majority of these businesses (around 75 per cent) either did not have insurance, had a claim refused, or had an excess so high that it was commercially unviable to submit a claim. Similar to the business community's response during the global recession, most employers worked hard to retain staff with only 7 per cent of companies, largely those forced into a very lengthy period of non-production, initiating stand downs. The average clean-up bill alone was \$70,000 – this is just the costs associated with removing mud, debris and other impacts of floodwaters. On top of this there was also an average of slightly more than \$580,000 in lost trade as a result of an average of 16 working days lost.

One of the ongoing issues impacting affected business following the event has been cash-flow - with costs including payroll and outstanding accounts, clean up and refit, replacement of damaged or lost equipment, temporary relocation, diversion to mobiles, and generators pushing many businesses into distress. In relation to recovery, many affected businesses have only recently returned to full production. Some continue to face long delays to replace specialised equipment that needs to be sourced from overseas. Complex legal issues continue to emerge relating to flood damage to premises and stock.

A range of case studies outlining the experiences of individual businesses follows. Only one of these businesses (Company D), qualified for early financial assistance offered to small businesses (<20 employees) under the Natural Disaster Relief and Recovery Arrangements (NDRRA) support initiatives. The subsequent introduction in March of the Exceptional Disaster Assistance Scheme, administered by the Queensland Rural and Regional Adjustment Authority (QRRRA), has significantly expanded post-disaster business relief. This followed strong representations made by Ai Group to both the Federal and State Government. Ai Group welcomed the introduction of this scheme, which means affected businesses with over 20 employees can now apply for concessional loans of up to \$650,000, including a grant component of up to \$50,000. Further, Ai Group believes it would be advisable that this program be made a permanent response to natural disasters of similar magnitude, as is the case with NDRRA arrangements for small businesses.

Currently the only permanent post-natural disaster government financial assistance for business is the NDRRA arrangements which are limited to small business (<20 employees) and primary producers. Grants of \$25k for clean up and refit and concessional loans (4 per cent interest for up to 7 years) of \$250k to replace plant and equipment have been available in disaster declared areas. It is the view of Ai Group that there is now a compelling case for State and Territory Governments to negotiate with the Commonwealth to extend NDRRA support to larger businesses with between 20 and 200 employees into the future in the worst cases of natural disaster.

Some with significant payroll commitments, who face lengthy forced closures, have reluctantly initiated stand-downs amongst their workforces. This represented only 7 per cent of businesses surveyed. This obviously exacerbates the community and social impacts of the floods and Cyclone Yasi. Stand-downs will also have long-term impacts for families as well as for the employers in a tightening labour market, as staff look to relocate to find alternative employment.

During the negotiations with the Commonwealth Government over extending QRRRA financial support to business in an ongoing way, State and Territory Governments could also commit to temporary payroll tax relief in a targeted way in the immediate aftermath of severe natural disasters to lessen the burden on SME's as a short-term

measure The case for this has sound rationale underpinning it in that any short-term assistance would remove the perverse incentive to stand-down staff so as to lessen an enterprise's payroll tax liability.

Flooding Impacts on Queensland Industry – Quick Facts

- Average overall cost per business - \$1.15m
- Average clean-up cost - \$70k
- Average lost or damaged stock / consumables - \$252k
- Average lost or damaged plant & equipment - \$394k
- Average lost production - \$581k
- Average structural damage (owned occupier) - \$220k
- Average working days lost: 13 – 17 depending on size of the enterprise
- Average days without electricity: 13
- Percentage of companies who stood down staff – 7%
- Percentage of businesses sampled who had, or believed they had, flood insurance cover – 50%
- Percentage of businesses who had, or believed they had, flood insurance cover, whose claim was refused, ineligible by virtue of flood definition, or whose excess was too high to make claiming cost effective - 50%

Rebuilding flood and cyclone affected areas across Australia is expected to cost the Federal government approximately \$6billion. The State Government's reconstruction costs associated with flooding alone are likely to be over \$5billion. The Federal government has indicated that two thirds of the Federal costs will be funded through budget savings, with the balance funded via a temporary flood levy. Under the NDRRA the Commonwealth provides financial assistance to the states comprising partial reimbursement of actual expenditure on disaster relief and recovery payments and infrastructure restoration. This assistance is intended to complement other strategies in relation to natural disasters, including insurance and disaster mitigation planning and implementation.

The Queensland government has also indicated it would defer existing infrastructure projects, such as the proposed Cross River Rail in Brisbane, to fund its 25 per cent share of the reconstruction. While this may seem understandable it could, in time, come to be seen as a deeply regrettable decision. It has unfortunately now made the commitment to this project much more uncertain and has led to calls for it to be axed completely. These types of knee-jerk responses from policy-makers are very short-sighted and leave the business community with no alternative other than to lament short-termism by our elected representatives.

