



# **POSITIONING VICTORIA IN THE GLOBAL ECONOMY**

**Ai Group Submission on 2006/07 Victorian  
Government Budget Priorities**

**January 2006**

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## 1. Introduction

Whether supplying customers in local, national or international markets, Victorian industry is likely to be confronting unprecedented competition. In effect, many Victorian businesses are now competing in a global market place. And, as highlighted in a forthcoming Ai Group report on the future direction of Australian industry, entitled *Manufacturing Futures: Achieving Global Fitness*, survival, let alone prosperity, increasingly demands industry assume a global focus.

While exporting remains an important aspect of global orientation, so too is engagement in other global opportunities for innovation, production and investment. As well, with rapid rises in import penetration, many domestically oriented manufacturers are finding a need to act globally, seeking to use more imported materials, participate in global supply chains and lower labour costs through new investment.

Importantly, *Manufacturing Futures* reveals that industry believes the task of strengthening competitiveness rests largely with each individual company. Cutting costs, introducing new technology, building markets and fighting off competitors is what business must do to remain profitable. Nevertheless, it is equally clear Commonwealth and State Governments also have an important role in fostering industry competitiveness.

Ai Group believes the Victorian Government is well placed to further develop a framework in which local industry is able to flourish in this more competitive global environment.

The State Government's fiscal and financial strategy remains integral in achieving this objective. The strategy, including a commitment to sustainable government service delivery, budget operating surpluses, and a sound State government balance sheet, has contributed importantly to providing greater economic certainty for Victorian businesses. The ensuing improvements in confidence have underpinned strong investment across Victoria in plant and equipment, new technologies and processes, and new product development.

Similarly, increases in state infrastructure investment have enhanced private sector productivity growth and the functioning of industry supply chains. Cuts in State Government taxes and mandatory labour costs have also enhanced the international competitiveness and profitability of Victorian industry.

Ai Group strongly endorses the Victorian Government's current fiscal approach.

Nevertheless, Ai Group also believes there is scope to more directly strengthen the competitiveness of Victorian industry. *Victoria: Leading the Way*, released in April 2004, is a firm step in this direction. The Government also manages a number of specific industry plans and strategies, while *Moving Forward: Making Provincial Victoria the Best Place to Live, Work and*

*Invest*, identifies and responds to the specific needs of businesses in regional Victoria. It is anticipated the forthcoming statement on small business will also address competitiveness issues specific to that particular (and important) segment of the Victorian economy.

Recently the Victorian Government convened the *National Manufacturing Summit 2005*, attended by the various State and Territory ministers responsible for manufacturing, and other major industry stakeholders. Delegates agreed to establish a *National Manufacturing Forum*, the purpose of which is to build on and guide actions arising from the *Summit*. A key function of the *Forum* is to oversee the development of a *Strategic Action Plan for Manufacturing*, and to encourage the involvement of the Commonwealth Government. The responsible ministers also agreed to collaborate closely in implementing the measures and to determine future policy priorities.

Ai Group again welcomes these important Victorian government initiatives. As noted in the 2005/06 state budget, however, the rapidly evolving challenges and opportunities require more wide ranging economic reforms. In *A New Reform Agenda*, the budget detailed five areas in need of continuing State Government attention. *Manufacturing Futures* also identified a number of government policy directions to enhance the international competitiveness of industry, many of which overlap with the areas of reform set out in the Budget.

Ai Group believes these policy directions should form the basis of a longer-term blueprint for industry policy. While many reforms fall within the Commonwealth's jurisdiction, industry identified many areas in which State governments have a role (indeed, many reforms require a multi-jurisdictional approach). Similarly, these measures have little to do with special assistance, but are more about removing obstacles and improving incentives for investment and risk-taking.

The proposed initiatives are detailed in the remainder of this submission. Ai Group believes they are prudent and affordable, and consistent with the Bracks Government's broader fiscal and financial objectives.

