AUSTRALIAN CHAMBER OF COMMERCE AND INDUSTRY

# THE FUTURE OF AUSTRALIA'S MANUFACTURING SECTOR: A BLUEPRINT FOR SUCCESS

## POSITION PAPER

**January 2007**

# FOREWORD

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Changes, which the Australian economy has endured over the past three decades, are no more starkly highlighted than in the fortunes of the manufacturing sector.

Australia has followed a path of engagement rather than retreat by embracing the world through lower tariffs and lower barriers to inflows of international capital. These economic changes have been insurmountable for some manufacturing businesses while others have reaped the benefits of globalisation.

The rise of low cost production centres for simply transformed manufactures combined with lower tariffs has pushed some Australian firms offshore or out of business.

Those that have survived have needed to change. Manufacturers have become more outwardly focussed, manufacture higher value goods, develop niche products for global markets or mass-produced goods for global supply chains.

The manufacturing sector contains success stories that defy a negative view regarding the future of Australia's manufacturers. Australia has industries within the manufacturing sector which maintain comparative and competitive advantages over even the lowest cost countries.

While international competition has eroded some domestic markets, Australian manufacturers are producing more goods to sell internationally than at any other time.

The manufacturing sector, like all sectors of the economy, needs a strong macro-economic environment to utilise and fully develop foreign investment, free trade agreements, skills and infrastructure. Manufacturers must also be given incentives to produce R&D to remain competitive as well as opportunities to commercialise such developments.

No matter the decline of manufacturing relative to GDP, it is a vital part of the Australian economy and will remain so long into the future.

I would like to thank Peter Johnson for developing this position paper and Jennifer Jay for the presentation of the document.

Peter Hendy
Chief Executive

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ACCI
LEADING AUSTRALIAN BUSINESS




# ACCI
# LEADING AUSTRALIAN BUSINESS

## BACKGROUND

ACCI has been the peak council of Australian business associations for 105 years and traces its heritage back to Australia's first chamber of commerce in 1826.

Our motto is "Leading Australian Business."

We are also the ongoing amalgamation of the nation's leading federal business organsiations - the Australian Chamber of Commerce, the Associated Chamber of Manufactures of Australia, the Australian Council of Employers Federations and the Confederation of Australian Industry.

Membership of ACCI is made up of the State and Territory Chambers of Commerce and Industry together with the major national industry associations.

Through our membership, ACCI represents over 350,000 businesses nation-wide, including over 280,000 enterprises employing less than 20 people, over 55,000 enterprises employing between 20-100 people and the top 100 companies.

Our employer network employs over 4 million people which makes ACCI the largest and most representative business organisation in Australia.

## OUR ACTIVITIES

ACCI takes a leading role in representing the views of Australian business to government.

Our objective is to ensure that the voice of Australian businesses is heard, whether they are one of the top 100 Australian companies or a small sole trader.

Our specific activities include:

- representation and advocacy to governments, parliaments, tribunals and policy makers both domestically and internationally;
- business representation on a range of statutory and business boards, committees and other fora;
- representing business in national and international fora including the Australian Industrial Relations Commission, Australian Safety and Compensation Council, International Labour Organisation, International Organisation of Employers, International Chamber of Commerce, the Business and Industry Advisory Committee to the Organisation for Economic Co-operation and Development, the Confederation of Asia-Pacific Chambers of Commerce and Industry and the Confederation of Asia-Pacific Employers;
- research and policy development on issues concerning Australian business;
- the publication of leading business surveys and other information products; and
- providing forums for collective discussion amongst businesses on matters of law and policy affecting commerce and industry.

## PUBLICATIONS

A range of publications are available from ACCI, with details of our activities and policies including:

- the *ACCI Review* a monthly analysis of major policy issues affecting the Australian economy and business;
- issue papers commenting on business' views of contemporary policy issues;
- *Policies of the Australian Chamber of Commerce and Industry* – the annual bound compendium of ACCI's policy platforms;
- the *Westpac-ACCI Survey of Industrial Trends* - the longest, continuous running private sector survey in Australia. A leading barometer of economic activity and the most important survey of manufacturing industry in Australia;
- the *SAI Global-ACCI Survey of Investor Confidence* – which gives an analysis of the direction of investment by business in Australia;
- the *St.George-ACCI Business Expectations Survey* - which aggregates individual surveys by ACCI member organisations and covers firms of all sizes in all States and Territories;
- the *St.George-ACCI Small Business Survey* – which is a survey of small business derived from the Business Expectations Survey data;
- workplace relations reports and discussion papers, including the ACCI *Modern Workplace: Modern Future* 2002-2010 Policy Blueprint and the *Functioning Federalism and the Case for a National Workplace Relations System* and *The Economic Case for Workplace Relations Reform* Position Papers;
- occupational health and safety guides and updates, including the *National OHS Strategy and the Modern Workplace: Safer Workplace* Policy Blueprint;
- trade reports and discussion papers including the *Riding the Chinese Dragon: Opportunities and Challenges for Australia and the World* Position Paper;
- education and training reports and discussion papers;
- the ACCI *Annual Report* providing a summary of major activities and achievements for the previous year; and
- the ACCI Taxation Reform Blueprint: *A Strategy for the Australian Taxation System* 2004–2014.

Most of this information, as well as ACCI media releases, parliamentary submissions and reports, is available on our website – www.acci.asn.au.

# EXECUTIVE SUMMARY

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## INTRODUCTION

As the successor organisation of the Associated Chamber of Manufactures Australia (ACMA) which was created at the time of Federation, ACCI is the oldest business organisation representing manufacturing at the national level, with the widest reach across the manufacturing sector in Australia.

Many industry participants and observers have been encouraging governments to develop a specific manufacturing policy for Australia to deal with the challenges confronting the sector. ACCI considers that this already exists and it is embodied in the reforms undertaken to improve the efficiency in the areas of industrial relations, taxation, skills, investment and the regulatory environment. These macro economic challenges should be seen as the priority for improving Australian manufacturing's international competitiveness.

The priority for the manufacturing sector, as for all industry sectors in the Australian economy, is to ensure that we have the appropriate policy settings for each component part of the wider reform agenda. This allows producers to most efficiently deal with an adverse operating environment of any nature.

## AUSTRALIA'S MANUFACTURING SECTOR TODAY

Like many industrialised countries, Australia's manufacturing sector has suffered declining output as a proportion of GDP and a declining proportion of employment relative to the total labour market. Taken at face value this could be misconstrued as symptomatic of an ailing industry that is no long relevant to the Australian economy. ACCI does not support this proposition.

In fact, while the proportion relative to Gross Domestic Product (GDP) diminishes the manufacturing sector continues to grow. Since 1975 manufacturing has increased from $60.5 billion in the year to June 1975 to $96 billion in the year to June 2006.

Over the last 30 years manufacturing growth has averaged 1.5 per cent per year.

Australia as a small open economy has, for its betterment, long instigated policies designed to encourage competition between both domestic and international companies. The results have been a higher standard of living for Australians and a more dynamic, competitive, efficient and skilled economy. Australian companies have become more outward looking with views of larger and more lucrative markets.

Nevertheless, while successful Australian companies thrive, the adjustment process has proved insurmountable for many. Competition from low cost countries has pushed many labour intensive products offshore, with manufacturers of these goods unable to find cost savings great enough to compete on price or quality. Throughout this process the Australian government has provided structural adjustment payments for industries to exit the market or retool.

Imports of manufactured goods have increased by 7.0 per cent over the previous decade while manufacturers have found export markets for their goods, increasing by 4.4 per cent over the same period.

As companies moved offshore and closed, many unemployed individuals, particularly the low skilled, found re-entering the labour market difficult, often suffering long-term unemployment as a consequence (noting that technological change rather than trade has affected unskilled employees more). Simultaneously as product market reform began so labour market reform shortly followed. As great as there has been a shift in Australia's economic composition away from manufacturing then in equal measure employment in the manufacturing sector also declined.

However, Australia's manufacturing sector does not just face challenges but also real opportunities. It will continue to provide elaborately transformed products to world markets based on capital and highly skilled employees. At present the terms of trade may be presenting a difficult trading environment but policies of the past have been successful for Australia as a whole, something that should not be forgotten in the debate about the future of manufacturing.

In 2004-05 Australia's R&D expenditure measured $15.8 billion a 19.4 per cent increase on the previous year. Investment in R&D by business recorded $8.4 billion, up 21.5 per cent, while government spending remained relatively flat at $2.55 billion. The largest contributor to Business Expenditure on Research and Development (BERD) is manufacturing, accounting for 49.3 per cent or $3.451.1 million. Manufacturing also accounted for 45.3 per cent of all Capital expenditure on R&D, at $237.4 million, in 2004-05.

ACCI considers the following points, in addition to maintaining a stable macroeconomic environment, to be vital in providing the manufacturing sector with a viable and sustainable future.

## THE DUTCH DISEASE AND MANUFACTURING

The Australian resources sector today is experiencing a boom in demand for its products, particularly from China, India and Japan. Applied to the current Australian context, large inflows of foreign capital, due to the current mining boom, cause the real exchange rate of the Australian dollar to appreciate reducing the competitiveness of Australia's exports and increasing imports. Resources such as labour are being channelled away from the manufacturing, services and agricultural exporting sectors towards the mining sector.

Economists label this as an example of the "Dutch Disease", after events that occurred in the Dutch economy in the 1970s.

Overall, any policy response will depend on whether the increase in wealth is transitory or permanent. However, determining the length of the current terms of trade shock is difficult, implying policy makers run the risk of misjudging the nature of the current cycle.

ACCI supports the setting of the exchange rate by the market and not through Government or RBA intervention. The benefits to the Australian economy caused by the change from a fixed to a floating exchange rate in 1983 are clear and any return to a fixed or managed float would be harmful to the Australian economy.

## GOVERNMENT SUPPORT AND MANUFACTURING

Australian industry receives budgetary and taxation assitance totalling $4.6 billion of which $1.8 billion is for the manufacturing sector. Manufacturing tariffs are estimated to cost the Australian economy $7.5 billion, and the manufacturing sector accounts for $7.3 billion of that assistance.

Historically Australian manufacturers produced goods for the domestic market. They operated behind a wall of tariffs and other assistance protecting Australian companies and workers from international competition. However, over the years the economic consensus has seen developed countries reducing their tariffs in line with policies highlighting the benefits of liberalising trade.

Providing assistance to industries can be justified for a number of reasons, however, Government programs are not always analysed rigorously. ACCI supports thorough cost/benefit analysis being applied to all government programs and initiatives so as to increase transparency and predictability of funding.

## GLOBAL SUPPLY CHAINS AND MANUFACTURING

The design, sourcing of materials and manufacture of goods remained largely contained within the confines of national borders. Today this process, like the market and competition, has broadened to seeking out opportunities that exist

internationally. Design of goods is increasingly taking place in developing countries such as India, while materials are brought on to international markets from countries such as Brazil for transformation in factories located thousands of miles from head offices or across multiple countries.

The Government has an important role in making Australia an attractive destination for global manufacturing companies looking for a location to invest based on research and development capabilities, skills, taxation, regulation, energy and infrastructure.

## INTERNATIONAL TRADE AND MANUFACTURING

ACCI is firmly and unequivocally committed to the cause of free trade.

The ACCI stongly supports continuing removal of international trading barriers, but believes that reductions in Australian tariffs must be considered in the context of a whole of government industry policy.

Cuts in the level of protection must be part of a wider package of comprehensive, domestic reform to taxation, workplace relations, other regulatory compliance and microeconomic reform.

In assessing the possible outcomes of any reductions in assistance to industry, full account should be taken of the economic, strategic and social impacts. Governments should be involved in the market as a facilitator of trade.

The signing of bilateral agreements such as FTAs (Free Trade Agreements) can deliver benefits to Australia as long as they are comprehensive and meet the objectives of multilateral agreements. Agreements currently being examined for feasibility have the potential to profoundly alter the manufacturing sector.

ACCI recognises that trade related issues go beyond tariffs and quotas and include protection of intellectual property rights; rules of origin; investment; recognition of professional and skilled qualifications; import licensing; customs procedures; quarantine laws and policies; and dumping regulations.

Australian negotiators can help our exporters, and indeed the world trading community, by delivering outcomes that realise a stronger intellectual property law regime in countries that have FTAs with Australia.

Commerce and industry supports: the two-pronged recommendation by the Jollie Review to maintain current levels of program funding; indexing the Export Market Development Grant (EMDG) scheme budget to inflation to preserve its real value; and introducing a smoothing arrangement, where funds not expended in one year of the program can be retained and made available elsewhere over the life of the Scheme (especially in unexpectedly high demand years).