Recommendations – Natural Disaster Recovery

Queensland's future prosperity will rely heavily on the ability of businesses across all sectors to quickly recover from recent events.

Given this, government (Local, State and Federal) should take the following action to assist and support affected businesses and drive a sustainable economy:

- ensure the extension of current financial assistance programs (both NDRRA & QRRRA) as long term ongoing programs that can be called upon by businesses of all sizes following extreme hardship caused by natural disaster.
- drive new investment in capacity building projects around business continuity and flood preparedness
- resist the temptation to scrap current projects that have capacity-building at their core (such as Brisbane's Cross-River Rail)
- negotiate special short-term payroll tax relief following severe natural disasters
- investigate location of strategic industrial areas/ electricity substations supplying these out of flood.

Ai Group Members assist recovery

Ai Group recently sampled members across Australia for information regarding how they had contributed to flood relief and recovery. The responses from members showed that industry is giving generously both in cash donations and in-kind offers of help.

Ai Group member contributions to the Queensland Premier's Disaster Relief Appeal Fund totaled approximately \$10 million. Over 100 Ai Group member companies also contributed in-kind - school equipment, food supplies, transport, office equipment, and manpower to help with the clean-up and recovery efforts. There were also many examples of business doing all they could to help affected employees.

Ai Group's Industry Connection Directory, a national web-based directory industry can use to offer or seek assistance in response to flooding, includes 45 offers of discounted or free services or products, including some offering longer payment terms for flood affected businesses. Offers include free cleaning products, office equipment, storage products and legal mediation services. A range of heavily discounted products and services are also offered.

At a glance – back to business

- Adopt an ongoing approach to post-disaster financial assistance for business
- Explore payroll tax relief
- Provide relief from increasing utilities costs and environmental licensing fees for affected businesses
- Reduce red tape

Case Studies

The following case studies are based on information collected during January and February 2011.

Company A –Manufacturer

Company A's beverage manufacturing plant suffered major inundation to a depth of three metres. Damage included an estimated \$2 million in lost stock and \$12 million in equipment. The overall damage bill is expected to exceed \$18 million. The company has \$5 million in insurance coverage.

The company estimated limited production would recommence two months after inundation, full production in 6 months. Delays resulted from the need to source specialist equipment overseas. Casual staff were laid off whilst 150 permanent staff undertook clean-up on full pay. The company wishes to retain permanent staff however \$100,000/week in employee costs has made this extremely challenging during the period of partial / non-production.

Other issues included significant waste disposal costs (since waived by Council). On-site clean-up costs are substantial and exceed \$100,000. The company has contractual commitments on product volume and production had to be increased in other states during the Queensland site's closure. This has significant cost implications for the company (estimated at \$2 million) including in over-time premiums (extended operating hours) and additional freight costs.

Company B –Manufacturer

Company B's truck trailer manufacturing plant was inundated to 2.5 metres. Damage included loss of two air compressors valued at \$40,000 each, and four completed product units valued in excess of \$1 million. The two units had been paid for but not yet collected. The business does not have insurance for flood.

The company has 30 staff and a payroll of \$30,000/week. Some staff were involved in the clean-up on full pay and others are working from home to develop new design concepts. Once clean-up concluded the proprietor undertook staff training until production could recommence. Cash-flow is the key issue due to refit, payroll, utilities and equipment costs.

Production could not recommence until equipment was replaced and power restored. The locality was without power weeks after the flood event and industrial generators were expensive (\$5,000/wk) and difficult to obtain due to demand. Extensive water has been used for clean-up and relief provided by local authorities did not cover industrial clean-up. There are also on-going legal considerations in relation to ownership of the units paid for but not yet collected.

Company C – Engineering Services / Manufacturer

Company C designs, manufactures and installs lubrication modules for the mining industry. They have 50 staff.

The company anticipated a low intensity event assuming depths to 0.6 metres however inundation of 3.5 metres occurred. Damage in the order of \$1-2 million occurred plus lost production and opportunity costs including the company's server and welding equipment critical to business operations. All business related data was lost including accounts, HR records and payroll. Finished projects on site, including vehicles owned by several clients, were destroyed. Some had not been collected due to flood of mines in regional Queensland.

The company are still determining insurance status. One client indicated they will cover damaged vehicle costs however another has an expectation Company C replace the vehicles.

Company C remained unable to pay staff for an extended period due to payroll data loss (re. pay rates). All casual and contract staff were stood down indefinitely. They have indicated government financial assistance would be critical to re-establish the business. Such assistance has only just become available in March (via QRAA arrangements). The company has applied under this assistance program and is awaiting the outcome.

Company D – Manufacturer

Company D, a small business, is a leading manufacturer of boat trailers. Their premises were inundated to 1.5m resulting in structural damage estimated at \$200,000 and stock loss of \$600,000. The company does not have flood insurance.

