



**IMPORTANT STEPS
FOR A POSITIVE FUTURE**

APRIL 2011

Ai Group Pre 2011-12 Budget Submission to the Victorian Government

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Foreword

The 2011-12 Victorian Budget provides the opportunity for the Government to enhance the productive capacity of the economy. Victoria's economy has generally performed solidly but is facing increasing competitive pressures and this risks the longer term prosperity Victorians have become accustomed to. Ai Group urges the Victorian Government to implement a 2011-12 Budget which gives the highest priority to responding to the needs of the Victorian business community and assist businesses and industries achieve higher productivity growth.

This will involve carefully targeted expenditures and policy actions, including cutting regulatory red tape, building first class infrastructure, increasing funding on education, training and research and development programs, committing to removing inefficient state taxes, and developing environmental policies and programs that are conducive for sustainable and robust economic growth.

The risk to the Victorian Government and to the economy is that due to the challenging financial circumstances the Government may choose to reduce spending and investment in very important inter-generational infrastructure areas.

The Government should maintain a level of investment which continues to underpin the productive capacity of the economy and provide the necessary encouragement to business to also continue to invest.

Business will look to the lead from Government in developing its own investment strategy and the approach the Government takes in its first budget will be an extremely strong indicator for future business activities.

It also seems likely the New South Wales Government intends to develop a very strong competitive ethic and its main competitor will no doubt be Victoria. Whilst we cannot be caught in a competitive spiral, it is important that business is able to view the Victorian Government as being equally as proactive as is the new regime in New South Wales.

Fiscal sustainability and prudent resource management is important and Ai Group commends the Government maintaining sound fiscal settings. However, Ai Group believes that the Victorian Government has the financial capacity through the 2011-12 Budget to fund sound infrastructure initiatives through increased Government borrowing. The debt level of the Victorian Government has risen but remains low in comparison to other similarly sized OECD economies. Furthermore, the economic recovery in Australia has gained traction and the global economy has recovered, led by emerging Asian economies.

With a commitment by the Government through the 2011-12 Budget to programs and policies to enhance the competitiveness of Victoria's economy, Victoria will not only meet the challenges posed for all of Australia, such as lagging productivity, ageing of the population and skills shortages, but also remain a key destination for investment and a driver of innovation and economic growth to the benefit of all Victorians.

Tim Piper
Director, Victorian Branch
Australian Industry Group

Executive Summary of Recommendations

Build first class infrastructure

- The Government should invest in Victoria's economic future through important infrastructure investment that lifts the productive capacity and competitiveness of the economy.

Build world class skills and capabilities

- Supporting the further development of linkages between tertiary sector institutions and industry is a critical ingredient to growth.
- Committing significant resources to improving the literacy and numeracy levels of Victoria's workforce is also warranted in this Budget.

Help businesses prosper and cope with the strong Australian dollar

- The Government should assist exporters and import competing businesses by removing the proposed freight infrastructure charge, funding overseas trade missions and offering tax incentives.
- Full and fair access of local businesses in the procurement of major strategic Government projects is also important for local industry as is transparency of the degree of Australian content in major projects.

Implement climate and environmental policies conducive for sustained economic growth

- This Budget should provide financial assistance to help businesses increase the uptake of initiatives targeted to improve the resilience of businesses to climate change threats.
- In particular, a focus should be to increase funding for support programs designed to improve industry's water usage.

Develop a robust technology industry

- Ai Group seeks this Budget to invest in upskilling programs among the workforce in key industries to foster innovation that expands the employee participation and adoption of the broader aspects of technology.
- This could include offering funding to educate and support business in understanding the transformative opportunities that broadband infrastructure will provide.

Setting the context – Victoria’s comparative economic performance

The Victorian economy has performed well over the last two decades, expanding at an average annual growth rate of 3.2%, slightly below the national average but highest among the non-resource states (Table 1). Consistent with its solid economic performance, employment in Victoria increased at an average annual growth rate of 1.9% over the same period, the strongest employment growth recorded among the non-resource states (Table 2).

Table 1: Economic growth over the last two decades

	Average annual growth rate (1990-91 to 1999-00)		Average annual growth rate (2000-01 to 2009-10)		Average annual growth rate (1990-91 to 2009-10)
QLD	4.9	WA	4.9	QLD	4.5
WA	4.5	QLD	4.2	WA	4.4
Australia	3.8	NT	3.5	NT	3.4
NSW	3.8	Australia	3.2	Australia	3.4
VIC	3.7	TAS	3.1	VIC	3.2
NT	3.2	VIC	2.9	NSW	3.0
ACT	2.9	SA	2.8	ACT	2.8
TAS	2.5	ACT	2.7	SA	2.7
SA	2.4	NSW	2.3	TAS	2.6

Source: ABS data

Table 2: Employment growth over the last two decades

	Average annual growth rate (1990-91 to 1999-00)		Average annual growth rate (2000-01 to 2009-10)		Average annual growth rate (1990-91 to 2009-10)
QLD	2.8	QLD	3.6	QLD	3.1
WA	2.6	WA	3.2	WA	2.8
Australia	1.8	Australia	2.4	Australia	2.0
NSW	1.7	VIC	2.3	VIC	1.9
VIC	1.5	TAS	2.1	NSW	1.6
SA	0.5	SA	2.0	SA	1.2
TAS	0.4	NSW	1.6	TAS	1.0

Source: ABS data

It is crucial that the Victorian Government build upon these impressive achievements, and continue to pursue economic reforms including reducing the regulatory burden and lowering the tax paid by businesses, in order to lift the competitiveness of the Victorian economy.

Measuring cost competitiveness

The long term prosperity of Victoria crucially depends on the competitiveness of the Victorian economy. The term “competitiveness” could be used to describe several aspects of market performance, such as product quality, the ability to innovate and the capacity to

adjust rapidly to customers' demands. A narrower meaning of competitiveness based on costs is adopted in this pre-budget Submission.