## RESEARCH AND DEVELOPMENT AND MANUFACTURING

The Government must continue to support research and development (R&D) in Australia. The importance of innovation as a key driver of economic growth and the role of government in creating an environment in which innovation is fostered are increasingly being recognised in economic theories.

If Australia is to move higher up the value adding chain and into niche products that allow us to successfully compete with China and other developed countries, Australia's R&D policy must be to encourage investment in technology intensive industries, however, this should not be at the expense of broader R&D.

ACCI continues to consider that a simple and effective measure to promote business R&D is to increase the standard R&D Tax Concession from 125% to at least 150% and further reduce the burden of Capital Gains Tax (CGT).

## SKILLS DEVELOPMENT AND MANUFACTURING

All businesses require access to skilled employees particularly when competing with international firms. Australian policies must be directed towards overcoming the skills shortage currently faced by businesses including manufacturing businesses. To undertake world class R&D, Australia's manufacturing sector will rely on employees who have tertiary level education in areas such as engineering, maths and science. However, a skilled workforce not only relies on higher-level education but is also underpinned by trainees and apprentices.

- Employers seek quality outcomes from the Vocational Education and Training (VET) sector. It is therefore important that the Institute for Trade Skill Excellence provides employer endorsements for high performing schools in Registered Training Organisations (RTOs).

- ACCI advocates the reform of the highly successful Australian Apprenticeships program to make it much better. The Australian Apprenticeships program currently caters for a range of formal workplace training arrangements with one set of incentives and regulatory arrangements applying. Over the past six years the underlying concept of an apprenticeship, that is structured learning in a work based environment, has become well established outside the trades.

- ACCI believes that there is an opportunity for a new strategic positioning of the Australian Apprenticeships program in the VET system to revitalise its role in meeting the skills needs of those entering the labour market, those already in the existing workforce or those who are on income support.

- It is imperative that the incentive arrangements, which currently apply across all industries, be maintained. However, it would be timely to extend the arrangements to cover all levels of New Apprenticeship pathways, including at the higher levels of Australian Qualification Framework levels V and VI.

- The National Skills Shortages Strategy (NSSS) has funded a range of industry developed and managed projects that have identified significant issues regarding the recruitment, training and retention in occupations in shortage of suitably skilled workers across a range of industries.

- The Australian Technical Colleges will provide an innovative approach to encouraging young people to merge employment and learning options during their secondary senior years and will further help to raise the esteem of VET pathways in the community. Clearly identifiable industry leadership will be important to the success of the Colleges.

- ACCI believes that further sites for Australian Technical Colleges should be investigated, especially in regional areas experiencing skill shortages.

- ACCI members support the policy directions of the Government in the broad area of welfare reform and are particularly interested in programs that connect the various government agencies dealing with a specific issue taking a whole of government approach.

- As such, ACCI believes that the concept of providing Job Network clients with an opportunity to take up a Australian Apprenticeship is therefore critical in providing unemployed persons with dual opportunities of work and gaining skills, and providing targeted interventions to address the supply of skills problems.

## FOREIGN DIRECT INVESTMENT AND MANUFACTURING

Globalisation of the manufacturing sector provides not only opportunities and challenges for maintaining market share but also receiving foreign capital. Australia's national savings does not provide its industry with resources sufficient for capital accumulation and investment therefore we require overseas savings in the form of foreign investment.

Foreign investment can provide a stimulus to the host country's business sector, through its positive impact on productivity

growth and enterprise development, which in turn can enhance competition in previously sheltered markets.

Furthermore, foreign investment can deliver positive spillovers to domestic enterprises, especially in the form of newer and relatively more advanced technologies, and human capital (such as management skills). In essence all firms rather than just those firms receiving foreign capital will have higher productivity.

Australia requires an investment framework that encourages international businesses to provide capital and skills in Australia. The manufacturing sector is particularly dependent on and benefited by, governments improving Australia's attractiveness as a source of foreign capital.

## WORKPLACE RELATIONS AND MANUFACTURING

Past workplace relations reforms have significantly benefited the manufacturing sector, most noticeably in the reduction of strikes and other industrial disputation.

As a matter of priority business has worked with the Australian Government and will continue to do so to ensure that the Government's *WorkChoices* reforms are implemented smoothly as well as in accordance with the principles of our policy Blueprint *Modern Workplace: Modern Future* launched in November 2002.

The reform will kick start another round of productivity growth. We are confident this will mean lower unemployment than would otherwise occur and a continuation of real wage growth.

Manufacturing firms should seek to benefit from these opportunities as much as possible.

The Occupational Health and Safety (OHS) system in this country is in dire need of reform. The current system of regulation is seriously deficient.

Complex regulation is self-defeating and removes the incentive to invest in better OHS outcomes.

Just as tort (negligence) laws recently got out of hand and created major public liability problems, some OHS laws are now, for similar reasons, out of control and must be reined in. Some of Australia's OHS laws and court decisions are straight out of 'Alice in Wonderland'. They reek of employers being liable out of convenience or retribution, irrespective of commonsense.

There is excessive growth of OHS regulation and red tape. Many employers, especially small and medium businesses, find OHS laws and regulations to be complex, bureaucratic, difficult to understand and almost impossible to implement effectively.

There is a lack of balance in some existing legislation and court decisions. The trend across jurisdictions has been to broaden legal duties beyond reasonable limits, increase penalties, extend liability to individuals in the management and supply chain and seek to punish rather than prevent.

## TAXATION AND MANUFACTURING

If Australia's manufacturing sector is to compete internationally it is vital that the taxation regime does not disadvantage domestic firms. Comparisons against our nearest neighbours are more relevant than most others – for example, Hong Kong, Singapore and Taiwan which are developed non-OECD countries within the Asia Pacific, and South Korea and Japan which are OECD members. As global competition increases and Asian economies become more developed, Australia will need to compare itself with Asia.

The *International Comparison of Australia's Taxes Report* (Report) notes that the effective tax rates on various investments in Australia are very high and the majority of OECD-10 countries have a more lenient treatment of losses, with seven

providing for amortisation of goodwill (Australia does not). While Australia's depreciation allowances are low compared to the OECD-10, many small firms can access better depreciation arrangements through the Simplified Tax System (STS). ACCI believes the Government should examine the Report's findings on write offs and depreciation.

ACCI considers that it is important to revisit and improve on the CGT reforms introduced in 2000. We believe that the Government should seriously consider introducing a stepped rate CGT, where the proportion of the capital gain that is taxed diminishes over time.

## ENERGY AND MANUFACTURING

In Australia, the energy sector contributes significantly to our economic prosperity and standard of living. The reliable availability of competitively priced energy is fundamental to the international competitiveness of Australian industries, particularly those that are energy intensive. Exports of energy commodities, technologies and resources have also contributed to wealth and job creation. Put simply, the nation's economic prosperity is determined by access to energy at competitive prices.

The manufacturing sector is presently facing severe competition which will likely increase in the future. Increasing costs unilaterally by implementing a domestic Emissions Trading Scheme (ETS) as proposed by State Governments will severely damage sections of the Australian economy which rely on low cost electricity as a source of competitive advantage.

It is hard to fathom why governments would wish to embark on a policy that effectively imposes an energy tax which would send Australian jobs offshore, reduce the international competitiveness of our strongest industries and potentially lose some energy intensive industries to less developed economies with much less stringent environmental controls.

Furthermore, those States in which manufacturing plays a significant economic role such as Victoria will be the most disadvantaged through higher energy costs.

## REGULATION AND MANUFACTURING

Australian manufacturers require an efficient regulatory framework in which to operate competitively. ACCI believes that the aim of improving regulation can be achieved and has developed a position paper entitled Holding Back the Red Tape Avalanche, which addresses all regulation of economic significance affecting commerce and industry.

The specific features of the ACCI approach are as follows:

- Tabling in Parliament an annual regulatory budget that provides a cost and benefit analysis of all business-related regulations as measuring the cost of regulation is the first step in controlling its growth.

- All regulatory budgets to be placed on a centralised website. This will help to inform the public of the amount of regulation being created and the amount of regulation required to be complied with.

- The Office of Regulatory Review (ORR) should be moved from the Productivity Commission (PC) to the Department of the Prime Minister and Cabinet. The new body, to be known as the Prime Minister's Regulatory Reform Unit (PMRRU), should be headed by a Chief Executive chosen from the business community.

- A modelling unit located in the PC should be created to develop a standardised costing tool to be applied to all new regulatory proposals. Line departments will be required to apply this costing tool to objectively measure the compliance costs of their regulatory bids. We consider this initiative has been addressed through the development of the Business Cost Calculator.

- Regulation that does not pass the Regulatory Impact Statement (RIS) process as determined by the PMRRU must not be allowed to proceed.

## INFRASTRUCTURE AND MANUFACTURING

Infrastructure plays a key role in overall economic performance and development, influencing investment decisions, access to education and information, the ability to develop local small medium enterprises (SME) and generally enhances the ability of firms to participate in the globalisation process. ACCI has argued in a number of submissions that there is no overwhelming infrastructure crisis, but there are areas where significant infrastructure investment is needed.

ACCI has also recently adopted a new infrastructure policy. In summary, the policy argues:

- Infrastructure is vital to Australia. It is essential to improving Australia's economic performance; education and training; national security; social cohesion; and enhancing our built and natural environment.

- Infrastructure needs should be addressed by the private sector where possible, with the Government assisting investment through a facilitative tax and regulatory system.

- The private sector is generally more efficient at developing and operating infrastructure. Government investment should only be used when there is clear and demonstrated market failure and after a thorough cost benefit analysis has been undertaken.

- Where government involvement in infrastructure is required, governments should make full use of partnerships with the private sector to reduce costs.

- The tax and regulatory system should provide appropriate incentives to investment while restricting monopoly power. Reforms should continue under National Competition Policy, in line with the recommendations of a recent inquiry by the Productivity Commission.

- ACCI does not support proposals for an independent National Infrastructure Council or similar to take over decision making on infrastructure projects, but we do support proposals for greater coordination in infrastructure regulation.

It is imperative that current problems in manufacturing do not elicit impulsive responses to the detriment of Australia's overall wellbeing. The right environment must be created so as to allow manufacturing to compete globally, but policies should not wind back the clock on twenty years of reform.

Additional expenditure in the manufacturing sector should only be considered once current programs have been analysed as being world best practice. Higher expenditure requires higher government taxation which in itself is costly to raise.

## AUSTRALIAN MADE CAMPAIGN

The Australian Made Campaign has been an important component of promoting Australian manufacturing. Created in 1986 by the Australian Government to 'make Australians more aware of their skills and to encourage the country to strive for its full potential', the famous green and gold Australian Made logo has become Australia's most widely recognised and trusted country of origin symbol.

Buying Australian made is important to Australian consumers. When asked, almost half of all adults (aged over 14) claim to buy Australian made products whenever possible and another 21 per cent say that they 'do so often'. The Australian made logo is recognised by 96 per cent of consumers according to research conducted by Roy Morgan Research.

Australian Made Campaign Ltd (AMCL's) global focus has resulted in it recognising the need for Australia to have an official country of origin symbol which should be available to help exporters more easily identify their products as Australian. Very importantly, an official symbol would also enable the Government and its agencies to engage with the campaign to promote it - working constructively with the private sector, as part of its everyday activities the world over.

The Australian manufacturing industry is facing increased import competition, particularly from China, and the imperative of pursuing exports has never been more pronounced. An agreed country of origin symbol should be available to help Australian exporters sell their Australian made products.

## SURVEY OF MANUFACTURING COMPANIES

Over recent years there has been an attempt by many sectional interest groups to put arguments to government on what is best for the Australian manufacturing sector. Unfortunately a large amount of this advocacy is not much more than subjective opinion based on scanty empirical evidence. In this position paper ACCI has attempted, where at all possible, to use statistical sources to establish the validity of its arguments.

The most recent *ACCI-Westpac Survey of Industrial Trends* for the December quarter 2006 has confirmed that the general business sentiment in the manufacturing sector has deteriorated recently. Nonetheless, expectations as measured by the survey are for a renewed pick up in manufacturing consistent with trend growth above the decade average.

Indeed, twelve month manufacturing investment plans for plant and equipment are at relatively high levels, as are spending plans for buildings and structures.

Finally, export deliveries doubled in the September quarter 2006 and increased again in the December quarter.

The SAI Global-ACCI Survey of Investor Confidence shows that in 2006 the top five constraints on investment plans across the manufacturing sector were:

1. insufficient demand;

2. local competition;

3. business taxes and charges;

4. import competition; and

5. current levels of debt.

The survey material obviously shows that the level of demand for their product and the competitive environment weighs heavily on the future investment decisions of Australian manufacturers.

Nonetheless, business taxes and charges and debt levels are in the top five constraints and when we examine the full top twenty constraints manufacturing faces the same key generic issues, issues common across the Australian economy.