The business was unable to trade until equipment was replaced and power restored. The company employs 13 staff, all of whom were involved in clean up. The \$10,000/wk payroll means staff stand downs were necessary.

The boat trailer industry has been suffering from cheaper imports, and the company fears this set back will make it difficult for them to resume their place in the market. They intend to take advantage of government's small business grants, but so far have been too busy to explore this. The proprietors nominated tax relief as potentially critical to their recovery.

Company E – Regional manufacturer

Company E, a regional manufacturer servicing the mining industry, was not inundated but was significantly affected by road closures in and around Rockhampton. For an extended period they were unable to access raw materials to continue production and unable to dispatch goods completed.

Company F- Agricultural services

Company F, a sugar processor, employs 150 staff and has experienced inundation twice in close succession during December 2010. Production recommenced following a three week closure. The company was without power for a fortnight and insurance status remains unclear.

Local industry in the town is heavily reliant on this facility. Crops are anticipated to be down 80% on 2010 given the flooding, which will significantly impact local orders. Historically during flood and when local orders slow Company F focus on their export market however presently this has been impacted by the strong \$AUD.

Part 2: The Broader Economy

Government must address a range of pressing policy areas if the Queensland economy is to grow sustainably. The continued reliance on mining, agriculture and tourism limits Queensland's economic potential and initiatives must be undertaken to build and maintain the viability of a range of other sectors against a backdrop of decreasing productivity.

The Queensland government has indicated it would defer existing major infrastructure projects such as the proposed Cross River Rail in Brisbane to fund its 25 per cent contribution to reconstruction. This has, unfortunately, now made the future of this project much more uncertain and has even lead to calls for it to be axed completely. These types of responses from policy-makers are to be discouraged. The business community has no alternative other than to be critical of short-termism amongst our elected representatives if they do not commit to productivity enhancing projects like the Cross-River Rail.

Infrastructure

The post-disaster environment provides significant opportunity to future proof much of the State's infrastructure and in this regard the reconstruction should be approached with a view to improve rather than simply replace. Increasingly, climate change will result in more frequent and severe weather events. Policy makers must support delivery of robust infrastructure systems that will assist business continuity.

Queensland's road network

The Local Government Association of Queensland has estimated that 70,000-90,000 kilometres of public roads were affected by recent floods (nearly 19,000 kilometres of State roads), with government suggesting that road infrastructure will account for 80% of the flood repair bill. Industry remains firmly of the view the State's roads are the primary priority and the reconstruction and repair of these assets should be expedited.

A forward pipeline of major infrastructure projects

In order to fund recovery and reconstruction both State and Federal government have indicated a number of major infrastructure projects, including the critical Cross River Rail project, along with major upgrades to the Bruce Highway, are to be deferred with delays of at least two years.

While this decision, taken in the context of the immediate aftermath of the natural disasters, may be understandable, it is on balance a deeply regrettable decision. Cross River Rail is a major transformational city-building project critical to providing ongoing freight and passenger capacity in the State post-2016. With an estimated

cost of \$8 billion, the project was one of the last of Queensland's major infrastructure projects on the horizon.

Whilst the Queensland Government's infrastructure spend in 2009-10 at \$18.2 billion exceeded every other state and territory in the country, being 65 per cent more than the average of other states, by 2013-14 its capital program will reduce to less than \$10 billion per year⁴. This is to ensure the state's debt to revenue ratio remains comparable to other larger states.⁵

Whilst any deferral of the Cross River Rail project, described by Queensland government in 2010 as one of the biggest job generators in Queensland⁶ will have a range of undesirable medium term impacts, including major freight capacity issues, failure to deliver in the long term will have major impacts for a broader economy, which is already struggling due to declining productivity.

Cross River Rail is central to the *Connecting SEQ: 2031 Transport Plan* with capacity to move up to 240 000 people into the inner city during the two hour morning peak⁷ releasing pressure from congested road networks that constrain the ability for business and industry to operate critical local freight movements efficiently.

Industrial land availability and affordability

Industrial land availability continues to be a significant issue for industry. This has been emphasized by recent events, which affected some of the State's most strategic industrial land. The vulnerability of these areas highlights that ongoing vigilance will be required to ensure adequate levels of suitable, flood free and strategically accessible land are set aside for industry. This will be particularly important post-flood due to the potential for increased pressures from urban encroachment driven by residential construction in flood-free locations.

Housing Availability

There is an ongoing need to ensure an adequate supply of affordable housing located to provide easy access to existing and future employment centres and corridors including key industrial areas. Key worker accommodation is expected to become an increasingly critical issue into the future. There is a high risk gentrification of existing affordable suburbs will result in displacement of lower income workers if affordable options are not proactively incorporated into new developments in renewal precincts, particularly across South East Queensland.