## 2. The economic and fiscal setting

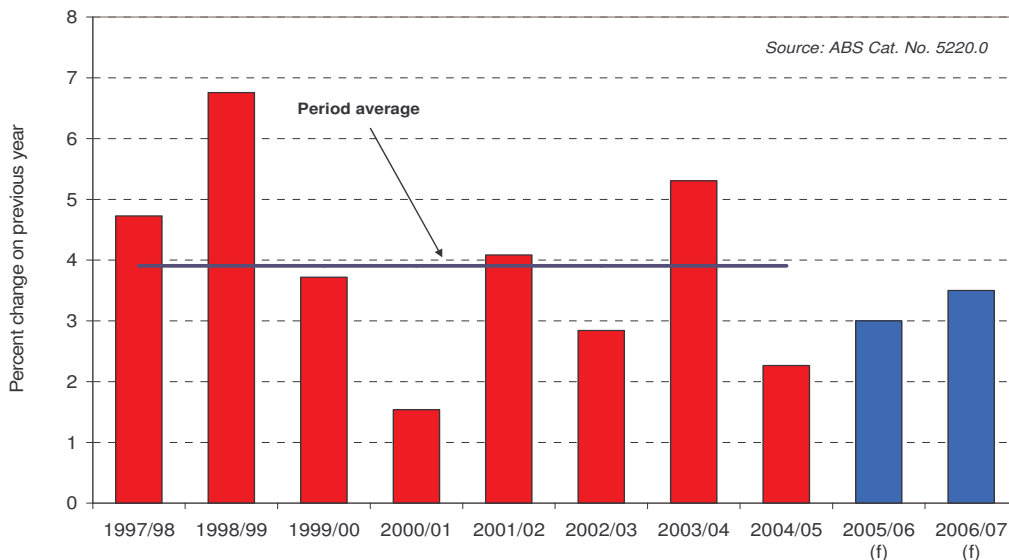
Victoria appears to have entered a phase of slower economic growth, which threatens to diminish much of the cyclical budgetary strength evident in the first half of this decade. Largely reflecting impressive control over general government service delivery and other expenses, however, the structural position of the budget remains relatively sound. As such, there is good reason to believe the government remains on track to continue delivering operating surpluses in excess of \$100 million over the forecast horizon (although, as discussed below, with some risk the surpluses could fall short of the revised estimates released in the December 2005 *Budget Update*).

Consequently, Ai Group believes the 2006/07 budget is an ideal opportunity to prudently extend the Victorian Government's reform agenda, and to implement a number of other initiatives in support of industry competitiveness. Indeed, these same measures could be expected to contribute to stronger economic growth in the second half of the decade. Financing these initiatives, without the same large windfall revenue gains of recent years, however, requires continued discipline over government recurrent spending.

Growth in Victorian Gross State product (GSP) slowed to 2.3% in 2004/05, less than half the 5.3% increase in 2003/04 and the weakest performance since 2000/01 (refer Chart 1). Similarly, the outcome in 2004/05 compares unfavourably with average growth of 3.9% in the eight years to 2004/05.

The slowdown in 2004/05 was concentrated largely in household sector spending, reflecting the downturn in the residential construction cycle and (to a lesser extent) the impact on consumption of much smaller increases in house prices. Residential construction activity fell by 3.9% in 2004/05,

**Chart 1: Growth in Victorian real Gross State Product**



compared with a 6.1% increase the previous year. Household consumption growth was broadly unchanged in year-average terms, easing from 4.9% to 4.8%, but fell away more sharply over the course of the year.

The downturn in household spending growth was partly cushioned by strengthening in private investment and State and Local government consumption growth (the latter jumping from 1.2% to 3.1%). In contrast to previous cyclical downturns in State final demand growth, however, exports also continued to lose momentum. The modest decline in 2004/05 follows the earlier sharp appreciation of the exchange rate and intensifying competitive pressures from Chinese and other low cost manufactured goods exporters (with manufactured goods comprising a larger share of total exports relative to other states).

Nevertheless, as detailed in the *Budget Update*, the Government expects Victorian GSP growth to strengthen to 3.0% in the current year, and to 3.5% in 2006/07. For a number of reasons, however, Ai Group believes the risks to these forecasts are tilted slightly to the downside.

Against the backdrop of the sharp structural weakening in labour productivity growth<sup>1</sup>, and lingering capacity constraints (particularly shortages of skilled labour), Ai Group is unsure whether a sustained upturn in demand could be accommodated without an unacceptable rise in inflationary pressures. Such an increase would almost certainly be accompanied by a further increase in the official cash rate, and heightened efforts on the part of households to consolidate balance sheets (current forecasts are based on the technical assumption of unchanged interest rates).

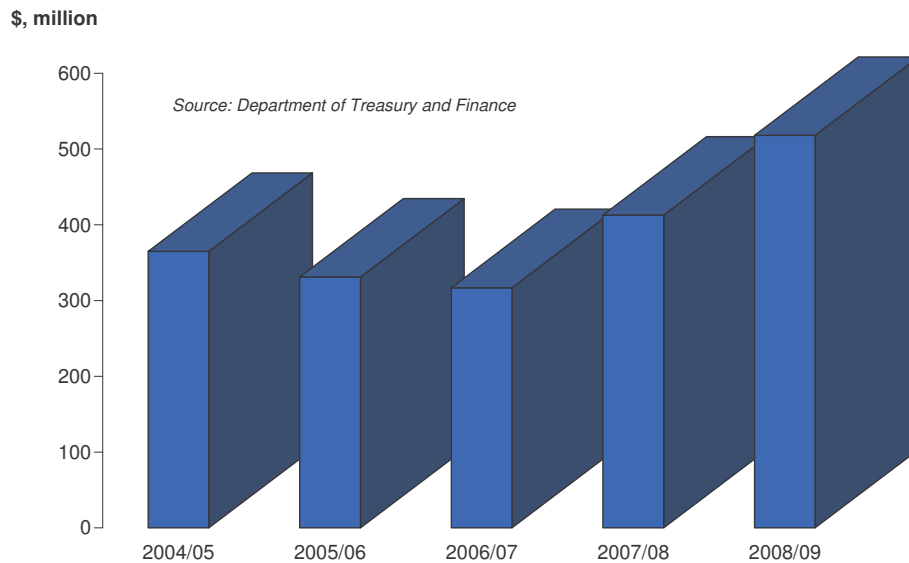
In the event, while acknowledging the continuing strong outlook for private and public investment (particularly non-dwelling and engineering construction), Ai Group is also uncertain over the potential for a diminishing drag from net exports. Ai Group's proprietary surveys foreshadow little further strengthening in manufactured goods exports, a function of the continuing loss of market share to lower-cost producers, a resilient exchange rate, and the prospect of moderately weaker global growth in 2006 and 2007. Ai Group is also wary of forecasts for a return to 'trend' levels of growth in residential construction activity, especially in the absence of a fall in interest rates.