## CONCLUSION

The Australian manufacturing sector has been facing challenging circumstances for many decades now.

The share of the Australian economy represented by manufacturing has been steadily declining. However, the important thing to note is that despite this long term decline of manufacturing as a share of the total economy the sector over the long term continues to grow.

Nonetheless the recent retraction in the manufacturing sector has caused concern.

Australian governments, both Commonwealth and State, must continue with economic reforms to help assist the manufacturing sector deal with the challenges it faces, not least the challenges of globalisation and the huge growth in Asian competitors like China and India.

ACCI is of the view that recent difficulties faced by manufacturing should not be the excuse to lead governments back to old, failed policies of protectionism and intervention.

Recent calls for a new manufacturing sector policy are in many cases simply a euphemistic call for a return to the past.

The future of manufacturing does not lie in raising tariff and non-tariff barriers nor in the pursuit of large industry specific taxpayer funded grant schemes.

The message is clear from the survey material ACCI has gathered that the priorities to deal with the issues facing manufacturing come back to securing the best possible policies on:

- industrial relations;
- taxation;
- skills;
- investment, including in infrastructure and R&D; and
- the regulatory environment.

ACCI, as a major stakeholder on behalf of the Australian manufacturing industry therefore will continue to argue for reform in all of these areas.

# Chapter 1
# Introduction

# INTRODUCTION

ACCI has produced the position paper *The Future of Australia's Manufacturing Sector: A Blueprint for Success* in light of a renewed focus on the sector and its role in the Australian economy.

ACCI is the oldest business organisation representing manufacturing at the national level (for 103 years), with the widest reach across the manufacturing sector in Australia.

ACCI is the successor organisation of the Federal Council of the Chambers of Manufactures of the Commonwealth of Australia created in August 1903 and renamed the Associated Chamber of Manufactures (ACMA) in 1908. In December 1977 ACMA merged with the Australian Council of Employer Federations to form the Confederation of Australian Industry (CAI). In August 1992 the CAI merged with the Australian Chamber of Commerce to create the ACCI.

During the course of the last twelve months a number of reviews into the situation of the manufacturing sector have been initiated:

- In December 2005 State and Territory Ministers responsible for manufacturing convened a National Manufacturing Summit in Melbourne and established a National Manufacturing Forum, which during 2006 has been examining an agenda for a growing and sustainable manufacturing sector within the Australian economy. Mr Neville Sawyer AM, represented ACCI on the Forum.

- On 3 May 2006 the Treasurer, the Hon Peter Costello MP, asked that House of Representatives Standing Committee on Economics, Finance and Public Administration undertake an inquiry into the state and future directions of Australia's manufactured export and import competing base.

- The Minister for Industry, Tourism and Resources, The Hon Ian Macfarlane MP, convened an Industry Policy Framework roundtable meeting in Parliament House on 23 August 2006 that discussed the manufacturing sector, amongst other sectors, and plans to produce a white paper on industry policy early in 2007.

- On 4 December 2006 in his inaugural press conference as Leader of the Opposition, Mr Kevin Rudd nominated the future of the manufacturing sector as one of his key policy areas.

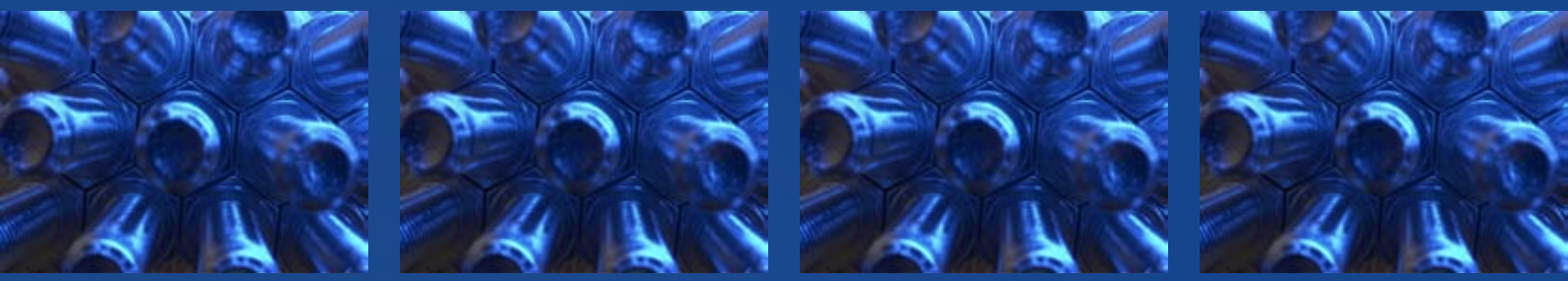
Many industry participants and observers have been encouraging governments to develop a specific manufacturing policy for Australia to deal with the challenges confronting the sector.

ACCI considers that this already exists and it is embodied in the reforms undertaken to improve efficiency in the areas of industrial relations, taxation, skills, investment and regulatory environment. These macro economic challenges should be seen as the priority for improving Australian manufacturing's international competitiveness.

The priority for the manufacturing sector, as for all industry sectors in the Australian economy, is to ensure that we have the appropriate policy settings for each component part of the wider reform agenda. This allows producers to most efficiently deal with an adverse operating environment of any nature.

The position paper *The Future of Australia's Manufacturing Sector: A Blueprint for Success* sets out ACCI's policy views as they relate to the manufacturing sector. We commend it to policy makers, not only in Canberra, but right across the nation's state capitals. In addition we believe that it should be a useful source document for those doing research on the manufacturing sector in Australia.

# Chapter 2
# Australia's Manufacturing Sector Today



# AUSTRALIA'S MANUFACTURING SECTOR TODAY

## MANUFACTURING'S SHARE OF THE ECONOMY

The latest full year statistics show that manufacturing output was $96 billion in 2005-06. Unfortunately, compared with the previous full year July 2004 to July 2005 manufacturing output fell by approximately $354 million. More positively the latest September quarter 2006 was $216 million higher than the previous quarter, growing by 0.9 per cent.

Nevertheless a long-term analysis shows that while manufacturing output has declined relative to GDP, overall output has increased by more that one and half times in real terms over 30 years. Since 1975 manufacturing has increased from $65.73 billion in the year to June 1975 to $96 billion in the year to June 2006.

Overall manufacturing output has risen in 23 of the 31 years since 1975. In the eight years that it did fall, three were in the deep recession between June 1989 and June 1992.

Since 1975 manufacturing growth has averaged 1.5 per cent per year, less than half the average GDP growth rate of 3.2 per cent per year which explains manufacturing's relative decline as a share of GDP.

The decline in the relative share of the manufacturing sector has occurred steadily over the past thirty years leading to changes in the nature of production. The rise of low cost production centres for simply manufactured goods combined with lower tariffs has pushed many Australian firms offshore or out of business. Increased international competition from low wage countries and offshore outsourcing has reduced manufacturing growth. ABS figures shows that growth in manufacturing over the past twenty-five years was 1.7 per cent per year, almost half the average sector growth rate of 3.3 per cent per year over the same period (see Figure 1).

The decline has seen manufacturing fall from approximately 21.0 per cent of GDP to approximately 12.5 per cent over three decades. Employment as a proportion of the total labour market has declined in lock step with that of production (see Figure 2). In absolute terms the manufacturing sector has lost approximately one hundred thousand employees since 1985, a trend reflected in many OECD countries (see Figure 3).

Long-term trends indicate that employment in the manufacturing sector is unlikely to return to previous levels. Strong productivity growth in the manufacturing sector combined with slower sales growth reduces overall employment. In Australia growth in demand for domestically manufactured goods has not kept pace with the growth in productivity, as consumers continue to devote more of their spending to imported goods and services.

While structural change between industries has resulted in a decline in the relative importance of manufacturing, structural change has also occurred within the manufacturing sector. Two examples of industries increasing their importance include:

> Manufacturing activities with strong links to Australia's natural endowments of food, forests and minerals account for a significant and growing share of manufacturing value added. In 1968-69, natural endowment-based manufacturing accounted for 36.5 per cent of manufacturing value added. By 2000-01, it accounted for just under 44 per cent.
>
> A second category of goods — more differentiated products with higher skill and R&D intensities — also have tended to increase in relative significance. These include Medicinal and pharmaceutical goods, Photographic, scientific and medical equipment and, to a lesser extent, Electronic equipment. These three groupings increased in importance from a small base of 3.5 per cent of manufacturing value added in 1968-69 to 6.2 per cent by 2000-01.[1]

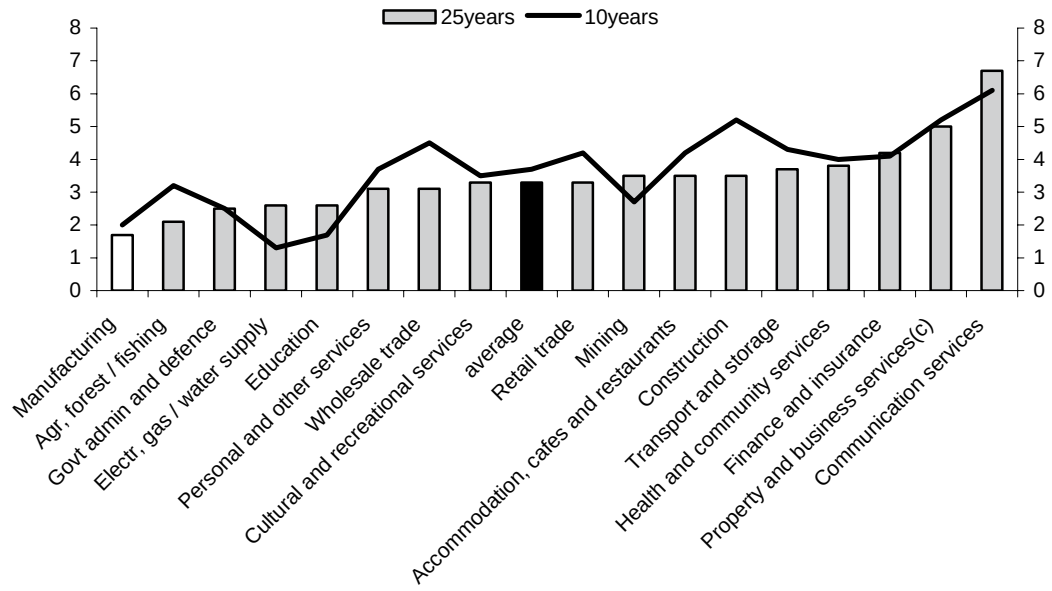
Figure 4 shows that within the manufacturing sector there are a number of success stories.

The manufacturing industry is moving away from low skilled and less complex goods such at Textile, Clothing and Footwear (TCF) towards more complex goods and manufactures with strong links to natural resources. The OECD has also noted that declines in the manufacturing sector have occurred in only a few industries while others have remained relatively stable.

> Recent years have seen a steep decline in manufacturing

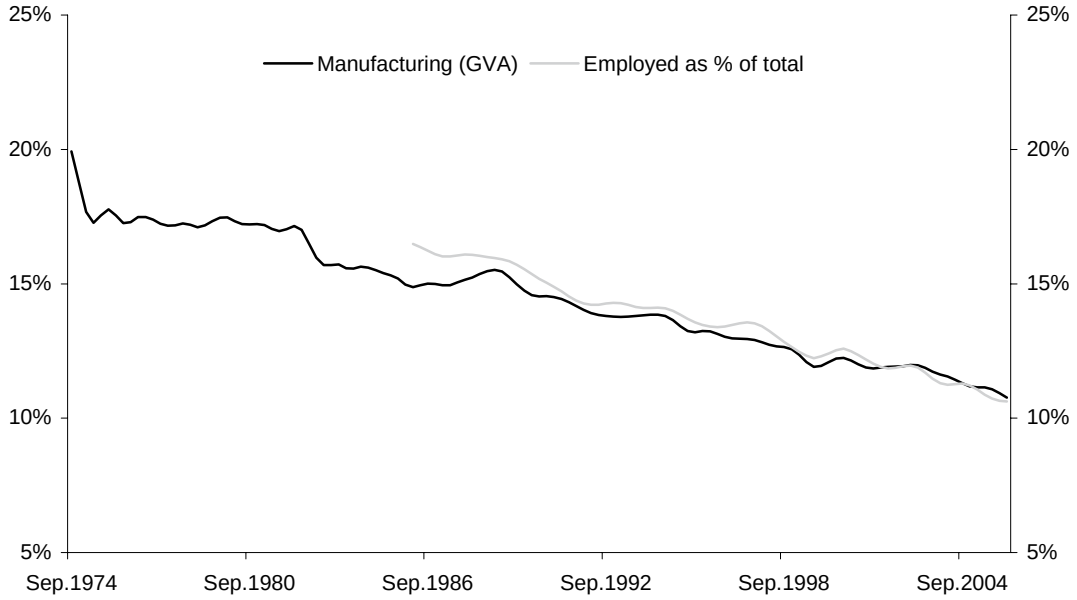
1 Productivity Commission (2003), *Trends in Australian Manufacturing*, Commission Research Paper, Aus Info, Australia.