4 IBIS World, 2011, p.5, Queensland Floods – The Economic Impact.

5 Queensland Department of Premier & Cabinet, 2010, p.12. Queensland Growth Management Summit Background Paper

6 Queensland Department of Infrastructure and Planning, 2010 p.5 SEQ Infrastructure Plan and Program 2010

7 Queensland Government, 2011, Cross River Rail: The benefits (<http://www.crossrivrail.qld.gov.au>)

Recommendations – Infrastructure

- Investment on Roads - That the Queensland Government ensures roads continue to attract much-needed investment with post-disaster repairs expedited and reconstruction approached with a view to improve rather than simply replace.
- A Forward Pipeline of Major Infrastructure Projects – That the Cross River Rail project is retained on Queensland's forward infrastructure program with delivery timed to ensure freight and passenger capacity constraints are addressed. Further, that as soon as practically possible Government commit funds to commence early works on the project and seek bipartisan political support as well as stimulate widespread community engagement on the project.
- Industrial Land Availability and Affordability - That the Queensland Government is vigilant in monitoring industrial land availability and affordability in Queensland, and take decisive action where necessary to address bottlenecks and overcome shortages.
- Housing availability – That the Queensland Government continues its vigilance in monitoring the current and future stock of housing in the state, and takes decisive action where necessary to ensure that access to affordable housing is an achievable goal for all Queenslanders.

The Right Environment for economic success

Now more than ever, with Queensland businesses facing a long recovery and challenges from a high \$AUD, policy makers must focus creating the right environment for driving economic success in the State. This will be achieved in part through a suite of mechanisms. Savings to government running costs, and further reductions to the cost of doing business in Queensland will be central to this aim.

Cost of doing business

In a post-natural disaster environment where businesses are struggling to get back to business, reducing the cost of doing business can be a critical form of relief and a catalyst to reinvigoration. Whilst direct relief has been discussed in Part 1 of this submission, reducing and streamlining existing regulation, including by reducing the quantity of existing regulatory stock and by improving the quality of future regulation must continue to be a key focus of policymakers for the long-term benefits provided to business. Further, a moratorium should be placed on increased fees, taxes and charges for businesses operating in the state so as not to jeopardise Queensland's post-disaster economic recovery.

Government spending

Government must restrict growth in government spending, alleviate increasing cost pressures for industry, and increase productivity in the state's economy with targeted investment in strategic infrastructure.

Specifically Ai Group believes there needs to be a renewed focus within the Queensland Government on public sector renewal, streamlined service delivery, coupled with a renewed focus on achieving increased efficiencies in the operation of Government departments.

As at June 2010 the Queensland Public Service (QPS) workforce comprised a total of just over 200,000 full time equivalent staff (FTE)⁸. The Queensland Public Service Commission (QPSC) reports that since June 2000, the QPS has grown 53,699 FTE or 36.70%. The proportion of QPS employees to the Queensland Estimated Resident Population (ERP) is also increasing. In June 2000 the QPS represented 4.11% of the ERP. This figure at June 2010 was 4.47%. The proportion of front line employees who provide services which are directly utilized by the community of Queensland have remained consistent over the past few years. QPSC reports indicate permanent employment in the QPS has been consistently high at around 81%.

Whilst Ai Group welcomes the news that between September 2010 and December 2010, there was been a decrease of 349.68 FTE employees in the QPS representing a decrease of 0.17%,⁹ a sustained effort is needed to reduce the size of the public sector. In this regard a 5% reduction over 3 years in actual numbers, using 2010 as the baseline, would yield significant savings to government.

Such a proposal would see FTE numbers decrease to 190,000 by 2015-16. This was the approximate size of the QPS in mid-late 2008.

Assuming an average FTE cost of \$85,000 annually per person (inclusive of salary, super plus on-costs such as rent, capital equipment etc.) then such a proposal would deliver an annual saving of \$850 million when fully realized in the final year (2015/16). Growth should then be capped at no greater than 1 per cent average over the following 5 years.

⁸ Queensland Public Service Commission

⁹ QPS Workforce Profile, December 2010

Recommendations - Right environment for economic success

- That the Queensland Government place a moratorium on increased fees, taxes and charges for businesses operating in the state so as not to jeopardise Queensland's post-disaster economic recovery.
- That the Queensland Government commit to significant savings in government running costs, committing to a 5% reduction in the total public service workforce over the 3 years to 2015-2016 and thereafter capping growth at 1% per year on average, resulting in annual savings of approximately \$850 million by 2015/16.
- That the Queensland Government outline a staged program of payroll tax reductions, and a complementary increase in payroll tax thresholds over several years to re-build Queensland's competitive position to do business.
- That the Queensland Government continue its efforts towards improving Government Service Delivery, particularly in relation to regulatory reform and the COAG reform agenda.
- That the Queensland Government should continue work with other states through COAG and the relevant Ministerial Council to initiate harmonisation in environmental legislation across States and Territories, similar to the recent exercise being undertaken in workplace health and safety legislation.