Despite Victorian GSP growth falling short of official forecasts in 2004/05, nevertheless Ai Group notes the general government operating surplus was higher than projected. At \$795 million, the surplus contrasted with the original forecast of \$529 million. Revenue was some 3.0% higher than forecast, with all major components (own-source taxation; Commonwealth grants; investment income; departmental sales of goods and services) above budget. Excluding depreciation and borrowing costs (which were both lower than forecast), by contrast, expenses were 2.6% higher than budgeted.

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<sup>1</sup> Australian Bureau of Statistics, *Cat. No. 5204.0*, 2004/05.

**Chart 2: Actual and Forecast Budget Operating Balance**



Consistent with unchanged GSP forecasts, the projected operating surpluses are little different from those published in the 2005/06 Budget in May. The surplus is estimated to narrow to \$331 million in the current year and to \$317 million in 2006/07, before climbing to over \$400 million and \$500 million in the subsequent two years (Chart 2). The downside risk to GSP forecasts suggest a growing possibility the 2006/07 surplus may fall short of current projections, and which would prove almost certain in the event recent signs of 'expenditure creep' continued unabated.

As detailed in the following sections, Ai Group's budget proposals acknowledge the limited capacity for the State Government to embark on a series of major new initiatives (in the absence of broad-based expenditure savings). Ai Group's proposals are prudent and affordable, and will allow the Government to continue running a surplus of around \$100 million. To the extent that they strengthen industry competitiveness, moreover, the proposed measures improve the prospects of stronger economic growth and greater budget flexibility over the remainder of the decade.

### 3. Summary of 2006/07 Budget Priorities

Within the constraints of the Government's fiscal and financial strategy, and reflecting also the various policy proposals likely to emerge from *Manufacturing Futures*, Ai Group proposes a five-pronged approach to further strengthen the international competitiveness of Victorian industry:

- A full-frontal assault on business costs;
- Revitalising incentives to invest in innovation, product development and process improvement;
- Nurturing a skilled and flexible workforce;
- Developing new market opportunities for Victorian industry;
- Sharing the cost of environmentally sustainable production processes

The key proposals are summarised below, and outlined in more detail over the remaining sections.

- ***Cut payroll tax from 5.25% to 5.0% in 2007 and commit to further reductions as budgetary circumstances permit.***
- ***Lower WorkCover premiums by a further 10%***
- ***Measure and cap business compliance costs***
- ***Continue to develop world class economic infrastructure***
- ***Regenerate the Agenda for New Manufacturing, including consolidation of programs into three streams (innovation and process improvement; training and skill development; and export capability). Provide additional funding for promotion and to accommodate increased demand for government programs.***
- ***Introduce an Innovation Accelerator program***
- ***Establish a Business Innovation Adviser Network***

- ***Re-affirm the Government's commitment to the Science, Technology and Industry (STI) Infrastructure Grants***
- ***Introduce a Competitiveness Boost Program***
- ***Formally extend 'whole-of-life' costing criteria across all State Government agencies and projects.***
- ***Halve the threshold on projects requiring VIPP implementation plans, to \$25 million in metropolitan Melbourne and \$2.5 million in regional Victoria.***
- ***Increase funding for the State Government's Business Energy Innovation Initiative***

#### 4. A full-frontal assault on business costs

- ***Cut payroll tax from 5.25% to 5.0% in 2007 and commit to further reductions as budgetary circumstances permit.***

The payroll tax rate has been lowered steadily since the Bracks Government assumed office in 1999. At 5.25%, Victoria's payroll tax rate is now the lowest of all the six states other than Queensland (4.75%). However, the tax threshold in Victoria remains considerably lower (\$550,000 compared with \$850,000 in Queensland).