One indicator of an economy's cost competitiveness is the real unit labour cost (ULC). The real ULC is an indicator of the average cost of labour per unit of output produced in an economy, adjusted for inflation.

Real ULC is calculated as the ratio of average real labour costs to real output per hour of work. Thus, the real ULC is a link between the cost of labour in producing output and labour productivity.

In the following analysis, labour cost is measured by employee compensation rather than wage. Employee compensation includes wage and other types of remuneration, such as severance payments, bonuses and welfare services provided in kind by employers. This makes it a broader measure of earnings and a more comprehensive indicator of labour costs faced by businesses.

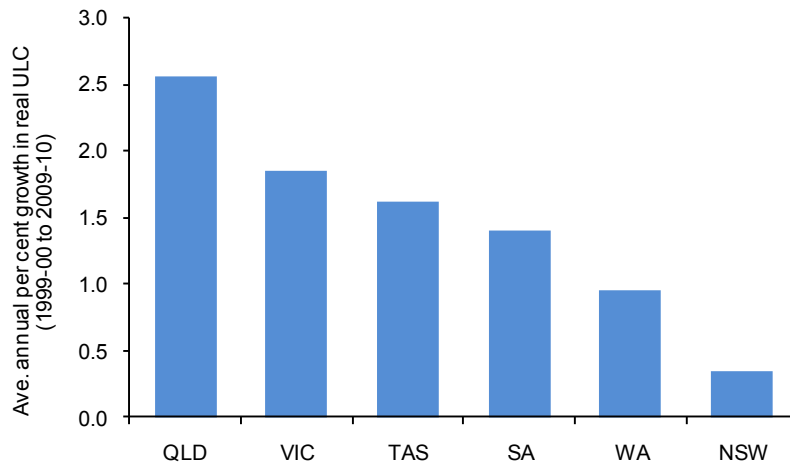
Labour productivity is calculated as industry real gross value added (less ownership of dwellings) per hour of work, as opposed to real gross state product per hour of work. The objective is to abstract from the influences of taxes and subsidies, statistical discrepancies and the ownership of dwellings, which do not involve the employment of labour and has no effect on labour costs.

An increase in real ULC indicates that growth in real employee compensation exceeds growth in labour productivity. This implies that an economy could become less cost competitive as real ULC rises. The real ULC for Victoria and the other states over the period 1999-00 to 2009-10 is calculated using data from the Australian Bureau of Statistics (ABS).

Competitiveness of the Victorian economy relative to the other states

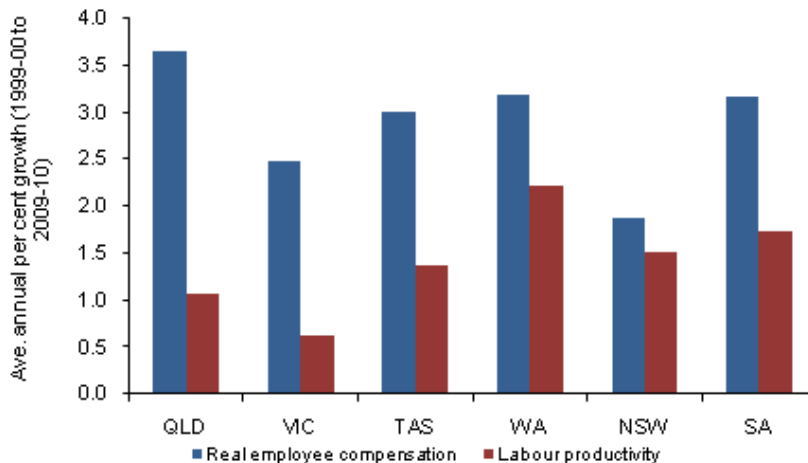
Victoria has the second highest average annual growth rate in real ULC over the period 1999-00 to 2009-10, behind Queensland (Chart 1). This implies that the cost competitiveness of the Victorian economy has worsened more quickly relative to most of the other states.

Chart 1: Growth in real unit labour cost (1999-00 to 2009-10)



The deterioration in cost competitiveness of the Victorian economy over the period 1999-00 to 2009-10 reflects strong growth in real labour costs and weak labour productivity growth. It is noteworthy that labour costs increased significantly faster than labour productivity (Chart 2)¹.

Chart 2: Labour costs versus productivity



In the absence of any policy intervention, the cost competitiveness of the Victorian economy is likely to worsen further for several reasons. Firstly, the strengthening of the Australian dollar is likely to lower the profitability of businesses, especially that of exporters. In attempting to cushion the impact on their profit margins, businesses may cut back on investment in research and development as well as staff training. This implies that labour productivity growth of Victorian workers could slow even more. Secondly, Australia faces an ageing population, which would add more downward pressures on labour productivity. Thirdly, as the resources boom continues in Australia, strong upward pressures on wages,

¹ Labour productivity is calculated as industry real gross value added (less ownership of dwellings) per hour of work.

especially in the non-resource states, would emerge as skilled workers are lured to better-paid jobs offered by mining businesses. Thus, labour cost in Victoria is likely to rise higher.

Need for policies to improve the cost competitiveness of the Victorian economy

The continued deterioration in the cost competitiveness of the Victorian economy could in the long run result in many Victorian businesses being priced out of the domestic and international markets, leading to widespread job losses and economic stagnation.

The Victorian economy needs to improve its cost competitiveness urgently through achieving stronger productivity growth. The policies proposed in this pre-budget submission will, if implemented, help to lift productivity growth in Victoria.

Ai Group urges the Victorian Government to frame the 2011-12 Budget with the highest priority given to responding to the needs of the Victorian business community and assist businesses and industries achieve higher productivity growth through removing inefficient state taxes, cutting regulatory red tape, building first class infrastructure, increase funding on education, training and research and development programs and develop environmental policies that would be conducive for sustainable and robust economic growth.