Skills

How Queensland can fulfill the projected demand for skilled workers into the future will continue to be a critical question for both business, government and the wider economy. Whilst growth of the resources sector and recovery efforts will strengthen the economy, it will also see the demand for skilled workers rise sharply, causing unemployment to shrink, impacting on wages and contributing to inflation.

Recent reports indicate up to 18 000 jobs could be generated by the emerging LNG/CSG projects, 9 000 in the construction phase alone, anticipated to peak in 2013. Recent approval of both the \$7.7 billion Santos/PETRONAS Gladstone LNG project and QGC Pty Ltd's \$8 billion Curtis LNG project would potentially mean up to 10 000 jobs. In 2010/2011 an additional 40 000 jobs were forecast to result from infrastructure projects proposed in SEQ alone¹⁰.

This level of activity, combined with the 9 000 jobs expected to be created through early stages of the LNG/CSG industry is likely to create strong and sustained

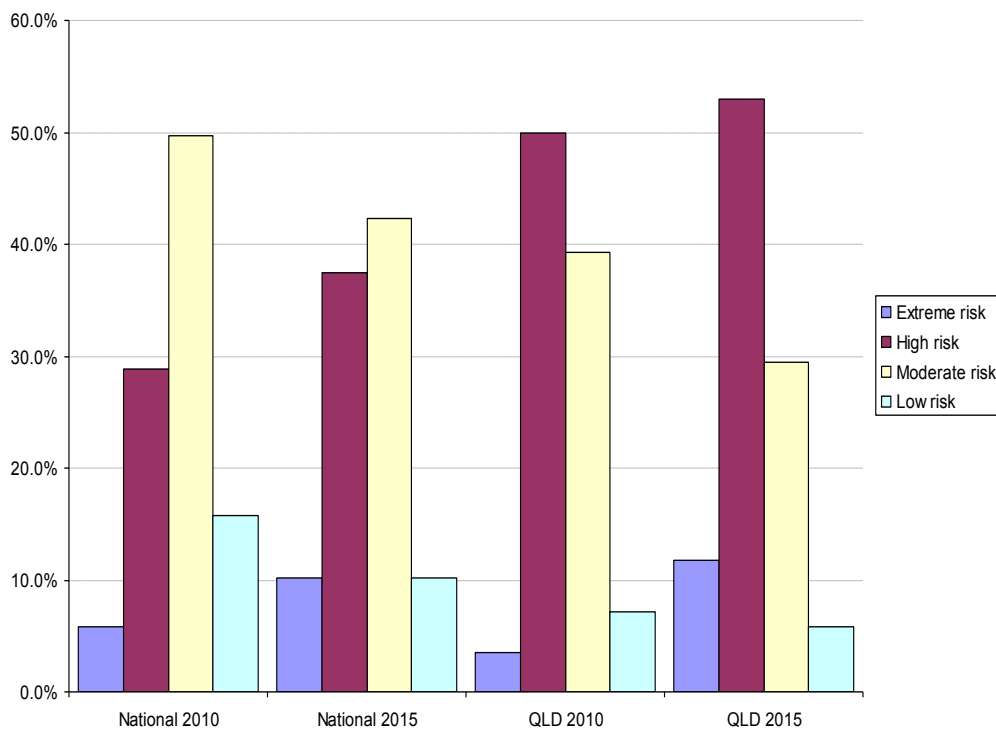
¹⁰ SEQ Infrastructure Plan and Program 2010

competition for skilled labour in Queensland in coming years with likely impacts for sectors such as manufacturing. Expectations of \$10 billion rebuilding program over the next two years as part of the reconstruction will also significantly add to a tightening labour market.

The Australian Industry Group & Deloitte National CEO Survey (*Skills shortages - A high risk business*) undertaken pre-disaster in 2010 found that skills shortages were an immediate issue of concern to business and that this concern was expected to exacerbate in the medium term¹¹.

Nearly half of all businesses considered there was a high to extreme risk of skills shortages impacting negatively on their operations in five years time. Businesses in Queensland had a greater level of concern than businesses nationally.