**Figure 1**
**Average Annual Change in Production Volumes Over Last 10 and 25 Years**




Source: Australian Bureau of Statistics, *Manufacturing Industry 2003-04*, Australia, ABS Canberra.

**Figure 2**
**Proportion of GDP and Total Employment**



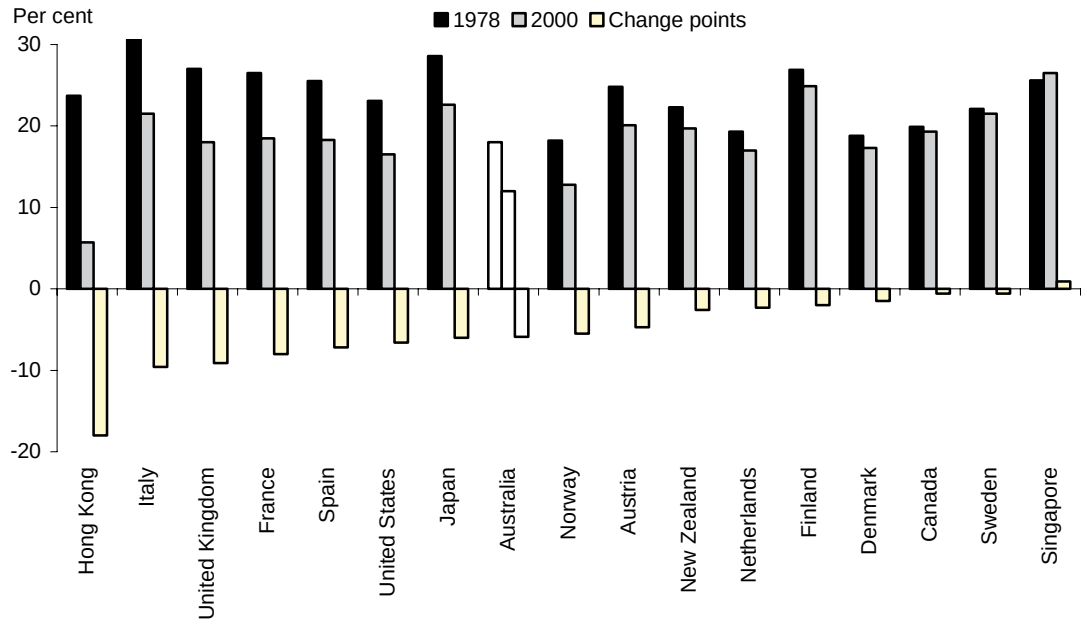

Source: *Australian System of National Accounts*, Cat. No. 5206.0, March 2006, ABS and *Canberra and Labour Force*, Australia, Detailed, Quarterly, Cat. No. 6291.0.55.033, May 2006, ABS Canberra.
Note: Manufacturing (GVA) is June, Sept, Dec and March quarters while Labour Force is May, Aug, Nov and Feb quarters.

employment in many OECD countries. While overall manufacturing employment has declined, not all sectors have fared equally. Most of the decline in manufacturing employment over the past three decades has occurred in only two activities, textiles products and basic metal products. In several activities, notably food products, paper products, chemicals, motor vehicles and other manufacturing, manufacturing employment in the G7 countries has remained relatively stable. This is partly because OECD countries still maintain a comparative advantage in certain sectors of manufacturing activity, in some of which demand has been quite strong, e.g. pharmaceuticals. In certain other industries, such as food products, manufacturing production is often located close to the market.[2]

Australian manufacturers are taking advantage of exporting

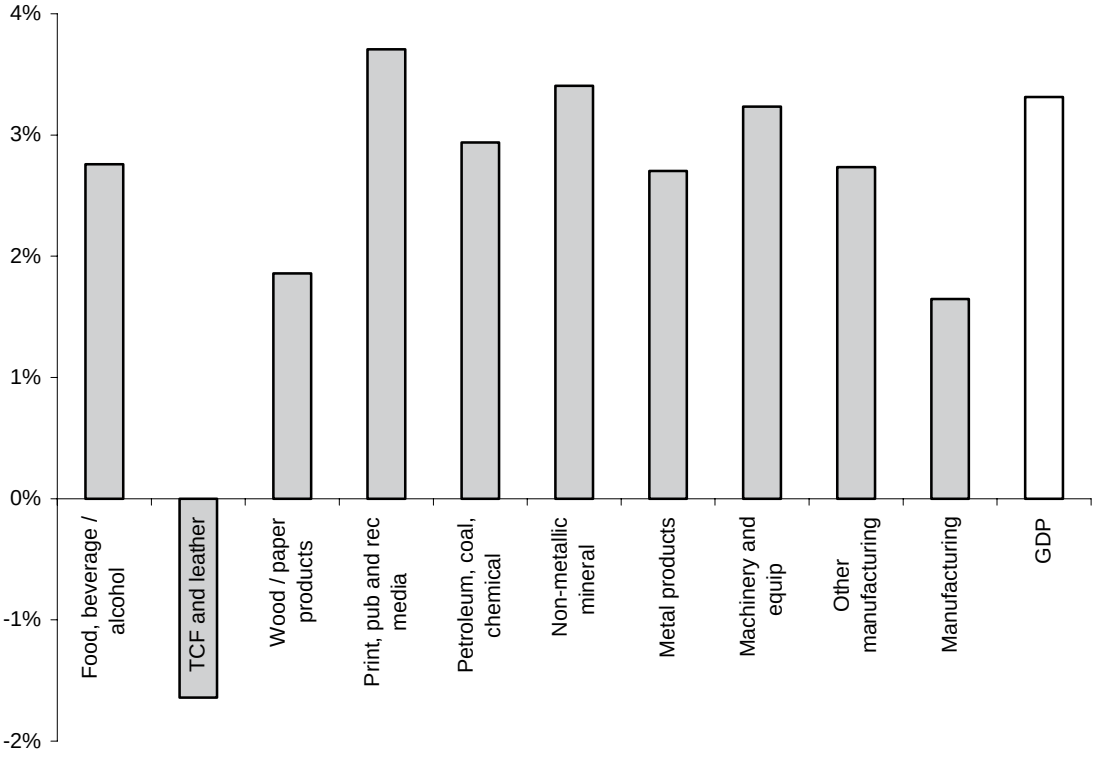
2 OECD, *OECD Science, Technology and Industry Scoreboard 2005 – Towards a knowledge based economy, the changing nature of manufacturing*, OECD Paris 2005.

**Figure 3**
**Manufacturing Value Added Shares Relative to Total Economy**




Source: Productivity Commission (2003), *Trends in Australian Manufacturing*, Commission Research Paper, Aus Info, Australia.

**Figure 4**
**Growth Rates Within the Manufacturing Sector Compared With GDP**




Source: *Australian System of National Accounts*, Cat. No. 5206.0, June 2006, ABS Canberra.

opportunities opened up through increasing trade. As noted previously not all the manufacturing sectors are struggling under international competition. For example, manufacturing sectors connected with raw materials and high value added products are competing successfully on the international market (see Figure 5).

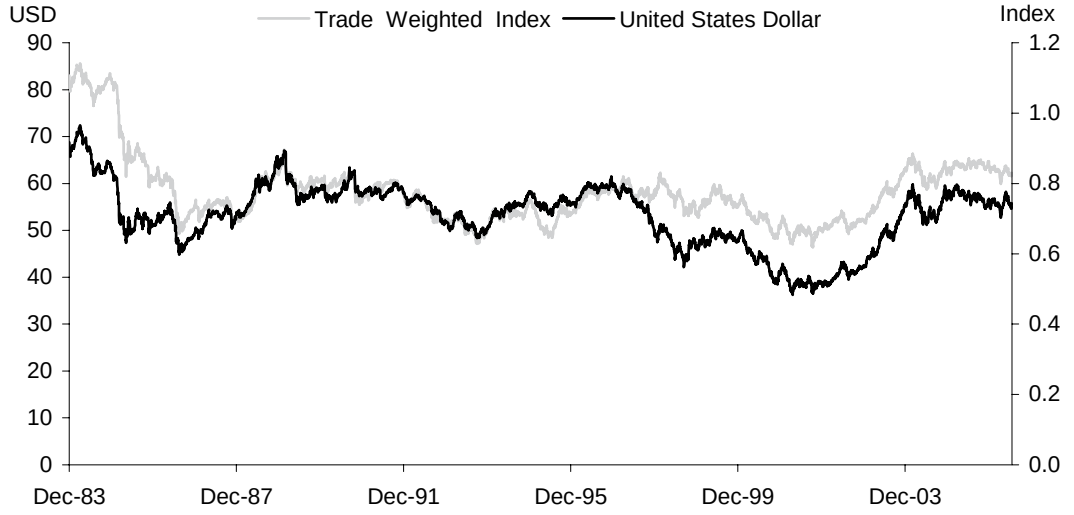
During this time Australia's manufacturing sector has experienced a number of shocks and is currently experiencing reduced competitiveness due to exchange rate movements (see Figure 6). While a strong currency and terms of trade (Australia's export price relative to import prices) are providing a difficult trading environment, the

**Figure 5**
**Top Ten Exporters by Per Cent of Revenue 2004-05**

| Rank | Industry | Revenue $m | Export $m | % |
|---|---|---|---|---|
| 1 | Meat Processing | 10745 | 7846.4 | 73 |
| 2 | Alumina Processing | 4742 | 4381 | 92.4 |
| 3 | Aluminium Processing | 5499 | 3712 | 67.5 |
| 4 | Vehicle Manufacturing | 16325.7 | 3259.6 | 20 |
| 5 | Nickel Smelting & Refining | 3151 | 3064 | 97.2 |
| 6 | Dairy Product Manufacturing | 4901.4 | 2950 | 60.2 |
| 7 | Medicinal & Pharmaceutical Product Manufacturing | 6320 | 2921 | 46.2 |
| 8 | Wine Manufacturing | 5272 | 2728 | 51.7 |
| 9 | Copper, Silver, Lead & Zinc Smelting & Refining | 4047 | 2653 | 65.6 |
| 10 | Basic Iron and Steel Manufacturing | 13950 | 2042 | 14.6 |

Source: Jason Baker, "Economy Watch", *Business Review Weekly*, October 19-25 2006.

**Figure 6**
**Exchange Rate and Trade Weighted Index**




Source: RBA, *Statistical Bulletin*, F11 Exchange Rates.

real export-weight index[3] is not at historic highs (see Figure 7). The benefit of a strong terms of trade to Australia is through higher incomes and employment related to increase activity in the minerals and resources sectors.

Many participants in the manufacturing sector are continually calling for a "lower exchange rate". However, a low exchange rate, while improving the competitiveness of the Australian manufacturing sector, can introduce a number of problems for the economy more broadly. Any policy recommendations to develop manufacturing must be made independent of the present macro-economic environment. The PC has noted that in the short run benefits from a higher terms of trade are positive:

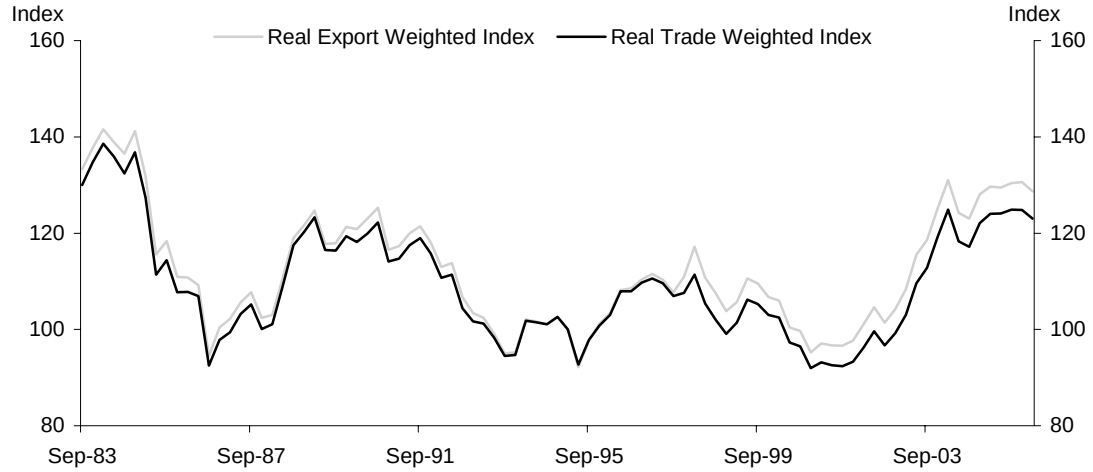
> The main conclusion emerging from this study is that, taken over long time periods of several decades, changes in the terms of trade have relatively little impact on Australian welfare. Welfare benefits from improvements in the terms of trade in one period tend to be offset by losses from subsequent deteriorations in the terms of trade. Over the last four and a half decades changes in the terms of trade have increased real income by less than 5 per cent in aggregate.
>
> There is evidence, however, that terms of trade changes can have a more important, albeit usually transitory, impact over shorter periods of time. In particular, improvements in the terms of trade over the decade up to 2003-04 led to an increase in real income of 7.5 per cent.[4]

While deregulation of the economy including financial,

3 Export-weighted index assigns relatively high weights to currencies of East Asian countries, reflecting their importance as export destinations

4 Productivity Commission (2006), *Measuring the contribution of productivity and terms of trade to Australia's economic welfare*, Consultancy Report, Canberra, March.