Capacity to raise Government borrowing to fund productivity enhancing infrastructure initiatives

Fiscal sustainability and prudent resource management is important. Ai Group supports the Government's sound fiscal framework.

However, Ai Group believes that the Victorian Government has the financial capacity through the 2011-12 Budget to fund additional infrastructure initiatives that meet stringent cost-benefit analysis and business case development to support industry and business development and lift the cost competitiveness of the Victorian economy.

The net debt level of the Victorian Government is low in international comparisons. This implies that the Victorian Government could also consider increasing Government borrowing to fund infrastructure initiatives that return a dividend in the form of higher productivity. Now is the opportune time to increase Government borrowing to fund infrastructure that would help to improve the competitiveness of the Victorian economy as the economic recovery in Australia has gained traction and the global economy has recovered, led by robust growth in emerging Asian economies.

Increasing infrastructure spending in a responsible and targeted manner today to lift competitiveness would yield dividends in the future in terms of sustained economic growth, which would in turn raise the Victorian Government's revenue inflows and help the Government to pay off the increased debt incurred today.

Build first class infrastructure

Key recommendations:

The 2011-12 Victorian Budget should:

- Further invest in Victoria's economic future through infrastructure investments.
- Clarify the Victorian Government's position on transport projects left over from the previous Government.
- Fund infrastructure investments with increased government borrowing, where required.
- Facilitate growth in the rail, tram and bus industries, as part of its overall plans to improve infrastructure.
- Provide for funding to encourage collaboration among businesses.
- Increase support to businesses, especially the small and medium sized businesses, in the defence industry.

Increase investments in infrastructure

The Victorian economy has performed well in the last decade and also emerged from the global financial crisis relatively unscathed despite having limited exposure to the resources boom, in part due to the significant infrastructure investments by previous Victorian Governments.

In the 2010-11 Victorian Budget, the then Victorian Government budgeted \$6.4 billion in 2010-11 and an average of \$4.6 billion annually from 2011-12 to 2013-14 to invest in roads and public transport, including new trams, more stations and road projects. These infrastructure investments formed part of the Government's \$38 billion Victorian Transport Plan.

Ai Group commends the Government for being committed to building first class infrastructure in Victoria. That the new Victorian Government has decided to proceed with the Victorian Regional Rail Link project, despite an expected two-year delay to the completion of the project as well as a forecast \$1 billion higher-than-budgeted cost outlay, is evidence that the Government recognises the importance of continuing infrastructure investments throughout Victoria to assist Victorian businesses, generate jobs, raise productivity and enhance the competitiveness of the Victorian economy.

Ai Group urges the new Victorian Government to ensure clarity in its position on transport projects worth many billions left over from the previous Victorian Government while developing its own long term transport plan for Victoria. Ai Group believes the Victorian Government should undertake this task as a matter of urgency because Victorian businesses and members of the community want certainty regarding the state of Victoria's infrastructure in the coming years. Such investment certainty would be especially helpful in informing the formulation of businesses' long term strategies.

The Victorian Government should thoroughly review the recommendations in the Eddington Transport Report that have yet to be accepted. Ai Group is prepared to be involved in discussions on Victoria's transport plans with the Government and on behalf of businesses.

Funding infrastructure investments

The challenge for the Victorian Government is to continue investing significantly in infrastructure while exercising fiscal prudence in funding the investments. This will be especially challenging given the anticipated decline in GST revenue allocated to Victoria by the Commonwealth Government.

Ai Group urges the Victorian Government to adopt a long term view in deciding on infrastructure investments. An important motivation for the Victorian Government to increase investments in infrastructure is that infrastructure investments yield economic benefits for current and future generations of Victorians.

Since infrastructure investments yield economic benefits for future generations of Victorians, Ai Group proposes that the Victorian Government consider funding infrastructure investments with increased Government borrowing, such as in the form of infrastructure bonds. This government debt could have longer repayment periods, with the debt burden shared across current and future generations of Victorians.

Ai Group stresses that borrowed funds must be invested wisely in productive infrastructure projects.

Transport industry policies

Ai Group recommends the new Victorian Government increase investments in the rail, tram and bus industries, as part of its overall plans to invest in Victoria's infrastructure. Such investments, which could include purchases of more trams, buses and trains as well as improvements to the tram, train and bus networks, would benefit local manufacturers, improve Victoria's public transportation network, contribute to environmental protection and create more jobs.

Encourage development of the rail, tram and bus industry supply chain networks

Even if upfront investments cannot be made due to funding constraints, Ai Group strongly suggests that the Victorian Government undertake a firm commitment to these investments, so that businesses that support the rail, tram and bus industries would find it easier to plan and invest in capital for the future. Such clarity in the Victorian Government's infrastructure investment plans will greatly help businesses plan ahead, and facilitate development of the rail, tram and bus industry supply chain networks.

In this regard, the new Victorian Government should continue to support the Transport Infrastructure Manufacturing Scheme (TIMS) to encourage businesses to supply to rail, tram and bus manufacturers. As part of the TIMS process, Victorian suppliers are being encouraged to undertake an accreditation process to ensure the products supplied to rail, tram and bus companies meet predetermined international industry standards, and assist in the procurement process in the industry. Such accreditation is a vital part of equipping companies to become involved in higher performance local manufacturing and in building capabilities that are fundamental to taking advantage of export opportunities.

Facilitate demand management

Victoria is the leader in developing the rail, tram and bus industries. It should continue to collaborate with other states, particularly in assisting demand management of rolling stock. In order to encourage rolling stock manufacture in Victoria and in other Australian states, all State Governments must be encouraged to have a longer term outlook on the purchase of infrastructure. For example, a decade-long demand cycle would enable companies to confidently invest in capital equipment, knowing that significant purchases will be worthwhile over a longer period. Certainty in the market could create a relatively large manufacturing sector in a number of States.