Risk of skills shortage impacting on effective operation



¹¹ Australian Industry Group & Deloitte National CEO Survey: *Skills shortages - A high risk business*, July 2010

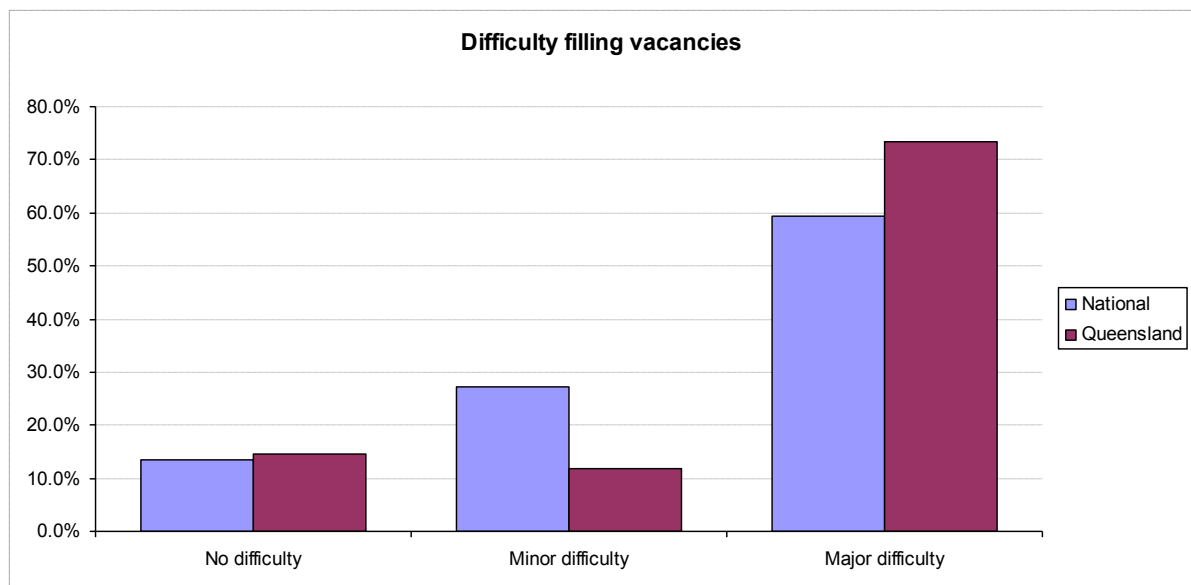
Findings indicated businesses are actively working to manage this risk and expect to increase this focus in the coming years. Nearly 50% of businesses are giving the management of skills shortages a high priority (38.8%) or top priority (8%) now.

In five years time the proportion of businesses expecting to be giving skills shortages management a high priority will increase to 43.3% (53% in Queensland) and those assigning top priority will stay steady at 8% (12% in Queensland).

Businesses are looking for their increased emphasis on managing skills to be complemented by increased government action in this area. Almost three quarters of all businesses are of the view that it is extremely or highly important for governments to take more active steps to address skills shortages immediately (72.6%) and into the future (75.2%).

There is a belief by some businesses that there is an underinvestment in skills linked to the high rate of labour mobility and government should help to address this through targeted skills development initiatives. As skills development is a shared Commonwealth and State and Territory Government responsibility this call for more action is directed to all governments.

Almost two-thirds of companies had difficulty filling vacancies in the 6 months preceding the study.



The major reasons why vacancies could not be filled related to skills: the lack of specialised skills required for the job (59.3%); the lack of applicant skills and experience (54.1%); and the absence of local training options (32.6%). A further major difficulty reported was simply a lack of applicants (48.5%).

Recommendations - Skills

- That the Queensland Government continues to increase overall investment on skills development with a particular focus on supporting sectors (such as manufacturing) vulnerable as a result of increasing skills demand from the resources boom and reconstruction efforts.
- That the Queensland Government commit significant resources to improving the literacy and numeracy levels of Queensland's workforce.
- Review current models of employer support for apprentices with a view of improving the level of support provided to employers who take on apprentices (particularly small employers without a HR capability)
- The Right Job – Pilot Career Diagnostic for School Students – pilot the extension of the compulsory career planning (SET plan) with a career diagnostic test which helps students identify possible career paths. This psychometric analysis will support existing literacy and numeracy testing as well as support more directed conversations between students, parents and teachers.

Innovation

Innovation is increasingly recognised as a key source of competitive advantage for small through to large firms, especially in the context of growing competition from globalised markets and low labour cost nations¹². Australian business R & D expenditure remains below the OECD average of 1.63%.

There are concerns that Australian innovation policy is too focused on “research driven” approach to fostering innovation. There is an urgent need to build capacity in Queensland companies to normalize innovation as part of everyday business strategy. A greater focus on a market facing agenda for Australian innovation is urgently required if the core nexus of productivity, competitiveness and economic diversification is to be strengthened.

Several important aspects of current practice in Australian innovation were revealed by a recent Ai Group *Innovation Survey, part of Innovation – New Thinking > New Directions: A Report* to the Ai Group by the Innovation Review Steering Committee, released in October 2010.

The report and associated survey found that while businesses mainly innovate by introducing new products/services and improving business processes, adopting new technologies and introducing new skill sets are also significant. The key barriers to

¹² Innovation – New Thinking > New Directions: A Report to the Ai Group by the Innovation Review Steering Committee, October 2010.

innovation were identified as lack of funds, appropriate skills, time and resources. Insufficient tax incentives were also seen as an inhibitor to innovation.