**Figure 7**
**Real Export and Real Trade Weight Index**




Source: RBA, *Statistical Bulletin*, G04 Other Price Indicators.

product and labour markets, has brought major benefits to the national economy, not all sectors have been successful in taking opportunities. Wide ranging reforms have included floating the Australian dollar, deregulation of the banking and financial system, National Competition Policy (NCP), privatisation of government businesses, workplace relations reform, taxation reform and reductions in tariffs and industry assistance.

Australia and the manufacturing sector is experiencing the benefits of deregulation policies such as declining unit labour costs which to some extent counterbalance Australia's increasingly "less competitive" exchange rate (see Figure 8).

As noted above, while manufacturing output has declined relative to GDP, overall output has almost doubled since 1975 (see Figure 9). The manufacturing sector is also the largest employer relative to other individual industry divisions. Interestingly, Australia's long-term exporting trend has seen a shift from rural and minerals and fuels towards manufacturing and services (see Figure 10). Indeed, manufacturing while declining as a proportion of GDP has trended higher as a proportion exports. However, very recently all sectors have been losing ground to minerals and fuels due to the current mining boom.

Further, while Australia's export share from manufacturing has risen steadily, exports have increased in absolute terms, stabilising recently, with the proportion of elaborately transformed materials (ETMs) remaining relatively stable over the previous decade (see Figure 11).

Australia's exports grew strongly, rising 15 per cent, in the calendar year 2005, according to a report *Exports of Primary and Manufactured Products* (June 2005), produced by the Department of Foreign Affairs and Trade. Manufactures exports grew 10 per cent, well ahead of services exports (up 4 per cent), compared to the previous calendar year. Within the manufactures category, exports of simply transformed manufactures (mainly base metals) rose by 9 per cent (to just under $A 11 billion), while those of elaborately transformed manufactures (more sophisticated products, such as electronics and motor vehicles) rose by 10 per cent, to almost $A21 billion.

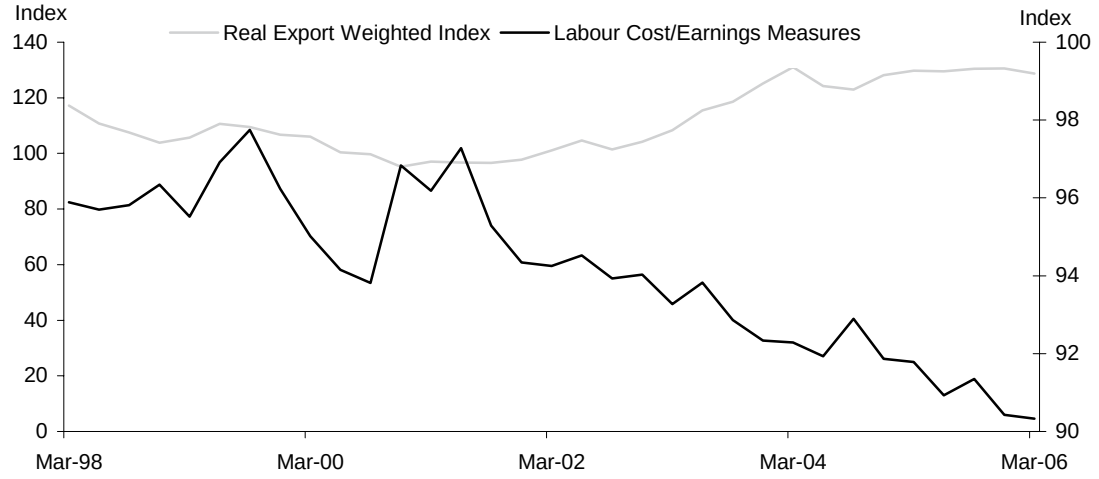
## MANUFACTURING'S CHANGING PROFILE

As noted previously manufacturing output has been growing over the previous decade by an average of 1.8 per cent (see Figure 12). Domestic manufacturing demand, calculated as the sum of domestic manufacturing output plus net manufactured imports into Australia (i.e., imports minus exports), for manufactured goods has increased over the previous decade by approximately, 4.4 per cent (see Figure 12).

Overall, the manufacturing industry is facing increasing competition at home through greater international integration. Imports of manufactured goods have increased by 7.0 per cent over the previous decade (see Figure 13), while manufacturers have found export markets for their goods, increasing by 4.5 per cent over the previous decade (see Figure 13).

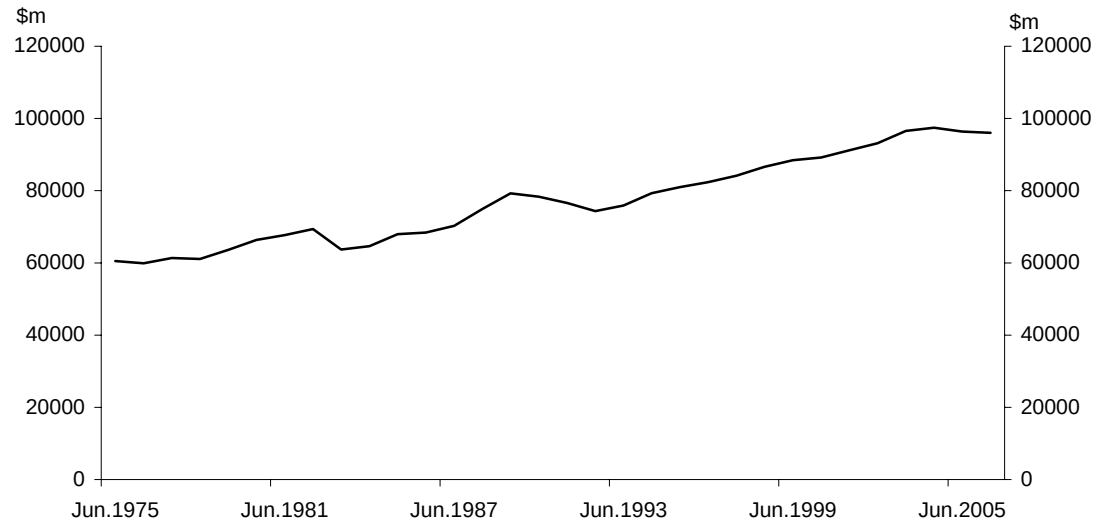
The resulting reforms from the liberalisation of trade has seen Australia's trade intensity (the ratio of exports plus imports to GDP) rise from 27 per cent in the mid 1980s to

**Figure 8**
**Real Unit Labour Costs and Real Export Weighted Index**




Source: Department of Treasury, *Unit Labour Costs Overview*, Quarterly and RBA, *Real Exchange Rate Indices*, Updated Quarterly.

**Figure 9**
**Manufacturing Gross Value Added**




Source: *Australian System of National Accounts*, Cat. No. 5206.0, March 2006, ABS Canberra.

44 per cent in 2003.[5]

The shortfall between increasing demand for manufactured goods and domestically produced manufacturers has been filled by imports. Australian consumers are still demanding clothing and other types of products, however, the largest source of supply is China.

Australian manufacturers have not been fully exposed to declining demand in Australia as exports have provided new markets for development. That is, while the proportion of manufactured goods bought domestically are less likely to be manufactured in Australia, buying a manufactured good overseas is more likely to be produced in Australia.

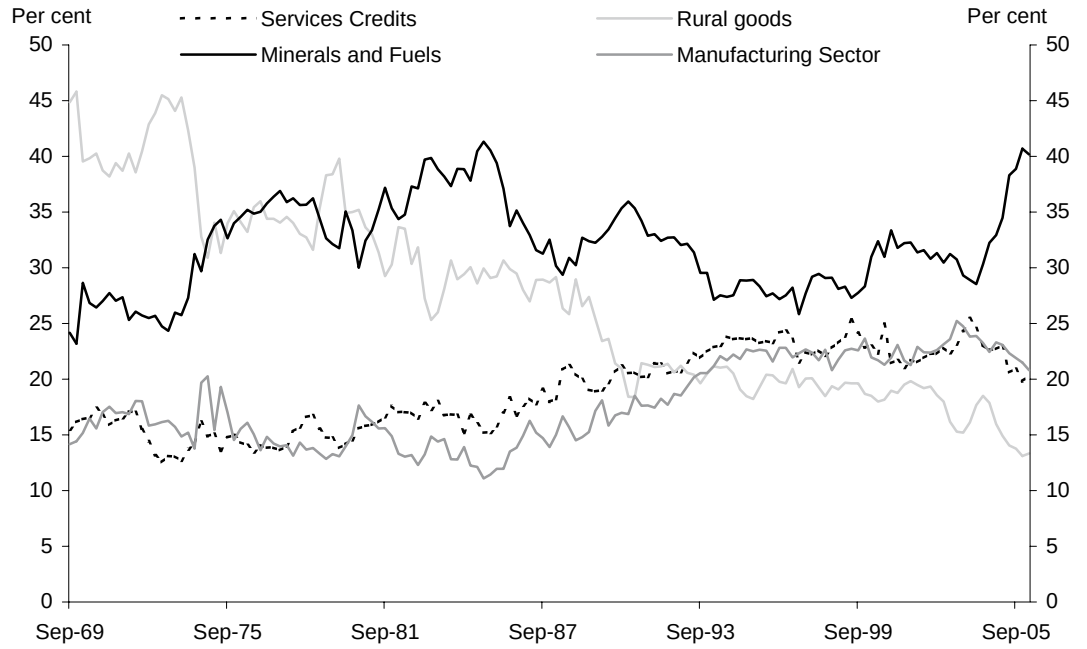
Therefore, while Australians may not be buying as many Australian made products as previously, the rest of the world is.

However, measuring domestic demand for manufactured goods, as a proportion of GDP, indicates that demand has remained relatively stable over the past decade (see Figure 14). The data in Figure 13 shows that domestic demand for manufactured goods has fluctuated between 18.0 to 19.5 per cent of GDP.

While consumer demand has been declining as a share of expenditure, domestic demand is nevertheless increasing. Further, investment by businesses in new machinery as a proportion of GDP has been increasing, particularly over the previous three years (see Figure 15).

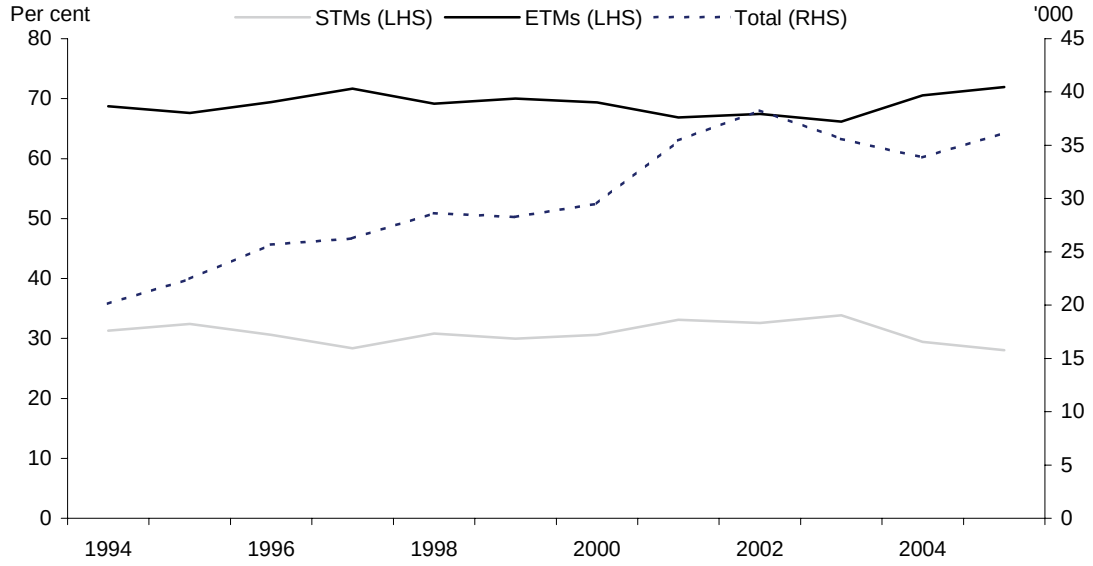
5 Productivity Commission, 2005, *Review of National Competition Policy Reforms*, p 44.