The South Australian Government has contracted Bombardier Transportation to supply and maintain 66 new X'Trapolis rail cars. The contract is valued at approximately \$269 million, and the rail cars will be built at Bombardier's Dandenong (Victoria) and Maryborough (Queensland) manufacturing facilities. Ai Group proposes that the Victorian Government seize this opportunity to tender any new X'Trapolis rail cars required in Victoria at a similar time to that in South Australia. The possibility for Bombardier Transportation to exploit economies of scale in producing the vehicles could translate to lower cost of purchase for the Victorian Government. It could also provide a significant boost to local component suppliers which may be able to price based on a significantly larger order, and be assured of a long term project. It would also boost confidence in the sector, recognising state governments are working together.

The Victorian Government's commitment to the rail, tram and bus industries has increased considerably over the past few years and Ai Group believes that should continue. Current efforts revolve around developing and maintaining supply chains and ensuring local companies have the opportunity to be involved with the larger manufacturers. Government and industry should build on the experience with similar programs in other high-tech manufacturing sectors and develop a new approach to ensure a long-term outlook for the industry.

Encourage consolidation in the rail industry

Ai Group notes that there are many small businesses supporting the rail industry. Lessons from the car and car parts industry would suggest consideration must be given to these

smaller businesses reviewing their long-term future. In the medium-term, this could lead to a consolidation in the industry and put the businesses on a firmer footing to overcome future economic challenges.

Promote collaboration among businesses in defence, rail and vehicle manufacturing industries

Also, Ai Group recommends that the Victorian Government encourage businesses to move between the defence, rail and motor industries, should tough conditions persist in any one industry. This is manageable given the complementarities in the product design of such businesses. The Victorian Government could facilitate the technological transfer across industries by funding appropriate training courses, targeting knowledge and technological transfer.

Help alleviate shortage of skilled labour in defence industry

The defence industry sector in Victoria provides critical support to the Australian Defence Force through the provision of new and upgraded equipment, and through-life support. Victorian-based businesses work in all the major sectors of the defence industry, including aerospace, armoured vehicle and ship construction and sustainment. In partnership with the Defence Science and Technology Organisation, many businesses contribute substantial research and development input to high-tech systems and equipment, with a focus on reducing risk associated with complex weapon systems integrations. Many companies are experiencing skills shortages, particularly for systems engineers and highly skilled technicians, including in the aerospace sector. Further government support is required to assist industry to address the current skills challenge.

Some small and medium sized enterprises (SME) in the defence industry have had profit margins significantly reduced and growth inhibited by the strong Australian dollar. This has led to layoffs in the industry. In light of these developments, Ai Group proposes that the Victorian Government engages in discussions with businesses in the defence industry to understand the challenges they face and increase targeted financial assistance to the businesses to help them overcome the tough business conditions facing the industry.

Help businesses prosper and cope with the strong Australian dollar

Key recommendations:

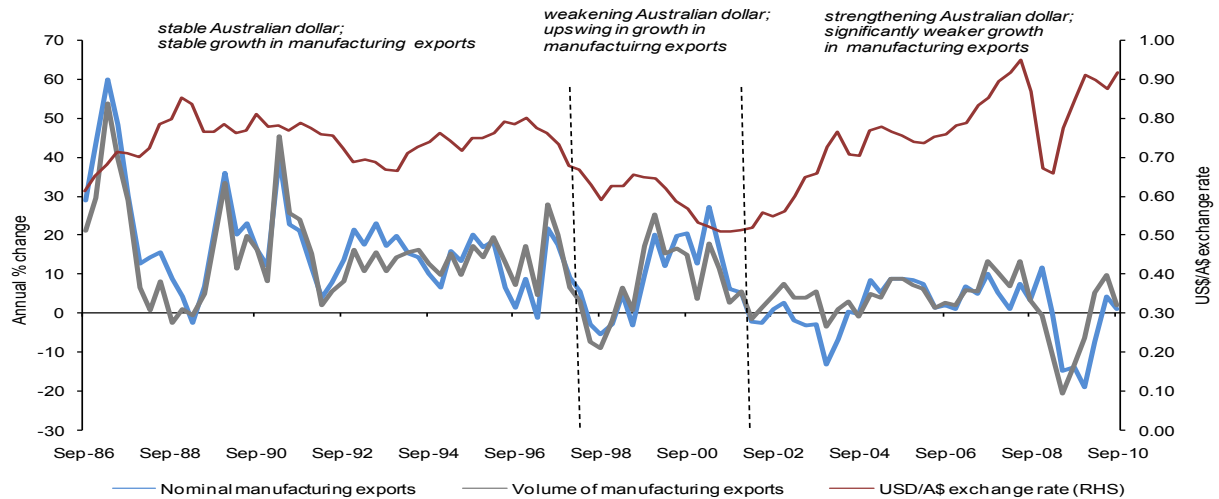
The 2011-12 Victorian Budget should:

- Reconsider the Freight Infrastructure Charge – and its timing - at the Port of Melbourne.
- Boost export growth by increasing funding for overseas trade missions.
- Offer tax incentives for exporters.
- Support full and fair access in procurement for major strategic Government projects. Support further disclosure of local content contributions to strategic Government projects.
- Lower payroll tax and WorkCover premiums.
- Engage in further tax reform drawing on the Henry Tax Review recommendations.
- Extend the Competitive Business Fund (CBF) beyond June 2012 and expand the CBF to include funding for organisational innovation in businesses.
- Provide funding to facilitate innovation in businesses by supporting technological developments.
- Deepen talent pools in industries by funding scholarships that incorporate work secondments at overseas multinational companies.

Australian dollar to strengthen further

The Australian dollar has strengthened significantly over recent months. This upward trend in the Australian dollar is likely to persist in the period ahead, reflecting rising interest rates in Australia and record low interest rates and weak economic growth in developed economies, such as the US, UK, Japan and the Euro area. The strong Australian dollar will lower the export earnings of businesses in the export sector (Chart 3), while businesses in the import competing sector will face increased competition from abroad.