While it is generally accepted payroll tax is a relatively efficient means of raising revenue (sharing many characteristics of a broadly-based consumption tax), nevertheless Ai Group believes the Victorian government should aim over the longer-term to build a greater reliance on other superior taxes (including the proceeds of the GST and land tax). Indeed, the spectacular strengthening in budgetary positions in the resource-rich states highlights the urgent need to review the method by which GST grants are distributed, and from which Victoria stands to benefit disproportionately.

In the event, with the intensification of international competitive pressures and widespread skill shortages, arguably many Victorian companies (and manufacturers in particular) are unable to pass on the full burden of payroll tax. At the very least, the view that payroll tax is a cost to be absorbed by business, and therefore a tax on jobs and exports, remains deeply entrenched across the community. To the extent that these adverse perceptions of payroll tax are shared by offshore investors, the tax is likely to remain a barrier to attracting offshore investment. The presence of the threshold also suggests any burden falls relatively heavily on the Victorian tradeables sector<sup>2</sup>, and therefore relatively more heavily on manufacturing industries.

Certainly, there can be no dispute the administrative costs of payroll tax are real (exacerbated also by the various enterprise and threshold exemptions).

Against this backdrop, Ai Group recommends the Government lower the payroll tax rate to 5.00% on 1 January 2007, and commit to further reducing the rate to 4.75% as budgetary circumstances permit. The estimated cost of reducing the rate to 5.0% is \$80 million in 2006/07, and approximately \$170 million in the first full financial year.

The direct benefit to many individual employers of a 0.25 point cut is likely to be relatively small. However, the reduction and the proposed further decline send a firm signal the Government is committed to strengthening the competitiveness of Victorian industry.

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<sup>2</sup> State Business Tax Review Committee, February 2001, "Review of State Business Taxes. Full Report". Department of Treasury and Finance. State of Victoria.

- ***Lower WorkCover premiums by a further 10%***

The financial performance of the Victorian Workcover Authority has improved markedly under the Bracks Government. Reflecting improvements in both workplace safety and claims management, the Authority delivered a net profit of \$775.2 million in 2004/05. This follows a net profit of \$1.2 billion the previous year. Projected future claims have fallen by over \$1.0 billion since 2001/02.

This substantial turnaround has allowed the Bracks Government to reduce average WorkCover premiums by 10% in 2005/06, with premiums in Victoria now the second lowest of the mainland states (behind only Queensland). The government also recently announced substantial improvements in benefits to claimants.

Nevertheless, Ai Group believes there is considerable scope for further reductions in insurance premiums. Ai Group understands WorkCover will remain fully funded with an average premium of 1.62% of wages and salaries, considerably lower than the current average of 1.80%. In addition, Ai Group understands the Authority is targeting a further \$150 million of savings over the next year.

Given the prospect of WorkCover's continuing sound financial performance and the contribution of improved workplace safety in lowering injury and claim rates, Ai Group believes the Government should reduce premiums by a further 10% in 2006/07. Such a reduction would bring the average premium closer to the rate of 1.43% currently levied in Queensland. While there are many remaining differences between the Victorian and Queensland schemes, continuing convergence in premiums is consistent with recent State and Commonwealth initiatives to develop national standards for both workers compensation and occupational health and safety.

- ***Measure and cap business compliance costs***

Numerous recent studies have re-affirmed the significant and growing cost on business of complying with government regulations and administrative requirements<sup>3</sup>. While Ai Group accepts government regulation is necessary to meet the community's social, environmental and economic objectives, nevertheless the 'information obligations' accompanying many of these regulations remain a considerable drag on international competitiveness. Indeed, in the *Manufacturing Futures* project, local companies nominated the reduction in regulation and compliance costs as one of the two top priorities for government action.

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<sup>3</sup> For example, see Australian Industry Group, *Compliance Costs Time and Money*, November 2004

To be sure, much of the growth in compliance costs has been at the Commonwealth level. Ai Group notes the Commonwealth Government has since responded with several reviews of regulation, including the recent establishment of the Australian Government Regulation Taskforce (the terms of reference for which are to identify 'practical' means of alleviating the costs on business of complying with Commonwealth Government regulations).

However, it is clear the costs to local industry of complying with Victorian Government regulation have also increased. While Ai Group research suggests the cumulative impact is the main issue for business<sup>4</sup>, the specific regulatory areas cited most frequently as hobbling competitiveness – workers compensation and environmental regulation – fall entirely or partly under State Government jurisdiction. To this end, Ai Group believes there is a strong need for Victorian government to also consider ways of reducing the costs on business of administering and complying with State Government regulation.

The rapid spread of government regulation, and the potential for both duplication and gaps in regulation across different jurisdictions, highlight the need for a multi-jurisdictional approach. Ai Group believes the Victorian Government is well positioned to take the lead in initiating a co-ordinated national approach to reducing compliance costs. Ai Group urges the Victorian and Commonwealth Governments to seek agreement from other State and Territory Governments to review all aspects of government regulation.