Of Queensland companies, nearly 64% identified lack of skills amongst staff as a factor inhibiting the organisation from being more innovative.

Innovation Vouchers

The recent success of the pilot Innovation Vouchers program, a partnership between Ai Group and the Queensland Government, which attracted in excess of 620 applications, for 18 grants of \$50,000, demonstrates latent demand for assistance to drive company innovation. Ai Group welcomes the recent Queensland Government announcement that a further round of the project will be rolled out in 2011/12. Consideration should be given to introducing the program on an ongoing basis.

Tomorrow's Entrepreneur

A culture of innovation and entrepreneurship will be increasingly critical to driving increased productivity in a globally competitive environment. To complement the innovation skills program Queensland Government should investigate the establishment of a new program "Tomorrow's Entrepreneur". The program would encourage and support entrepreneurial individuals currently within the schooling system, and to develop a leadership or mentoring program that support these individuals exploit and develop opportunities.

Emerging technologies

Policymakers should give consideration to funding assistance and support for businesses that will create opportunities to leverage off forthcoming emergent broadband technologies by building capacity in the Queensland business community in early release areas. Such a program would support innovation by assisting the business community to understand and fully utilise emerging technologies to their competitive advantage.

Recommendations – Innovation

- That the Queensland Government consider introducing the "innovation vouchers" (What's your Big Idea Queensland?) program as an annual rolling program including investigating opportunities to promote innovation and/or research activities in targeted sectoral areas to promote diversification of the State's economy.
- That the Queensland Government investigate the establishment of a new program "Tomorrow's Entrepreneur". The program would encourage and support entrepreneurial individuals currently within the schooling system, and to

develop a leadership or mentoring program that support these individuals exploit and develop opportunities.

- That the Queensland Government investigate opportunities to build innovation skills capacity across Queensland businesses through introduction of a targeted training program that aims to normalise innovative thinking and behaviours within business culture.
- That the Queensland government establishes a program of assistance and support for Queensland businesses in early release broadband areas driving capacity building and supporting them to become early adopters who fully utilise emerging technologies to their competitive advantage. This could be in the form of a number of funded industry liaison officers.

Local industry content

Nationally concern is increasing regarding diminishing Australian content in major resource and infrastructure projects in Australia.

Specifically there are concerns offshore companies, and Australian companies financed offshore, are increasingly procuring manufacturing off-shore, often using specifications beyond Australian capability to avoid existing local content policy.

Despite the Australian Industry Participation National Framework advocating a consistent national approach, current local industry policy differs across Australian States and territories. Whilst broadly consistent in the requirement that major projects be subject to development of a Local Industry Policy (LIPP) or similar, thresholds for the requirement vary significantly, as do other mechanisms to facilitate local industry involvement from State to State.

Ai Group welcomes the Queensland Government's recent moves to strengthen existing local industry policy however concerns remain about the ability for the policy, or existing Industry Capability Network's (ICNs) to increase local participation in the supply chain for emerging major projects.

Enhanced data collection and reporting practices by government would potentially contribute to a greater understanding regarding the level of local participation achieved.

Due to this growing government interest in the issue driven by major resource and infrastructure projects in Queensland, and increasingly patchy performance in the Australian manufacturing sector, a project partnership with government around the issue of local content could greatly assist in development of effective strategies to

address the issue.

Once in a generation infrastructure and resource projects constitute critical opportunities for Australian industry that should be leveraged for the benefit of the broader Queensland economy.

Recommendations – Local Industry Content

- That Queensland Government funds development of a corporate social responsibility rating tool such as a '*Local Industry Sustainability Index*' (LISI) to measure and report local industry content in major infrastructure and resource projects in Queensland.
- That Queensland Government develops a system for improved tracking and reporting of existing local industry policy performance.

Asset Sales

The Queensland Government has unfairly faced significant criticism for its decision to undertake a forward program of asset sales in recent years. Ai Group has strongly supported targeted asset sales that deliver increased economic competitiveness and productivity.

The future well-being of Queensland's economy largely depends on the infrastructure that can be delivered from the proceeds of the recent and future rounds of asset sales. Not only are asset sales a means of financing critical new infrastructure without debt, they can also potentially assist the State to return to a AAA credit rating, thereby reducing its ongoing interest bill. Further, there is significant potential to improve the operational efficiency of the assets.

QR National listed on the Australian Securities Exchange on 22 November 2010, after the successful completion of the second biggest initial public offering in Australia's history. The sale yielded Queensland a dividend of \$4.6 billion, critical to reducing debt, delivering key strategic infrastructure investments and establishing a stronger balance sheet.