Chart 3: The negative impact of a strengthening Australian dollar on the export revenue and export volume of Australian manufacturers



Reconsider the Freight Infrastructure Charge

In light of the challenging conditions faced by Victorian exporting and import competing businesses, Ai Group urges the Victorian Government to consider funding in the 2011-12 Budget that further develops an exporting culture by removing barriers to exporting businesses. Ai Group suggests that the Victorian Government reconsider the Freight Infrastructure Charge at the Port of Melbourne. This levy effectively makes businesses less competitive in the global market. Furthermore, the levy disadvantages some large businesses because they tend to have heavier loads and can use only individual containers, rather than dual containers on the one vehicle.

The cost to some companies which utilise the Port for significant export container traffic is extraordinarily significant and Government must take account of the impact on exporting opportunities.

Boost exports growth by funding overseas trade missions

Ai Group believes that the Victorian Government could help to lift Victoria's export growth by using the 2011-12 Budget to fund more overseas trade missions for businesses to participate and to facilitate co-funding exporters' businesses trips overseas to establish and/or increase contacts with overseas business partners. Such networks would help to increase the chances of Victorian businesses being able to successfully break into new overseas markets. The Victorian Government should develop an export target and a process to achieve it.

Ai Group stresses that the Victorian Government could play a proactive role in leading businesses to overseas markets. The Government could provide the initial push by paying the airfares incurred in these overseas study trips.

Enhance opportunities for local businesses

Ai Group commends the Victorian Government for its continued commitment to local procurement, as this provides much needed support to import competing businesses. Ai Group continues to believe that the Victorian Government – especially Government departments - must be clear in the support for local procurement in Government purchases. This could be achieved by the Government encouraging all Government departments to ensure Australian suppliers are given full and fair opportunities to succeed in winning procurement contracts.

Government departments should recognise the value of purchasing locally, taking into account many value-for-money factors, such as quality and servicing ability. This would effectively encourage local purchases and develop a recognition that the taxpayer can benefit through a local purchasing policy. Of course, benefits which also arise include development of job opportunities and maintenance of skills.

Ai Group urges the new Victorian Government to continue with the policy of nominating strategic projects. The Government could designate all Government projects over the value of \$100 million as strategic projects, and continue existing approaches to mandatory local content and provide disclosure of local content contributions in major Government projects. Local procurement serves as a demand for the services and products offered by Victorian businesses, and provides incentives for them to plan longer term and go beyond initial investments.

Offer tax incentives for exporters

Ai Group proposes the Victorian Government supports Victorian exporters in the 2011-12 Budget through tax reductions and grants. Such policies would further demonstrate the Victorian Government's proactive stance in assisting businesses.

Suggestions are the Australian economy will need to deal with a strong currency for some considerable period. Industries with an export outlook and focus must be supported during this period to ensure that we do not lose those industries which have supported the economy for many decades and which will be vital when we inevitably have a change of economic circumstances. It is periods such as this that Government support is recognised as appropriate in backing industries, commerce, jobs, skills retention and market development.

Lower payroll tax and WorkCover premiums

Ai Group commends the Victorian Government for steadily lowering the payroll tax rate and recognises the Government's commitment to reducing costs to business. Nevertheless, Victoria does not have the lowest payroll tax rates among the states (Table 1).

States	Payroll tax rate
Tasmania	6.10%
Western Australia	5.50%
New South Wales	5.45%
South Australia	4.95%
Victoria	4.90%
Queensland	4.75%

Sources: Various 2010-11 budget papers and state government websites

It has been Ai Group's long-standing view that the Victorian Government should commit at the earliest opportunity to lower the payroll tax rate to 4.75%. Payroll tax remains the tax Victorian businesses find most pernicious.

Reform inefficient state taxes

Ai Group believes the Victorian Government should take the lead in taxation reform as it is doing in other areas. Ai Group proposes that the Victorian Government consider closely the Review of Australia's Future Tax System (Henry Tax Review) recommendation to replace inefficient state taxes including payroll tax, stamp duties on conveyances, insurance contracts, transfer of ownership on motor vehicles and other financial transactions, with more efficient forms of taxation. Such measures would help lower the tax burden for Victorian businesses and would lift productivity.

Ai Group recommends that Victoria extends its credibility as the leader of tax reform among the states by developing farsighted reform measures that draw on the Henry Review analysis and advocate them actively in the context of the national tax summit to be held later in 2011.

Extend the Competitive Business Fund

Ai Group recommends that the Victorian Government extend the Competitive Business Fund (CBF) beyond June 2012 and also ensure there are considerably more funds available. Funding similar to the Industry Transition Fund which offered \$50 million over a two-year period would ensure more businesses gain an opportunity for support. As businesses are widely expected to continue to face challenging domestic and international economic conditions, additional funding from the Government would help promising businesses to improve competitiveness. The establishment of the CBF is a positive step in assisting businesses to expand their market opportunities, thus enabling new orders to be created.

Further, in the continued operation of the CBF, Ai Group encourages the Victorian Government to ensure that the categories of funding incorporate organisational innovation in the activities, in order to facilitate business model transformation in Victorian businesses. Ai Group emphasises that the CBF is intended for supporting strong and promising businesses rather than to reinvigorate poorly managed businesses.

Deepen talent pool in industries

The Victorian Government, through its Manufacturing Hall of Fame and its skills initiatives, has helped to improve the image of manufacturing and to encourage young people to consider the industry as a career option.

Ai Group strongly believes that graduates working in the manufacturing industry will benefit from having international experience at multinational manufacturing companies. Ai Group urges the Victorian Government to use the 2011-12 Budget to fund graduate scholarships in the manufacturing industry to work and study overseas to gain experience and knowledge, which will help the Victorian manufacturing industry develop more strongly. The programs could involve attachments at multinational manufacturing companies. The scheme could also allow for group international visitations to overseas plants to ensure young local manufacturers are provided with an insight to overseas developments.