In the interim, Ai Group requests the Victorian Competition and Efficiency Commission (VCEC) to undertake a wide-ranging review of Victorian Government regulation. It is envisaged the State Government review could form a model for the broader national review, or at the least provide the basis of Victoria's contribution to the national review project.

While identification of specific areas for reform should remain a priority (similar to the Australian Government Regulation taskforce), Ai Group envisages a much broader ambit for both the state and national reviews. As an overarching theme, Ai Group believes governments must in future focus more carefully on the (public and private sector) costs of administering additional regulatory burdens, and the costs of behavioral changes brought about by additional regulation. At the Commonwealth level, existing procedures, most notably the Regulation Impact Statement process, have been shown to be seriously inadequate<sup>5</sup>.

Consequently, Ai Group proposes three facets to the review process.

Firstly, the state review should establish a framework to measure the impact of the compliance burden. Measurement should seek to capture an index of the total compliance burden as well as burdens associated with particular regulatory instruments. In relation to the regulatory impacts of specific regulatory instruments, measurement should capture:

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<sup>4</sup> Australian Industry Group. *Manufacturing Futures. Achieving Global fitness*. Forthcoming.

<sup>5</sup> Productivity Commission. *Regulation and its review*, Annual Report Series, November 2004.

- The private and public sector administrative costs;
- The effectiveness of regulation in achieving explicit goals;
- The opportunity costs of regulation-induced behavioral changes.

Secondly, there should be a clear political commitment to reduce the costs of compliance and to adopt world's best practice in regulatory approaches. For example, the Government could commit to reducing the aggregate compliance burden by 15% over a specified timeframe.

Each department and agency should be compelled to identify areas of regulatory improvement and should commit to:

- Reducing the compliance burden associated with the stock of existing regulation on a progressive basis;
- Adopting world's best practice in any additional regulation;

The responsible Ministers should report to Parliament annually on progress against pre-set targets.

Thirdly, and discussed above, institutional arrangements should cover both regulations administered by the individual levels of government, and also the inter-jurisdictional aspects. Institutional changes should be aimed at transforming the internal cultures of administrative agencies, extending to the allocation of responsibilities and accountabilities for reducing compliance costs (in line with pre-set targets). Overseeing this process should be a separate Regulatory Review Unit (RRU), comprising an independent Board to monitor the conduct of the RRU.

- ***Continue to develop world class economic infrastructure***

Ai Group strongly endorses recent and budgeted increases in state government infrastructure spending (including estimated average annual expenditure of \$2.6 billion in the four years to 2008/09), and the prudent use of government borrowings to partly fund this investment. World class economic infrastructure is vital in contributing to strong productivity growth, as well as lowering important input and distribution costs for industry. Providing interest, depreciation and other recurrent costs are funded within the context of a budget operating surplus, government borrowing is an appropriate means of financing the accompanying increase in the capital stock.

More recently, however, the large increases in public and private sector infrastructure spending appear to have accentuated earlier increases in costs,

skills shortages and other 'supply constraints'. These developments have impeded the timely completion of some government priority projects.

Given the budgeted level of spending and the expected persistence of these constraints, Ai Group acknowledges there is little scope to further increase funding for infrastructure investment. Rather, Ai Group believes there is a case to rebalance some existing infrastructure priorities. Specifically, Ai Group strongly urges the State Government focus on alleviating transport bottlenecks and strengthen the operation of industry supply chains.

To this end, Ai Group requests the Government expedite an assessment of completing the remaining gaps in the Melbourne freeway network, including linking the Eastern Freeway and CityLink. Similarly, Ai Group requests the Government provide additional funding to examine means of alleviating congestion on the West Gate Bridge, including the possibility of constructing a second bridge.

Ai Group also seeks from the Bracks Government a continued commitment to the Port Phillip Bay channel deepening project. The project offers substantial economic benefits to Victoria, which have been detailed in the relevant environmental effects statement and in other Ai Group submissions to the State Government. However, Ai Group believes the Victorian community may not be fully aware of these benefits, and at the same time may have exaggerated perceptions of potential environmental risks.

To this end, Ai Group welcomes the recent appointment of Mr Bill Scales as the new Chairman of the Port of Melbourne Corporation, and looks to the State Government and the relevant authorities to continue promoting the economic benefits of the project. Upon satisfactory completion of the trial dredging phase, moreover, Ai Group urges the Government to quickly approve the project.

Ai Group also proposes the Victorian Government fund the relocation of essential infrastructure necessary for dredging around the port area, which Ai Group understands have been estimated at around \$100 million. Any additional funding requirements should be met from the proposed rebalancing of priority infrastructure projects. Full government funding of the project will also assist in alleviating cost pressures on Victorian exporters.

## 5. Revitalising incentives for innovation, product development and process improvement

While a reduction in business taxes and compliance costs will significantly enhance the competitiveness of Victorian industry, it is by no means the end of the story. Ai Group research has frequently re-affirmed the strong link also between international competitiveness and a company's commitment to innovation, product development and process improvement<sup>6</sup>.