The 99-year lease of the Port of Brisbane and Abbot Point Coal Terminal have also been completed. The State will receive total consideration valued at \$2.1 billion for the lease of the former, in addition to the buyer taking responsibility for future upgrades of sections of the Port of Brisbane Motorway. This represents in total \$2.3 billion worth of value to the State and Queenslanders also avoiding expected Port infrastructure expansions valued at \$1 billion. The latter will return \$1.8 billion to the State, an amount significantly above that expected.

Due to the clear benefits outlined above, following the success of the lease of Port of Brisbane, Queensland Motorways, Abbot Point Coal Terminal and Forestry Plantations Queensland and the recent float of QR National, government should now quickly move to identify further potential asset sales.

This includes giving particular consideration to the sale of government owned energy assets including Powerlink and the State-owned generators.

Powerlink

Powerlink is a government-owned corporation (a regulated monopoly) that owns, develops, operates and maintains Queensland's high-voltage electricity transmission network, annually transporting 50,000 gigawatt hours of energy to consumers. With \$375 million in profit in 09/10 and overall revenue of \$735 million, Powerlink increased its revenue by more than \$120 million in period 2007-08 through 2009-10 (24 months), which represented an increase of some 20%.

With published total assets in excess of \$6billion and liabilities just under \$4billion, it has a net asset value of more than \$2billion. Powerlink is a profitable regulated monopoly business that represents an attractive privatisation opportunity for government. Sale of such an asset could return a considerable dividend to the State of Queensland in the form of either reducing debt or investing in future infrastructure needs.

Existing Government-Owned Energy Providers

A range of government energy generation assets also represent an opportunity for government to embark upon further privatisation. Ai Group has a long-held view that these types of assets are much more efficiently and productively managed by the private sector. They do not represent assets that governments ought to be in the business of running. Currently Queensland has a mixture of private and publicly owned energy generation assets. The remaining publicly owned energy generators including Stanwell Corporation, Tarong Energy and CS Energy should be closely examined and put to the market at an appropriate time to maximize the return for their current shareholders, the people of Queensland.

Stanwell Corporation

Total Assets	\$1.98bn
Revenue	\$663m
Net profit	\$149m

Tarong Energy

Total Assets	\$2.55bn
Revenue	\$490m

Net Profit	\$91m
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CS Energy

Total Assets	\$1.8bn*
Revenue	\$748m
Net profit	(\$47m)

*Estimate based on published debt ratio of 45% and debt of \$826m)

Totals for Queensland Government-Owned Power Generators

Assets	\$6.33bn
Revenue	\$1.9bn
Profit	\$193m

Recommendations – Asset Sales

- That the Queensland Government prepare a second tranche of asset sales headlined by the energy transmission company Powerlink and the remaining government-owned energy generators.

Conclusion and summary of recommendations

The 2011/12 Queensland State Budget will be critical for industry and the state's economy. Not only will the Government need to continue its work towards restoring the State's credit rating and positioning the Budget for a return to surplus, it needs to do this in a context of a need to continue building the long term frameworks catering for recovery, and towards building Queensland's economy for the future. Ai Group understands that this is a very difficult task in the aftermath of our State's worst natural disasters in over a century, but to fail to tackle these challenges would indeed be to 'Waste the Crisis' and the opportunity it represents for a long-term re-shaping of Queensland's economy. As we have now entered into the final 12 months before an election industry would like to see our elected representatives work constructively to advance the proposals and recommendations contained in this submission. To do so would be to position Queensland strongly for the future and provide the most robust footing upon which our ongoing prosperity and standard of living can continue to be advanced.

ATTACHMENT 1: CONSOLIDATED RECOMMENDATIONS

Natural Disaster Recovery

Take the following action to assist and support affected businesses and drive a sustainable economy:

- ensure the extension of current financial assistance programs (both NDRRA & QRRRA) as long term ongoing programs that can be called upon by businesses of all sizes following extreme hardship caused by natural disaster.
- drive new investment in capacity building projects around business continuity and flood preparedness
- resist the temptation to scrap current projects that have capacity-building at their core (such as Brisbane's Cross-River Rail)
- negotiate special short-term payroll tax relief following severe natural disasters
- investigate location of strategic industrial areas/ electricity substations supplying these out of flood.

Infrastructure

- Investment on Roads - That the Queensland Government ensures roads continue to attract much-needed investment with post-disaster repairs expedited and reconstruction approached with a view to improve rather than simply replace.
- A Forward Pipeline of Major Infrastructure Projects – That the Cross River Rail project is retained on Queensland's forward infrastructure program with delivery timed to ensure freight and passenger capacity constraints are addressed. Further, that as soon as practically possible Government commit funds to commence early works on the project and seek bipartisan political support as well as stimulate widespread community engagement on the project.
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- That Queensland Government develops a system for improved tracking and reporting of existing local industry policy performance.

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