Provide funding for growth

Victoria is finding itself in the positive position where companies are willing to expand and regenerate their businesses. In some cases this means expenditure of hundreds of millions of dollars. However, there are often other states and countries which are also looking for footloose investment and are willing to make significant offers to attract that investment.

While Ai Group recognises that Victoria does not – and should not – want to be part of a bidding war either nationally or internationally, reality suggests there needs to be a certain level of encouragement for these businesses.

The Victorian Government needs to maintain a funding model which will ensure that companies with significant investments, which are maintaining skill levels and jobs, are given a level of assistance which equates to their value to the economy.

Support the food and beverage industry

The food industry is Australia's largest manufacturing sector and a large rural employer, representing around 28% of total manufacturing turnover (around \$100 billion). It is comparable in size to the Australian mining sector and is more than four times larger than the automotive sector. The sector accounts for 18% of total trade in the manufacturing sector valued at \$44.8 billion in 2009-10. It is also a major contributor to the Australian economy, generating sales and service income of around \$102 billion annually.

Victorian businesses in the food and beverage industry has performed well in recent times, but they face increasingly challenging business conditions in light of the strong Australian dollar, cheaper import substitutes and slowing domestic demand. Ai Group urges the Victorian Government to do more to assist businesses in the Victorian food and beverage

industry. This is a promising area for the Victorian manufacturing sector, especially given the high food and safety standards in Victoria and throughout Australia. Victoria has a competitive advantage in this area, and Victorian exports of food and beverage products could be boosted with more assistance from the Victorian Government. Ai Group looks forward to further discuss initiatives with the Victorian Government.

The Government should consider a wide ranging research paper which assisted in developing a future template for the manufacturing food industry in this state. The many possibilities which are available need to be appropriately channeled, and to do so, a consistent focus will be required.

Build world class skills and capabilities

Key recommendations:

The 2011-12 Victorian Budget should:

- Support the further development of linkages between tertiary sector institutions and industry.
- Provide funding to improve the quality of training delivery.
- Support the establishment of a national vocational education and training regulator to ensure training quality improvements.
- Provide funding for the development and publish information on Registered Training Organisation performance to allow the consumers of training to make informed decisions.
- Commit significant resources to improving the literacy and numeracy levels of Victoria's workforce.
- Encourage participation by senior secondary school students in vocational programs.

The Victorian tertiary sector

The Council of Australian Government targets – 40% of 25-34 year olds attaining bachelor degrees by 2025 – will be a challenge for all jurisdictions, including Victoria. As will the equity target of 20% undergraduate participation being drawn from the low SES quartile. These targets will only be achieved through all components of the tertiary sector collaborating closely and it is recommended that the government actively support the further development of linkages between the vocational education and training and the higher education providers to bring about an effective tertiary sector and to ensure the quality of all delivery.

The tertiary sector needs to produce graduates which meet the needs of industry and the economy more broadly. Networks between institutions and industry need to be strengthened and the Victorian Government has a role to play here.

Monitor the impact of the Victorian skills reform

The Victorian skills reforms have been progressively implemented since July 2009. Ultimately these reforms have the potential to change the nature and shape of the Victorian training system and to address many of the challenges confronted by both industry and individuals.

Previously Ai Group has called for rigorous monitoring and evaluation processes to accompany the introduction of these sweeping changes. We note the recent review of the implementation and the Government's response and welcome the new financial commitments which support exemptions to various categories of learners allowing them

access to the Victorian Training Guarantee. The anomalies addressed through these changes have been issues of concern to industry since the reforms were introduced. Our call now for the 2011-12 Budget is to make these changes a permanent part of the Victorian skilling arrangements, rather than a series of exceptions funded for limited periods.

The review only looked at implementation, which was appropriate given the infancy of the reforms, but we remain concerned that the new flexibilities will have an adverse effect on enrolments in some areas of fundamental importance to industry which traditionally have difficulty attracting students. Early figures of the decline in engineering enrolments, for example, demonstrate that this concern is not without foundation. For this reason we continue to call for the Victorian Government to closely monitor the impact of the reforms and to develop strategies to overcome skills shortfalls in those areas critical to the economy.

Improve the quality of training delivery

Concern over the quality of training delivery is arguably the most important issue facing the Victorian vocational education and training sector at this time; too often the training delivered is quick and shallow and the trainers lack the expertise needed to contribute to the building of a workforce with world class skills.

Our view is that the establishment of a national vocational education and training regulator will make a significant contribution to training quality improvements. Ai Group acknowledges the current Victorian Government's position of introducing mirror legislation rather than joining the national regulator from the outset and encourages the new government to closely monitor and evaluate this initiative over the coming years.

The continued opening up of the training market will help to drive quality improvements where the consumers of training have the information they need to make decisions based on quality. The impartial, comparative information on Registered Training Organisations and their performance across a range of quality indicators that the market needs to make informed decisions is not currently available and its development and publication should be a priority for the incoming Government.

Address workforce literacy and numeracy shortfalls

According to the Australian Bureau of Statistics, nearly half of adult Victorians are below "the minimum required for individuals to meet the complex demands of everyday work in the emerging knowledge based economy". Specifically, 48.8% are below the level required for prose literacy and 49.2% for document literacy. The statistics are even worse for numeracy where 54.4% are below the required level.

Against this backdrop, Victorian companies are again facing skills shortages and responding to these skills shortfalls by upskilling their existing workforce. Low literacy and numeracy levels make this upskilling task particularly difficult.

It is essential that the new Victorian Government commits significant resources in the 2011-12 Budget to improving the literacy and numeracy levels of the state's workforce. A recent Ai Group project working directly with enterprises and employees, on site, is yielding very encouraging results. The project has resulted in tangible improvements in productivity and profitability for a relatively modest investment indicating that long term benefits flow for the economy, as well as for the individual, from this investment in the foundation skills of the workforce.