Much of the government support in Australia for research, development and innovation is funded and administered by the Commonwealth. Nevertheless, the State Government also assists Victorian industry invest in new products, processes and technologies. Broader schemes include VicStart and STI Infrastructure Grants. Recognising the unique needs of the sector, State Government support for manufacturing R&D and innovation is also provided under the *Agenda for New Manufacturing*. Schemes include the *Technology Demonstration* program; the *Technology Evaluation* program; *Business Innovation Workshops*; *Value-Chain Workshops*; and the *Innovation Insights Visits* program.

Reflecting the primary role of the Commonwealth in providing direct assistance for R&D and innovation activities, the Victorian Government programs largely seek to crystallise benefits from technology diffusion, collaboration, information sharing, networking and mentoring among various industry partners. Despite a much narrower avenue to assist industry, nevertheless *Manufacturing Futures* detected widespread support within industry for the State Government's manufacturing programs.

At the same time, however, a number of shortcomings were also identified. In particular:

- Funding and/or grants tend only to be available from development to sample/prototype stage, rather than extending through to full commercialisation;
- Funding and/or grants are difficult to secure for innovation or modification of existing products or technologies (current funding is confined largely to new products or inventions);
- The plethora of (Commonwealth and State Government) assistance programs is confusing, and contributes to inadequate awareness;
- The approval process is often slow, cumbersome, and 'bureaucratic', and fails to acknowledge the increasing pressure to reduce product development cycles and quickly 'get to market'.

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<sup>6</sup> For example, see Australian industry Group, *Industry in the Regions 2004*. November 2004.

- The schemes are often focused on program objectives rather than business outcomes.

Indeed, Ai Group understands the entire *Agenda for New Manufacturing* (encompassing also assistance for manufacturing exports, investment, skill development, workplace reform, image and environmentally sustainable processes) is currently under review. Ai Group also notes the Government has refused to commit funding to the *Agenda* beyond 2005/06.

- ***Regenerate the Agenda for New Manufacturing, including consolidation of programs into three streams (innovation and process improvement; training and skill development; and export capability). Provide additional funding for promotion and to accommodate increased demand for government programs.***

As detailed in our 2005/06 pre-budget submission, Ai Group believes there is a strong case to regenerate the *Agenda*, with a refocusing of goals and objectives to reflect the intensification of competitive pressures among local manufacturers and the challenge to maintain and grow market share. To this end, Ai Group continues to recommend the consolidation of existing and proposed programs into three streams: innovation and process improvement; training and skill development; and export capability.

Ai Group also urges the Government expand funding for the new strategy (in comparison with the \$27 million allocated to the *Agenda* over the four years to 2005/06), commensurate with the need for additional promotion, and to accommodate the expected increase in demand for new programs.

Ai Group's proposals to strengthen assistance programs for innovation and process improvement are detailed in the remainder of this section. New measures to enhance skilling and training, and export capability, are outlined in the ensuing sections. The proposals are designed to help increase industry access to State Government schemes, and to streamline the application and approval processes. These proposals draw on earlier recommendations, as well as addressing the specific concerns raised in *Manufacturing Futures*.

- ***Introduce an Innovation Accelerator Program***

In addition to the innovation and technology schemes currently available under the *Agenda for New Manufacturing*, and in order to directly lift the number of companies involved in R&D activity, Ai Group recommends the Victorian Government introduce an Innovation Accelerator Program. The scheme is aimed primarily at those firms which have no prior experience in R&D, and are having difficulty attracting industry partners or collaboration, but nevertheless are interested in starting an R&D project. These firms often find

it difficult to compete with larger and more experienced firms for government funding, and which acts as a barrier to involvement.

The program therefore is mainly targeted towards small- to medium-sized businesses (SMEs). As highlighted by the Manufacturing Industry Consultative Council (MICC), larger customers often demand SMEs invest in R&D activity to drive down costs and conform with production requirements. Such a program would help overcome a shortage of capital for investment in R&D by SME's.

Under such a program, grants could be provided to companies (on a competitive basis) on a matching dollar for dollar basis, and be used for a broad range of purposes. Uses could include purchasing specialist equipment to undertake proposed R&D, engaging a consultant to assist in R&D activity, employing a scientist or engineer to undertake R&D, or engaging the expertise of a university, CSIRO or another research centre.

• ***Establish a Business Innovation Adviser Network***

In order to raise awareness of these various programs and help streamline approval processes, Ai Group recommends the Bracks Government establish a network of Business Innovation Advisers. It is proposed the network emulate the approach of the *Next Step Exporter*, and other State Government schemes, where Advisers work closely with individual companies to assess the suitability of the company for various State Government assistance schemes (specifically in relation to innovation, product and process development).

The focus of the advisers initially should be to link individual manufacturers with the various State Government innovation and best practice schemes. These programs include those currently available under the *Agenda for New Manufacturing*, as well as other broader industry schemes (including VicStart and the STI Infrastructure grants). It is envisaged the advisers would assist companies prepare applications for State government funding and assistance, as well as guide and monitor the application through the approval process.