**Figure 10**
**Proportion of Exports by Sector**




Source: Australian Bureau of Statistics, *Balance of Payments and International Investment Position*, Cat. No. 5302.0, March Quarter 2006.

**Figure 11**
**Australia's Merchandise Trade by ETM and STM as a Proportion of Total Trade**




Source: Department of Foreign Affairs and Trade, *Exports of Primary and Manufactured Products*, Various issues, DFAT Canberra.

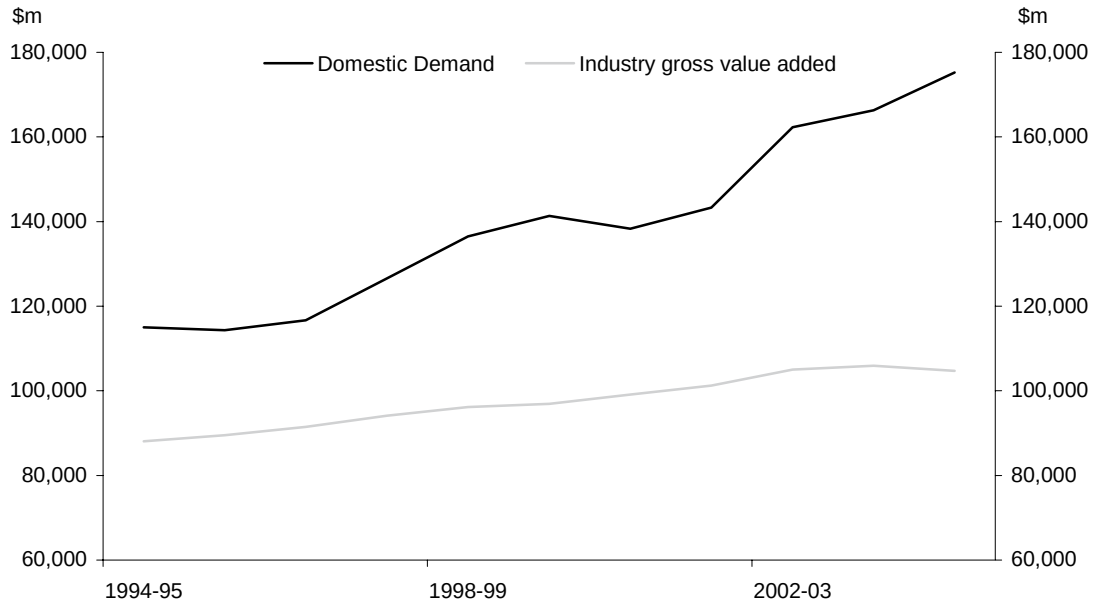
This may indicate that the manufacturing sector is more geared towards producing goods for the domestic production process rather than the domestic consumption. The fortunes of Australia's domestic manufacturing sector may be more tied to Australia's investment cycle than its consumption cycle.

At present Australia is experiencing strong investment in the minerals sectors which may be helping to keep manufacturing more competitive and financially secure.

Manufacturing's rising share of export while declining share of output is a pattern repeated throughout the OECD:

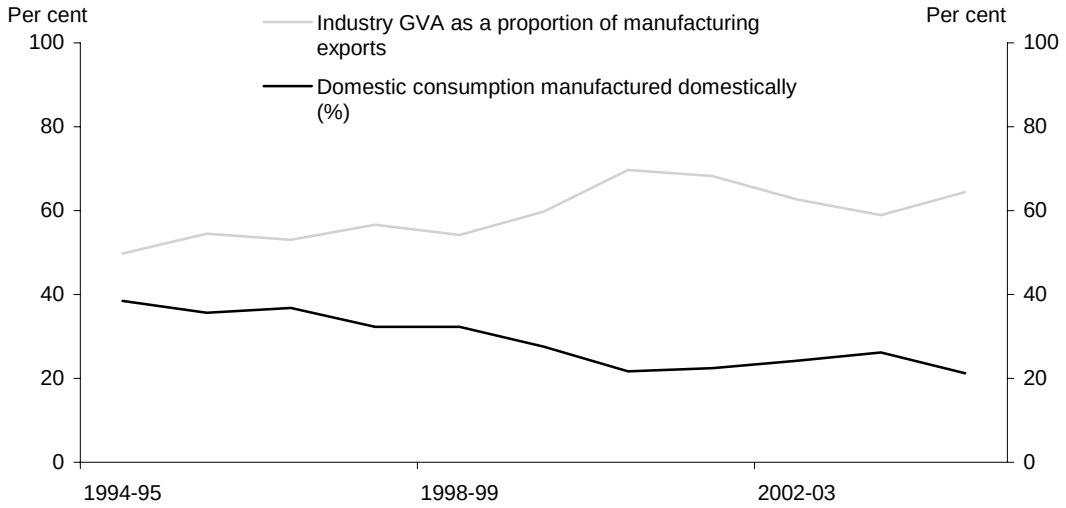
> During the past 30 years, almost all developed countries have experienced increases in manufacturing exports as a share of GDP. Figure 1 shows that, among 22 OECD countries, only one has experienced a decrease. For the OECD overall, the manufacturing export share of GDP rose at an annual rate of 1.4 percent per year between 1970 and 1998. Figure 1 also shows, however, that during the same period, all but three countries have experienced

**Figure 12**
**Domestic Demand for Manufactured Goods and Production of Manufactured Goods**




Source: Australian Bureau of Statistic, *Manufacturing Indicators*, Cat. No. 8229.0, Australia, March 2006.

**Figure 13**
**Industry GVA as a Proportion of Manufacturing Exports and Domestic Consumption as a Proportion of Domestically Produced Manufactures**




Source: Australian Bureau of Statistic, *Manufacturing Indicators*, Cat. No. 8229.0, Australia, March 2006.

declines in manufacturing value-added as a share of GDP. Again, for the OECD overall, this share declined at a rate of 1.3 percent per year.[6]

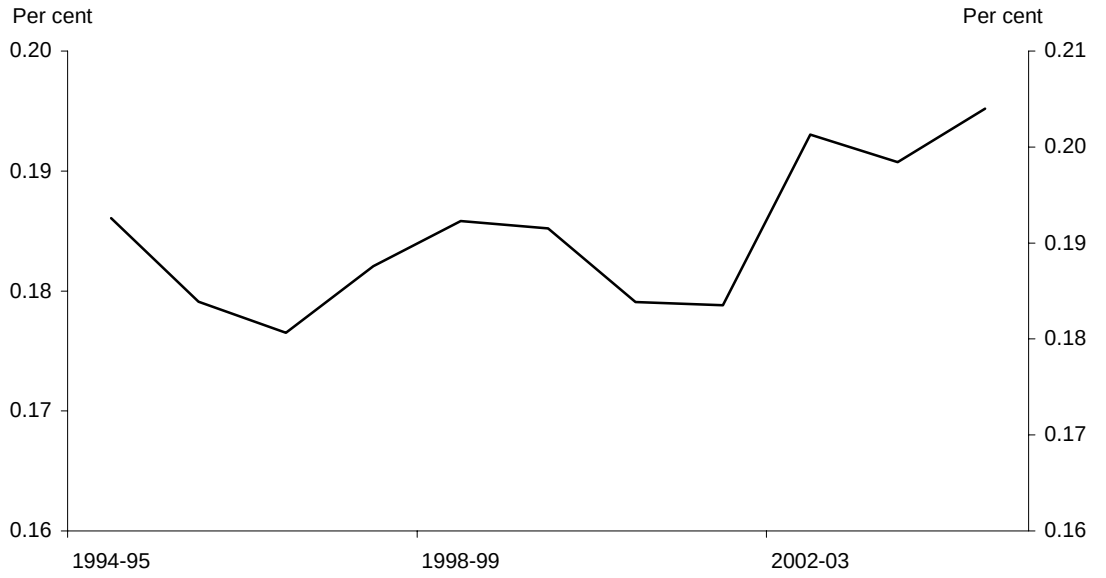
The redirection of national manufacturing output from domestic to international markets may have a number of explanations. One such position put forward is the increasing incidence of multiple boarder crossings for goods which are transformed in different countries along its production chain.

> We conclude by suggesting an additional propagation mechanism, vertical specialization. We mean the phenomenon by which countries increasingly specialize in producing only particular stages of a good's production sequence so that a good crosses multiple borders while in process. Recent research has shown that this phenomenon is increasingly empirically important.[7]

6 Raphael Bergoeing, et al., (2004), *Why is Manufacturing Trade Rising Even as Manufacturing Output is Falling?* Paper prepared for presentation at the American Economics Association Meeting Session "Dissecting International Trade: The Dimensions of National Market Penetration", San Diego, January 4, 2004.

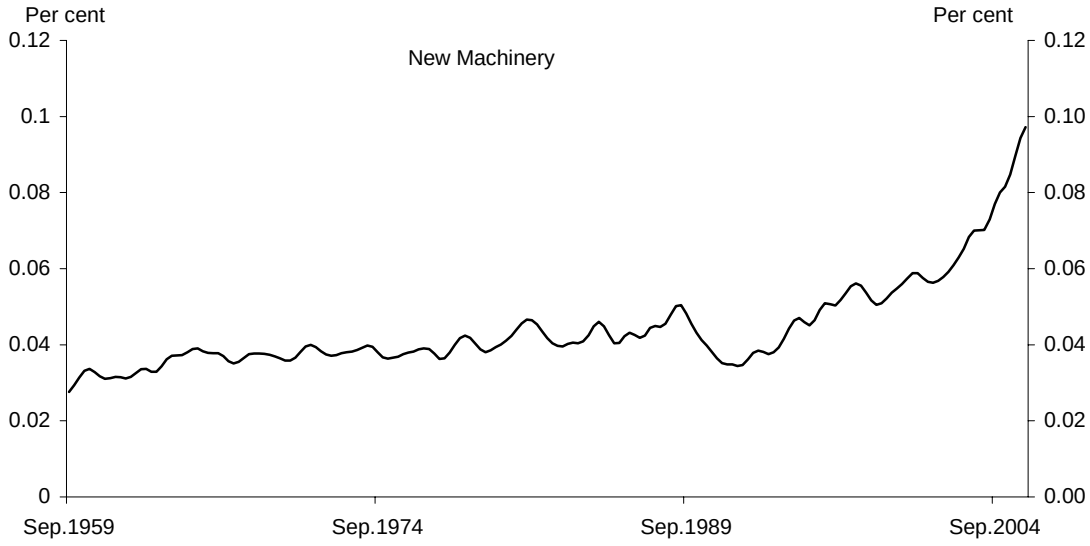
7 Ibid.

**Figure 14**
**Domestic Demand for Manufactures as a Share of GDP**




Source: Australian Bureau of Statistic, *Manufacturing Indicators*, Cat. No. 8229.0, Australia, March 2006 and *Australian System of National Accounts*, Cat. No. 5206.0, March 2006, ABS Canberra.

**Figure 15**
**New Machinery Investment as a Share of GDP**




Source: *Australian System of National Accounts*, Cat. No. 5206.0, March 2006, ABS Canberra.

It is important that we understand the forces being applied to the manufacturing sector before implementing policies that are costly and may be soon outdated and inappropriate in the event of change to international and domestic circumstances.

## EXPLAINING THE RELATIVE DECLINE OF MANUFACTURING

Import competition from low cost economies such as China and India has largely replaced Australia's labour intensive and low skilled industries as sources of consumer goods. A PC paper[8] on manufacturing identified a number of potential sources for the relative decline of manufacturing including changes in preferences, changes in measurements of manufacturing, shifting trade patterns and relative price changes.