Improve vocational education and training in schools take up

Recent data suggests that participation by senior secondary school students in vocational programs has plateaued. Further measures need to be considered to provide all students with the opportunity to participate.

Recent changes by the Commonwealth Government and the introduction of a range of new brokers and coordinators, combined with a range of State Government services in this area have left enterprises uncertain as to what is available. Efforts need to be made by Government to clarify for industry the purpose of the various entities and interventions in a straightforward and accessible manner.

Implement climate and environmental policies conducive for sustained economic growth

Key recommendations:

The 2011-12 Victorian Budget should:

- Fund programs to promote and accelerate the uptake of initiatives by businesses to effectively manage their carbon footprint.
- Provide financial assistance to help businesses increase the uptake of initiatives targeted to improve the resilience of businesses to climate change threats.
- Offer practical assistance to industry to assist businesses in identifying and implementing cost effective initiatives to improve energy efficiency.
- Provide funding to help businesses cope with the anticipated increase in industrial waste levy.
- Ensure that revenue generated from higher industrial waste levy is used to help industry and households reduce their waste.
- Increase funding for support programs designed to improve industry's water usage.

Ai Group supports a nationally consistent approach to climate policy. Consideration of climate policies should factor in the support of the major political parties national for action to reduce greenhouse gas emissions to 5% below 2000 levels. The Victorian Government should only implement policies which reduce emissions at low cost. Victoria's emissions reduction target – currently aimed at a 20% reduction on 2000 emissions levels by 2020 – should be consistent with any national target adopted in legislation and not disadvantage Victoria against other states.

Support for business energy efficiency, emissions reductions and climate change adaptation

The results of the Ai Group/KPMG survey *Gearing up: Business Readiness for Climate Change* highlight the important role which exists for Government, in partnership with industry associations, to promote and accelerate the uptake of initiatives by businesses to effectively manage their carbon footprint.

Ai Group seeks to work closely with the Victorian Government in the development and delivery of targeted initiatives to:

- Promote integration of carbon efficiency into industry's core business practices;
- Identify and implement initiatives to reduce carbon intensity of processes, supply chains, and products; and
- Identify areas of emerging business opportunity.

Successful adaptation will necessitate action by industry to identify and respond to climate change threats at an early stage. Ai Group seeks to work closely with the Victorian Government in the development and delivery of targeted initiatives to develop strategic resilience in industry through:

- Addressing the need of industry for practical, tailored information on projected economic, social and environmental impacts of climate change;
- Identification, assessment and implementation of innovative solutions adaptation solutions and carbon efficiency initiatives, including across supply chains; and
- Development of industry's in-house expertise in climate risk assessment and carbon management plans.

Ai Group's recent survey of energy input costs and energy efficiency efforts identified that 73% of businesses have either made no energy efficiency improvements or experienced reductions in energy efficiency over the last 5 years, with a further 12% reporting improvements of 5% or less. Further, over half of all companies surveyed (57%) indicate that their energy efficiency will be about the same over the next 2 years, while around 27% envisage making marginal energy efficiency improvements. Just 3% of respondents expect to make significant energy efficiency improvements, with a similar number of respondents expecting deterioration in energy efficiency.

Clearly there is a need for provision of practical assistance to industry to identify and implement cost effective initiatives to improve energy efficiency; even the so-called 'low hanging fruit' is proving challenging to pick. The Energy Efficiency Demonstration Project being delivered by Ai Group for the Department of Sustainability and Environment is good example of a program which addresses the needs of businesses in this area.

Environmental regulation

Businesses operating in Victoria report energy, emissions and other information under a range of state and federal programs. Many with operations in multiple states face multiple inconsistent reporting regimes. Ai Group strongly supports the EPHC's moves towards harmonisation and advocates that Victoria continue to take a leading role in this initiative. Victoria should continue to lead efforts to reduce the burden of inconsistent reporting, particularly by advocating for, and facilitating, a single national online reporting portal.

The Government's response to the recommendations of the independent Environment Protection Authority (EPA) review of compliance and enforcement must deliver a consistent and balanced approach to encouraging compliance and taking enforcement action. Where enforcement is merited it should be pursued, but the existing focus on cooperative relationships and "beyond compliance" activities should be maintained. However, in addition, Ai Group welcomes the EPA's pragmatic view to assist companies to develop environmental compliance measures. Many businesses, especially small and medium size businesses, remain unaware of what they must do to comply. They need assistance which

will help to improve the Victorian environment. The need for greater clarity of environmental standards, regulatory and reporting requirements and key terminology in relation to licensed and un-licensed sites, must be addressed.

Ai Group seeks close engagement in the development of the revised compliance and enforcement policy which should be developed in close consultation with industry and other key stakeholders.

The recent *Climate Change Act* expanded the powers of EPA Victoria to cover greenhouse gas emissions. These broadly framed powers must be used in a cautious and responsible fashion, consistent with EPA practice in other areas and the emphasis that recent Victorian Governments have placed on minimising unnecessary regulatory burdens. Any extension of greenhouse gas regulation beyond the electricity sector should be consistent with the recommendations of an Industry Advisory Group established to consider the issue.

Uptake of sustainable business practices

Ai Group research has identified that 54% of firms had no staff with environment responsibilities. The lack of environment skills within a company severely limits its ability to identify opportunities to identify and implement opportunities for improved environmental management. Ai Group seeks to work closely with the Government in delivery of initiatives to improve the sustainability performance of Victorian businesses.

Waste policy

The industrial waste levy will increase by 255% for metropolitan and provincial centres and 280% increase for rural areas over the period 2009-10 to 2014-15. Waste levies are a blunt instrument which adversely impact many businesses and may do little to establish the infrastructure and markets needed to make diversion of wastes sustainable. Any increases in levies must be calibrated to ensure that any benefits are not outweighed by the significant extra cost burden it will impose on industry and households, with revenue generated hypothecated for programs to help industry and households reduce their waste.