While the advisers are essentially an intermediary between manufacturers and the State Government, they would also be in a position to promote the activities of companies to other potential partners in the manufacturing value chain. It is also expected the advisers will guide individual companies to Commonwealth Government assistance schemes.

In the event the scheme proves successful, Ai Group believes there may be merit in examining the scope to fully integrate the various adviser functions (including export advisers, innovation advisers, and industry liaison agents) into a single role. Ai Group believes there may also be potential for the scheme to evolve into a national network, and which would be particularly useful for Victorian companies with operations in other states.

- ***Re-affirm the Government's commitment to the Science, Technology and Industry (STI) Infrastructure Grants***

Ai Group strongly commends the Government for its recognition that science, technology and innovation are key drivers of future prosperity and quality of life. Across a number of areas, Government has shown foresight in providing funding to assist businesses in these areas and to help develop the Victorian economy. One of the most recent innovations is VISTECH which will provide Victorian businesses with the opportunity of a closer liaison with like-minded organisations in Israel.

On a similar basis, the Science, Technology and Innovation Infrastructure Grants have shown positive State Government commitment to improving opportunities for business in Victoria. The third tranche of the STI Initiative showed Government willingness to support the acquisition and development of new private and public sector infrastructure in Victoria in priority industry sectors and strategic technologies.

The funding granted in Round 3 of the Program will enable technologies in priority sectors to be developed that can catalyse new levels of R&D innovation, commercialisation and industry development. The Program should also enable – in fact require – levels of collaboration and cross-disciplinary interaction between researchers and industry. Ai Group has, for some time, been critical of a lack of interaction between research institutions (such as CSIRO and universities) and industry.

The STI Initiative has strongly encouraged partnerships and should be indicative of how such partnerships can be beneficial for all organisations involved.

It is Ai Group's understanding that the scheme has required demonstration of sustainable benefits to industry and the research community prior to grants being offered. Indeed, research conducted by The Allen Consulting Group showed the first generation of the STI Grants would increase total net investment in the State by \$868 million over 2000 – 2014 (compared with the absence of the STI Initiative) and real Gross State Product up to \$2.18 billion higher, over the same period. It also forecast an overall increase in employment in Victoria of 1,700 jobs due to the Initiative.

Ai Group strongly encourages the Victorian Government to maintain the STI Infrastructure Grants. The Grants provide important growth funding for Victorian businesses and a reason for businesses to establish and promote themselves within the Victorian economy. The Grants should continue to have strict requirements and compliance to ensure the Victorian tax-payer benefits from the investment and that the Grants be recognised as an investment in Victoria's future prosperity.

## 6. Nurturing a skilled and flexible workforce

Ai Group research, including *Manufacturing Futures*, has consistently found a skilled workforce crucial to sustaining and strengthening the international competitiveness of local industry. Accordingly, Ai Group welcomes the additional funding in the 2005/06 budget for new pre-apprenticeship training places, and which have been targeted in areas of identified shortages. Indeed, *Manufacturing Futures* also re-affirmed the widespread shortages of skilled labour and the diminishing pool of younger workers seeking to enter manufacturing industry.

In addition to entry level training, however, Ai Group strongly believes there is a need to build formal educational arrangements around the continuous upskilling of the existing workforce. A steady stream of skilled new entrants to the labour force is crucial for industry. But, with the growing demand among employers for a flexible and adaptive workforce, and one with enhanced problem-solving skills, so too is the need for continuous skill development. Indeed, it is widely recognised the skills increasingly valued by employers are specific to particular technologies and enterprises, and cannot be adequately provided through broader training schemes.

Under the banner of *World Class Skills for World Class Industries*, Ai Group has commissioned the Allen Consulting Group to explore these issues further. The findings are expected to be released in the first half of 2006, and will also include a series of formal policy recommendations. Nevertheless, the preliminary findings suggest a need for governments at all levels to consider ways of rebalancing current arrangements towards upskilling the existing workforce; to help firms articulate a 'whole-of-enterprise' skills development strategy; and to assist firms formally identify and recognise the 'hidden' skills of employees.

Ai Group acknowledges these new policy directions may require modest additional budget allocations, although new funding needs are unlikely before 2007/08.

## 7. Developing new market opportunities for Victorian industry

- ***Introduce a Competitiveness Boost Program***

Many existing State Government assistance schemes, as well as the proposed Innovation Accelerator Program, are targeted at SMEs. As revealed in *Manufacturing Futures*, however, many larger companies would also benefit from additional assistance, particularly in relation to full commercialisation of proprietary technologies and processes. To this end, Ai Group proposes a Competitiveness Boost Program, focusing especially on companies with a successful history of growth.