### Changes in Consumer Demand

Growth in disposable income can lead to higher consumption of services, such as health and financial advice, relative to manufactured goods. This decline in share of

8 See Productivity Commission (2003), *Trends in Australian Manufacturing*, Commission Research Paper, Aus Info.

consumer spending directed towards manufactured goods has occurred in much of the industrialised world. As noted by the PC:

> The broad pattern indicated by the household expenditure data suggests that shifting consumer preferences are likely to be the most important determinant of the relative decline of manufacturing output and the growing ascendancy of services.[9] This is not an adverse phenomenon — meeting people's preferences makes Australia better off. This underlines why the diminishing share of manufacturing in the economy is largely a positive for Australia, rather than a problem (see Figure 16).[10]

Furthermore, as incomes have increased consumers are more likely to purchase luxury goods and as such spend a higher proportion of their income on those goods. As noted in a Treasury *Economic Roundup*:

> Many imported consumer goods are luxury items such as prestige motor vehicles. As incomes increase, consumers spend a higher proportion of their income on such luxury goods, and hence on these types of imported goods. Accordingly, most estimates of the 'income elasticity of imports' are greater than 1. The short-run elasticity could be higher than the long-run elasticity if a surge in demand is temporarily met by imports, due to either physical capacity constraints or high costs of sharply increasing production.[11]

Domestic manufacturers are facing pressure from both a declining share of consumer expenditure and a substitution into goods that are generally produced internationally. The manufacturing sector is also facing other changes in preference where consumers are more likely to purchase imported goods:

> Consumers may now prefer more imported goods, either because of an increased interest in diversity, more cosmopolitan tastes (immigration from non-Anglo-Saxon cultures may be adding to this) or demands for new goods (for example, plasma TV screens and mobile phones) that are not (yet) made domestically. Krugman (1989) has stressed the importance of new goods ('product proliferation') in the growth of GDP and the faster growth of imports.[12]

The effect on the manufacturing sector of changes to consumer preferences and incomes are natural economic cycles and do not represent failure on the part of manufacturers. However, in order to continue trading manufacturers must change the way they operate and see the market.

## Changes in Measurement

The increasing importance of the services sector can be partly explained by the increasing use of outsourcing by the manufacturing sector. This shift in the measurement of manufacturing overstates the decline experienced by particular economies as manufacturers increasingly rely on, and exploit, telecommunications, business and computer services. These are industries that have grown strongly over the past decade.

> By the mid-1990s the amount of services embodied in one unit of final demand for manufactured goods was significantly higher than in the early 1970s for all ten countries covered (see Figure 17).[13]

The increasing use of services embodied in the manufacturing process, previously measured under manufacturing, is now captured in services accounts. Some decline in the manufacturing industry is therefore illusory shifts in firm's boundaries rather than output.[14]

## International Competition

The decline of manufacturing as a proportion of GDP can also be explained by greater international competition by low wage cost countries. Declines in labour intensive industry within the manufacturing sector, such as textile, clothing and footwear are primarily victims of developing countries' cost advantage. As noted by the PC:

> One of the pressures on manufacturing in developed countries (the 'North') has been the expansion of trade in manufactures, especially labour intensive manufactures

9 Unfortunately, it is not possible to directly relate changes in the shares of household expenditure accounted for by manufactured goods to changes in the share of manufacturing in real GDP. This is because household consumption includes imported goods (while production includes exports). It also reflects the fact that household expenditures are final goods, whereas, at the production level, sectors often provide inputs to other sectors.

10 See Productivity Commission (2003), *Trends in Australian Manufacturing*, Commission Research Paper, Aus Info.

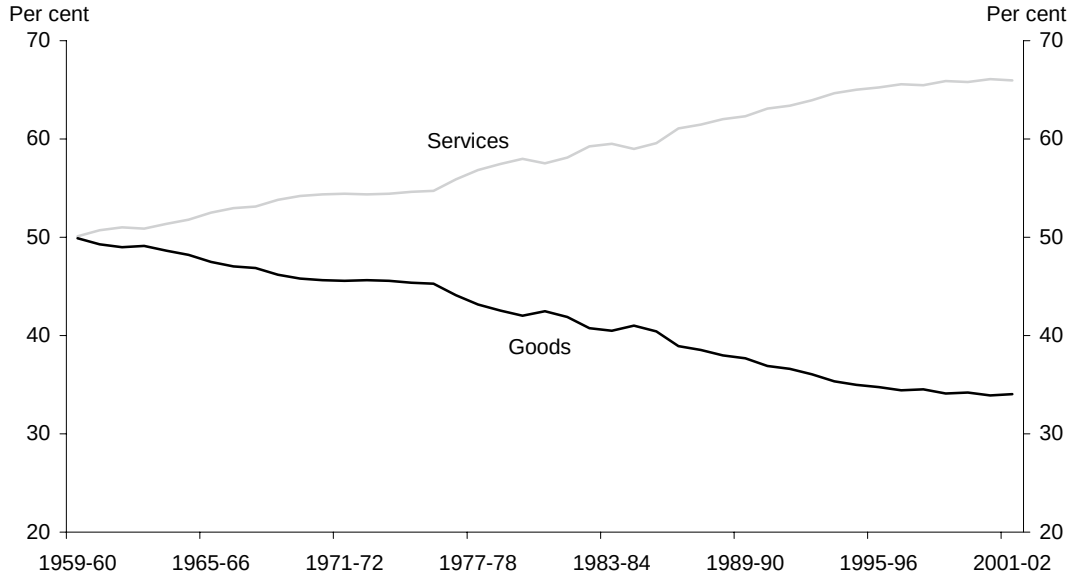
11 Deborah Dark, John Hawkins (2005), Why have Australia's imports of goods increased so much? *Economic Roundup Summer 2004/05*, Treasury, Canberra.

12 Ibid.

13 OECD, *OECD Science, Technology and Industry Scoreboard 2003 – Towards a knowledge based economy, Productivity and Economic Structures*, OECD Paris 2003.

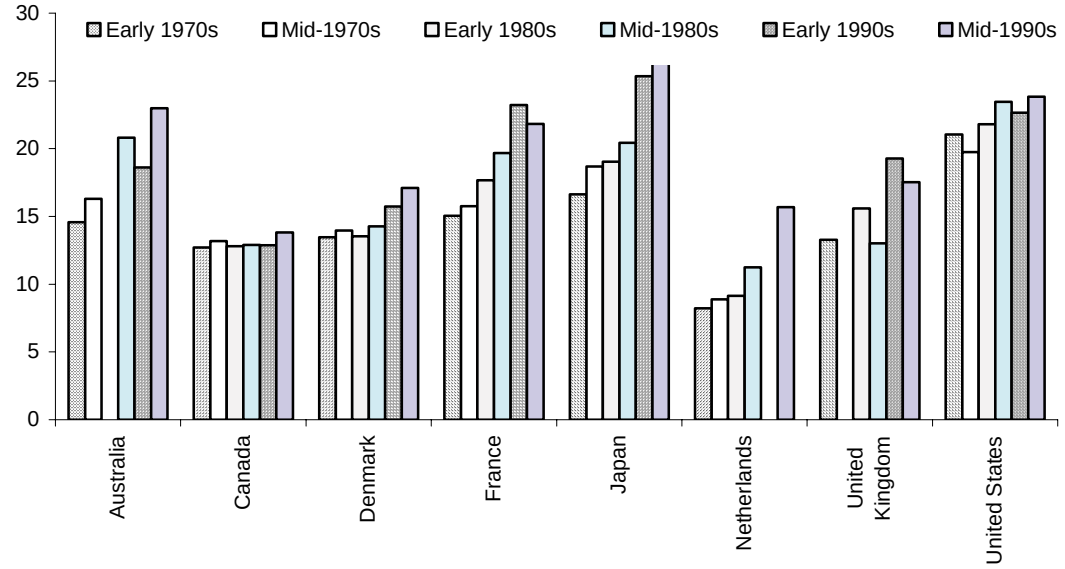
14 Productivity Commission, 2003, *Trends in Australian Manufacturing*, Commission Research Paper, AusInfo.

**Figure 16**
**Share of Consumer Expenditure Accounted for by Goods and Services[a]**




Source: Ibid.
a: Calculations derived from PC (2003) Report. The definition of goods are food, alcohol and tobacco, clothing and footwear, furnishings and household equipment, purchase of vehicles, goods for recreation and culture, books, papers, stationary and artists' goods and personal effects. Constant price data for the last three categories are not available prior to 1985 86. The price index for these goods was imputed on the basis of movements in the aggregate price index for prior years, and a constant price series derived for the remaining years. Services are defined as residual consumption expenditure.
Data source: ABS, *Australian System of National Accounts*, 2001 02, Cat. No. 5204.0.

**Figure 17**
**Services Sector Value-Added Embodied in Manufactured Goods, Percentage of Total Value of Manufactured Goods in Final Demand**




Source: OECD, *OECD Science, Technology and Industry Scoreboard 2003 – Towards a knowledge based economy, Productivity and Economic Structures*, OECD Paris 2003.

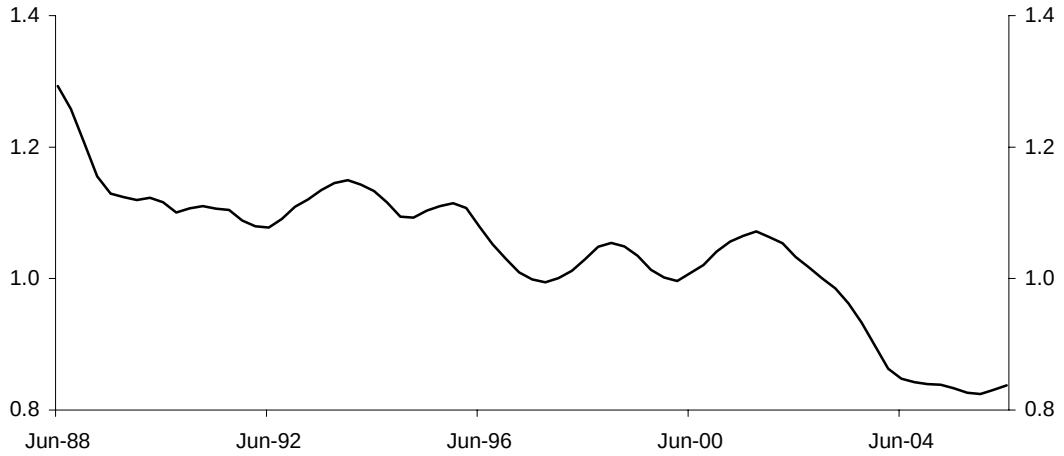
exported by low wage developing economies (the 'South') (Wood 1994). This reduces output of such manufactures in developed economies.[15]

Australian manufacturers have seen prices of imported goods relative to the price of domestic goods declining sharply of recent years (see Figure 18) as noted by Treasury in the Treasury *Economic Roundup*:

> Looking at medium-term trends, while the trade-weighted exchange rate index is now close to where it was in the early 1990s, the relative price of imports has dropped by a third over this period. Part of this reflects continual price

15 Ibid p 36.

**Figure 18**
**Relative Price of Imported Goods to Domestic Goods**




Source: *Australian System of National Accounts*, Cat. No. 5206.0, June 2006, ABS Canberra.

> declines of computers and telecommunication devices; […], these account for about a tenth of imported goods and their prices — particularly once adjusted for quality improvements — have fallen markedly.[16]

The lesson from this is that Australia's manufacturing must move up the value added chain and produce niche products. Therefore, increasingly, Australian manufacturers are moving away from the goods in which China and India are competitive.

## Offshoring

Increasing international trade has seen business moving offshore in order to remain internationally competitive. For business, the motivation for offshoring is reasonably straightforward - a drive to sustain and improve competitiveness and shareholder value through better management of costs and of quality.

Companies engaged in offshoring are able to achieve better management of costs by seeking out lower cost locations, consolidating operations and lowering the costs of infrastructure, training and management.

Research commissioned by the United Nations Conference on Trade and Development (UNCTAD) has found the overwhelming majority of European multinational companies have been able to realise cost savings from offshoring of between 20 and 40 per cent.

Australian manufacturing businesses and consumers stand to gain considerable benefits from the offshoring of the supply of some services. For business, offshoring can mean better cost management and improved competitiveness, while for consumers it can mean lower prices. Fear campaigns that equate offshoring to lost jobs are misguided and are often motivated by protectionist agendas that seek to lock Australia into the past and impede our capacity to capture the gains from freer world trade.

Offshoring provides benefits to both home and host countries. Home countries benefit through improvements in competitiveness, greater adaptability and productivity and superior trade performance. For many companies, offshoring is undertaken to enhance the competitiveness of the enterprise through better cost management and/or improvements in quality and delivery.

Furthermore, consumers in the home country also stand to benefit from offshoring, most prominently through lower prices.

Research by the respected Institute for International Economics has found that the global outsourcing of components has reduced the cost of information technology hardware by almost 30 per cent over the last decade - cost savings which have been passed on to consumers.

A common theme of critics of offshoring is that such activities cost jobs in the home country – they are being exported to developing nations. In reality, jobs created in host countries do not equal jobs lost in home countries.

Many of the jobs created offshore would not necessarily have been realised in the home country, reflecting the relative cost differentials; such jobs are often regarded as low prestige or undesirable jobs in developed countries,

16 Deborah Dark, John Hawkins, 2005, *Why have Australia's imports of goods increased so much? Economic Roundup Summer 2004/05*, Treasury, Canberra.

yet highly attractive and much sought after in developing countries.