The Ai Group/EPA Sustainability Covenant provides a model for the effective delivery of targeted programs that address the needs of businesses for technical advice and support required to achieve reductions in waste generation and to encourage development of supporting infrastructure and markets for diverted material.

Ai Group continues to oppose Container Deposit Legislation, as it fails to offer net community benefits and would undermine existing recycling systems. The *Beverage Container Investigation - Revised Report* released by the Environment Protection and Heritage Council (EPHC) concluded that a container deposit scheme is the least cost effective option to address beverage container waste, with an economic cost of \$680 million per year. The report further found that the litter reduction effectiveness of the policy

options is at best small, with only CDS making a modest contribution of a 6% reduction in litter count or 19% in litter volume.

Water

Ai Group does not support extension of the waterMAP program to include all industrial, commercial and institutional water customers that consume 5 million litres or more of drinking water per annum. Extension of the mandatory requirements may not in themselves cost effectively generate additional water savings given resourcing constraints within industry.

Industry is responding strongly to calls for greater water efficiency. Melbourne's non-residential customers have made significant water savings, reducing their per capita daily water consumption by some 41% per capita, compared with Melbourne's overall reduction of about 38% compared to the 1990s averages. WaterMAP customers have saved approximately 15 billion litres of water since the program's inception in 2007.

Ai Group recommends that the Government and water corporations work cooperatively with industry associations to support sustainable improvements in industry's water usage through delivery of a support program including:

- Broad industry reach program incorporating briefings and sustainability forums;
- Development and delivery of practical industry based training to develop the necessary in-house expertise to achieve sustainable environment solutions;
- Identification of priority sectors and projects to increase the uptake of water savings initiatives;
- Trialling of water saving options for different industry sectors; and
- On-site assistance.

Develop a robust technology industry

Key recommendations:

The 2011-12 Victorian Budget should:

- Offer funding to educate and support business, particularly in regional areas, in understanding the transformative opportunities that broadband infrastructure will provide.
- Allocate funding to develop and promote Victoria as a key industry hub for the cyber-security industry.
- Provide funding to educate businesses and the general population understand cyber-security risks, and how they can protect themselves online.
- Investment in upskilling programs among the workforce in key industries to foster innovation that expands the employee participation and adoption of the broader aspects of technology.
- Increase financial incentives that will deliver greater technology transfer linkages and commercialisation opportunities.

Technology has an important role to play in delivering growth, accelerating Victoria towards a smart economy and respond to environmental challenges including climate change.

Utilisation of new and emerging technology coupled with the immediate rollout of national infrastructure including the National Broadband Network (NBN) and the planned rollout of Long-Term-Evolution (LTE) - or fourth generation wireless networks - provides an important platform for business to harness productivity improvements, and turn new ideas into innovative products and services.

The Victorian Government, in its first term and budget, has the opportunity to position the state to showcase the transformational opportunities of applying technology solutions to improve business environmental performance, increase productivity, refine business processes and maximise investment in technology infrastructure and people.

The Ai Group identifies four key areas where programs should be developed by the Victorian Government in order to fully realise the benefits of productivity, economic development and innovation emanating from a robust technology industry.

Assist businesses to leverage broadband infrastructure

Ai Group recognises that there is evidence, albeit anecdotal, that small-to-medium-enterprises in particular substantially lack the understanding and capability to extract the full value of ubiquitous, high-speed broadband.

Ai Group encourages the Victorian Government to fund a new five-year-plan to educate and support business - particularly in regional areas - in understanding the transformative opportunities that broadband infrastructure will provide them.

The program may focus on the use of social media such as Web2.0 and emerging devices such as tablets and SmartTV to provide a platform for developing innovative new business and social services.

Position Victoria as the hub for the cyber-security industry

The development and application of cyber-security technologies, processes and innovation will underpin Victoria's ability to attract inward investment and provide the currency to retain and grow current business commitment across all services based industries.

Ai Group stresses the importance of developing Victoria as a key industry hub for the cyber-security industry.

Widespread take-up of the full range of broadband applications will require greater business and consumer knowledge of cyber-security risks and ways to manage these risks.

The future blueprint for a broadband enabled society should include initiatives to help business and the population at large understand cyber-security risks and how they can protect themselves online.

Ensure suitable skills development across key industries

Education and skills development amongst the existing workforce on the generation, adaptation and diffusion of technology is also fundamental to any strategy that will support a successful productivity, economic development and innovation framework.

Ai Group recommends complementary investment through the 2011-12 Budget in the development of suitable up-skilling programs among the workforce in key industries such as health, financial services, defence, transport and manufacturing in fostering innovation that expands the employee participation and adoption of the broader aspects of technology.

An increase in the supply of skills can generate skill-biased technical change in these industries to achieve the economic outcomes sought.

Stimulate a cultural change towards increasing investment in technology

Ai Group believes that a paradigm shift in thinking is required to establish a mechanism to increase linkages between research communities, small-to-medium-enterprises and large-corporate or multinational organisations, which are mostly neglected in current programs.

Ai Group calls on the Victorian Government to use the 2011-12 Budget to increase financial incentives (grants) that will deliver greater technology transfer linkages and commercialisation opportunities. This includes boosting the capabilities for stimulating greater collaboration between technology suppliers and technology users.

Stimulate a state government policy and public service cultural change towards increasing use of technology

To achieve many of the outcomes sought above, Ai Group calls on the Victorian Government to conduct a multi-stakeholder review task force to identify barriers and propose solutions to:

- Identify the scope of public services and state level organization benefiting from increased use of information and communication technology (ICT) or digital service delivery;
- Identify barriers (legal and cultural) for digital service delivery of public services to complement and over time substitute physical public service delivery;
- Create a best practice Governance and Change Management toolbox to help public organisations to transform their operations and service delivery; and
- Track and report on a periodic basis the progress of Multimedia Victoria in relation to the five-year business plan.



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