It is envisaged the program would support Victorian companies which have an established track record of international competitiveness, productivity or creativity, and which are able to provide specific proposals to lift productivity in their enterprises in a recordable manner. To be eligible a company would need to have a proven and successful record over the last five years in one or more of the following areas:

- Export market growth as part of an overall business strategy;
- Import replacement in a significant market area;
- Innovation, particularly in new product development; and/or
- Skills enhancement in their business operations.

Funding would be provided on a matching basis to support specific proposals to significantly enhance business productivity in a demonstrable way in one or more of the following areas:

- Supply chain improvements;
- New technology acquisitions;
- Skills upgrading;
- New product development; and
- Business transformation

Applicants would need to demonstrate not only how the grant will lead to significantly higher productivity, but also contribute to further advancing the companies activities in export growth, import replacement, innovation and/or skills enhancements. In order to expedite the approval process, the company would also be able to elicit the assistance of a Business Innovation Adviser.

- ***Encourage greater industry participation in State Government purchasing contracts by extending ‘whole-of-life’ costing principles.***

Government is a large consumer of goods and services. Together, purchases of ‘supplies and services’ by the Victorian general government sector and non-financial corporations amounted to over 6% of Victorian Gross State Product in 2004/05. Indeed, in many countries government procurement policies are a key means of fostering local industry development.

In Victoria, by contrast, government procurement decisions are driven primarily by ‘value for money’ considerations, while at the same time ensuring ‘open and fair’ competition among all potential suppliers. Purchasing guidelines and the monitoring of tender activities are primarily the responsibility of the Victorian Government Purchasing Board. These guidelines (as well as Victoria’s international obligations) explicitly preclude the Victorian Government from discriminating in favour of local suppliers, by affording protection, subsidies or premiums on price.

However, in 2001 the Victorian Government also implemented the Victorian Industry Participation Policy (VIPP), which is designed to encourage local industry and suppliers to participate in major State Government procurement projects. The VIPP applies to contracts of over \$3 million in metropolitan Melbourne and over \$1 million in regional Victoria, and requires bidders to detail level of local content. Bidders are required to provide additional information (and gain government certification) for metropolitan projects of over \$50 mill and over \$5 million in regional areas. VIPP statements are used as a secondary consideration in the tender process (ie they may help decide a contract where there is no clear preferred bidder).

Ai Group believes local industry participation in Victorian Government projects could be further encouraged by means of formally extending ‘whole-of-life’ costing criteria across all State Government agencies and projects. These criteria currently apply to State Purchasing Contracts, from which many agencies (and construction projects) are excluded.

- ***Halve the threshold on projects requiring VIPP implementation plans, to \$25 million in metropolitan Melbourne and \$2.5 million in regional Victoria.***

Ai Group also advocates halving the threshold on projects requiring VIPP implementation plans, to \$25 million in metropolitan Melbourne and \$2.5 million in regional Victoria. Both proposals could be funded by modest savings in other areas of agency or departmental running costs, while at the same time compelling all bidders to more carefully consider the inclusion of local suppliers in State Government projects.

## 8. Sharing the cost of environmentally sustainable manufacturing processes

- ***Increase funding for the State Government's Business Energy Innovation Initiative***

Industry recognises that minimising waste, recycling reducing inefficient energy use, and adopting more environmentally sustainable production techniques are positive for Victoria's environment, while also offering opportunities to grow new markets and boost competitiveness. However, the demands on Victoria's finite energy, land and water resources will continue to grow, reflecting a rising population and expanding industry sector. Finding new ways to reduce energy consumption and waste is therefore essential.

While continued advances in technological innovation are generating significant improvements in eco-efficiency across industry worldwide, nevertheless *Manufacturing Futures* identified environmental regulation as a potential drag on the international competitiveness of Victorian industry. Ai Group acknowledges regulatory requirements are necessary in many instances to meet the community's environmental objectives.

However, Ai Group also recognises that partnering arrangements between government and industry are a more effective way to achieve beyond-compliance improvements and sustainable industry outcomes. Hence, in order to ameliorate any potential competitive disadvantages to industry, Ai Group proposes the Victorian Government extend existing schemes assisting industry adopt more eco-efficient practices.

In Victoria, most assistance to reduce energy consumption is provided through the *Business Energy Innovation Initiative (BEII)*. The BEII also provides assistance where new energy solutions are combined with other sustainable business practices, including water conservation, cleaner production and waste and emissions reduction. The initiative provides an integrated approach and has encouraged innovation for reduction of Prescribed Industrial Waste and Trade Waste discharges. The BEII provides an effective mechanism for partnering to achieve sustainable industry outcomes.

Ai Group proposes the BEII be extended to focus more equally on these other aspects of sustainable industry practices, complementing existing partnerships between industry, Victorian water authorities and the Environment Protection Authority. Reflecting the often significant investments required to implement these practices, moreover, Ai Group also proposes the cap on government funding for specific projects be increased from \$150,000 to \$250,000 (although retaining the requirement for equivalent funding from the participating company).