Rather, many of the jobs offshored to developing countries are only really viable and sustainable in those lower labour cost environments and most likely would not exist in developed countries with higher labour costs and more regulated labour markets.

It is important that policy makers recognise that Australian manufacturing is not just taking place in Australia but is taking place internationally, however, it is difficult to estimate the amount of Australian manufacturing taking place overseas.

## GLOBAL OPPORTUNITIES

The proportion of foreign invested and export oriented trade can distort trade deficit figures between countries.

While much debate has taken place on the rise of China as an exporter of low technology products and its climb up the value added chain, figures indicate that at least half of China's exports are from foreign owned companies – and a higher proportion for high technology exports. This should be viewed as a major opportunity for Australian companies rather than a crisis to be addressed through increased expenditure in one-off taxpayer funded programs.

> In the first half of this year, foreign-invested, export-oriented processing firms generated total foreign trade of $465.3 billion, up 25.8% from a year ago, accounting for 58.5% of China's total.
>
> In comparison, state-owned enterprises posted $195.3 billion in foreign trade, up 11.7%, while private firms' imports and exports rose 34.9% to $135.1 billion.[17]

Furthermore, investing in China provides multinational corporations access to a large and growing consumer market. Companies located in China may sell a large proportion of their goods to the Chinese domestic market rather than exporting.

In some areas of China, particularly Shenzhen, factories are experiencing a shortage of skilled workers and are forced to pay high wages in accordance. This is a problem very familiar to Australian employers. It is difficult to know the extent or severity of any labour shortage but it reflects the fact that countries experience many of the same problems faced by domestic companies.

Interestingly, the *Global Competitiveness Report 2005-06* (World Economic Forum) has shown China's global competitiveness ranking fall, from 33rd in 2002 to 44th in 2003, 46th in 2004 and 49th in 2005. India was ranked 50th, competing against Australia mainly in services rather than in manufacturing.

A more detailed analysis of Australia's commercial relationships with both China and India respectively can be found in two recent ACCI publications, viz:

- *Riding the Chinese Dragon: Opportunities and Challenges for Australia and the World*, Position Paper, August 2005; and

- *Riding the Indian Elephant: Opportunities and Challenges for Australia and the World*, Position Paper, August 2006.

Both papers are available on ACCI's website swww.acci.asn.au.

What the detailed analysis in these two papers emphasises is that to remain competitive governments must develop efficient regulations, labour markets, improve the workforce's skills and provide the necessary framework for infrastructure development. Governments cannot provide unlimited assistance to all sectors of the economy.

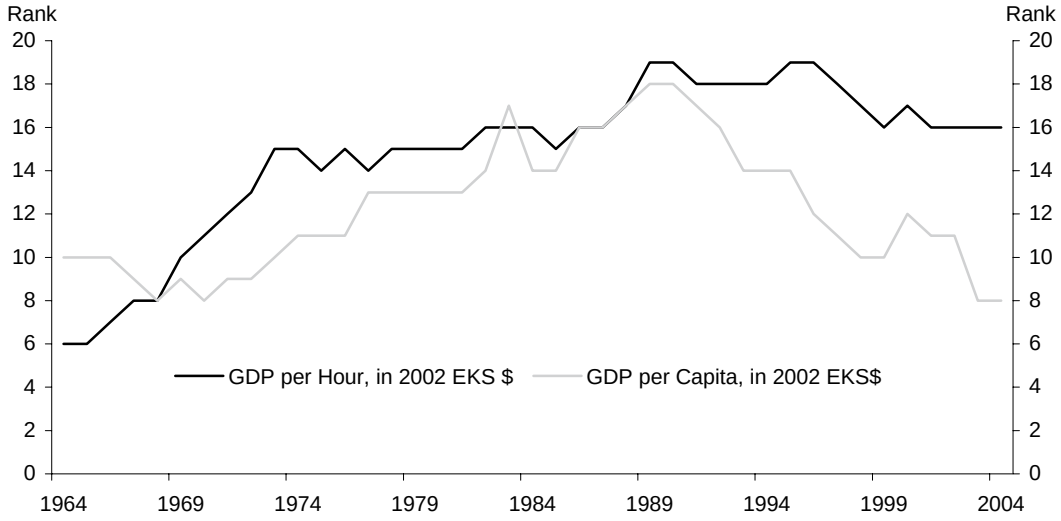
## IMPORTANCE OF CONTINUING REFORMS

Manufacturing still accounts for a substantial component of the Australian economy, therefore any improvement in government policies will have substantial flow-on effects for welfare. Over the past ten years Australia has compared more favourably with other nations in terms of GDP per head and GDP per hour worked (see Figure 19). Widespread reforms in the 1980s and 1990s have propelled employment and living standards to heights not seen for many decades.

Irrespective of the effect on certain sectors of the economy, economic reform has provided widespread and significant benefits. A PC study entitled *Review of National Competition Policy* (NCP) *Reform* identified benefits, just from NCP, of approximately $20 billion or $1000 per person. The report also notes this figure does not include dynamic efficiency gains. This provides strong and valid evidence

17 Online Asia Times, China Business, July 26 2006, accessed 31 August 2006. http://www.atimes.com/atimes/China_Business/HG26Cb01.html. Also see Sanja Lall and Manuel Albaladejo, "China Competitive Performance: A threat to East Asian Manufactured Exports?", *World Development* Vol. 32, No. 9, pp. 1441–1466, 2004.

**Figure 19**
**GDP Per Hour and GDP Per Capita**




Source: Groningen Growth and Development Centre and The Conference Board, *Total Economy Database*, August 2005.

for continuing down the reform path where the economy is efficient, flexible and dynamic.

As we see from suvey results from manufacturing companies later in this paper, providing the manufacturing sector with efficient industrial relations, taxation, skills and regulation environments should be seen as a priority for improving Australia's international competitiveness. This allows producers to most efficiently deal with an adverse operating environment of any nature.

While the present operating environment experienced by manufacturers may encourage some to argue for specific policy responses, it is the overall economic framework that will create efficient markets and provide the necessary incentives to invest and innovate.

# Chapter 3
# The Dutch Disease and Manufacturing




# THE DUTCH DISEASE AND MANUFACTURING

## WHAT IS THE DUTCH DISEASE?

The term 'Dutch Disease' was coined in the late 1970s after economists identified a link between the discovery of large deposits of natural gas in the Netherlands and the decline of the manufacturing sector.

The theory postulates that due to the resources boom, in the Dutch case it was the discovery of natural gas fields, the domestic currency appreciates due to increased export sales. This then adversely affects other, non-resource exporters. Additionally, the resources boom attracts scarce inputs to production such as labour and capital away from other sectors thus creating a double-whammy impact.

Applied to the current Australian context, large inflows of foreign capital due to the current mining boom cause the real exchange rate of the Australian dollar to appreciate reducing the competitiveness of Australia's exports and increasing imports.

## DOES AUSTRALIA HAVE THE DUTCH DISEASE?

The Australian resources sector today is experiencing a boom in demand for its products, particularly from China, India and Japan. Further we are seeing resources such as labour being channelled away from the manufacturing, services and agricultural exporting sectors towards the mining sector (the resource movement effect). However, given the capital-intensive nature of Australia's mining industry, labour movements away from other sectors of economy are less acute.

Furthermore, additional income (real net national disposable income) which grew by 4.4 per cent over the year to March compared with growth of 2.8 per cent in GDP increases expenditure on domestic non-traded goods (spending effect) increasing the demand for labour in the non-traded sector again pulling resources from manufacturing. Both these effects lead to the reallocation of resources from the high-tech services and manufacturing industry to the mining industry.

However this is not a zero sum game. The competitiveness of the manufacturing sector may be helped to some degree by a higher exchange rate due to many of the inputs used to produce manufactured goods being imported. As the exchange rate appreciates, those production costs fall (see Figure 20). Of particular benefit is declining information, communication and technology (ICT) prices which add to productivity. ICT imports can boost Australia's manufacturing sector by increasing its competitiveness.

The pass through effect of a higher exchange on investment in the manufacturing sector also has implications for future growth and competitiveness. Changes in the exchange rate affect investment through three conduits including profits of exporting firms, input costs of production and prices of imports.

Firms that are highly dependent on inputs will be able to invest relatively more following an exchange rate appreciation. While industries that face greater competition will not be able to absorb the exchange rate rise as easily.

One study[18] of the effect of a higher exchange rate on total manufacturing investment estimated that a 10 per cent real appreciation of the Australian dollar lowered investment on average by 8.0 per cent through the export channel and increased investment by 3.8 per cent on average through the imported inputs channel (see Figure 21) in the short run.

## WHAT TO DO ABOUT THE DUTCH DISEASE

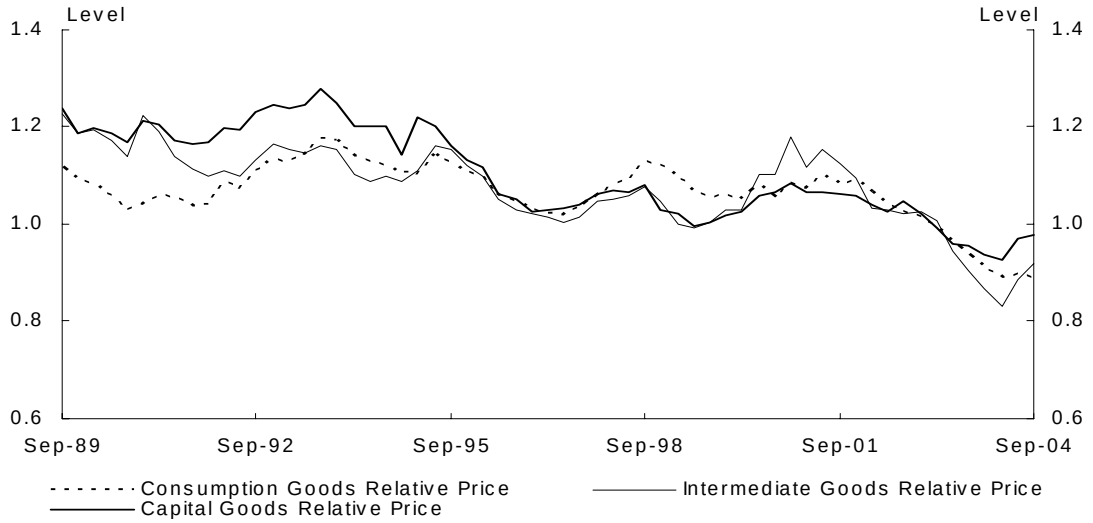
Any policy response will depend on whether the increase in wealth is transitory or permanent. However, determining the length of the current terms of trade shock is difficult, implying policy makers run the risk of misjudging the nature of the current cycle.

If the resulting increase in wealth is transitory some have called for policies that keep the value of the domestic currency lower than it otherwise would have been, by intervening in the foreign exchange market. If the increase in wealth is considered permanent then industries will need to become more productive either through increases in training or reducing regulation and taxation.

ACCI supports the setting of the exchange rate by the market and not through Government or the Reserve

18 Robyn Swift, "Measuring the Effects of Exchange Rate Changes on Investment in Australian Manufacturing Industry", *Economic Record*, Vol 82, September 2006.

**Figure 20**
**Relative Price of Imported Goods**




Source: Deborah Dark, John Hawkins (2005), "Why have Australia's imports of goods increased so much?", *Economic Roundup Summer 2004/05*, Treasury, Canberra.
Definitions: The relative prices are derived by dividing the import price by the domestic price for each category.

**Figure 21**
**Estimated Effects of a 10 Per Cent Appreciation of the AUD on Investment in Australian Manufacturing Industries**

| Industry (ANZSIZ code) | | Total Investment | | Investment in Equipment, Plant and Machinery | |
|---|---|---|---|---|---|
| | | Export Channel | Imported Input Channel | Export Channel | Imported Input Channel |
| | | % | % | % | % |
| Div. C: Total Manufacturing | | -8 | 3.8 | -7.3 | 3.1 |
| *Subdivisions* | | | | | |
| 21 | Food, beverages and tobacco manufacturing | -8.9 | 1.5 | -8.1 | 1.2 |
| 22 | Textile, clothing, footwear and leather manufacturing | -8.3 | 4.4 | -7.5 | 3.6 |
| 23 | Wood and paper product manufacturing | -2.7 | 2.7 | -2.5 | 2.2 |
| 24 | Printing, publication and recording data | -1 | 2.2 | -0.9 | 1.8 |
| 25 | Petroleum, coal and chemical manufacturing | -5.1 | 5 | -4.6 | 4 |
| 26 | Non-metallic mineral product manufacturing | -1 | 1.5 | -0.9 | 1.2 |
| 27 | Metal product manufacturing | -16.7 | 3.3 | -15.1 | 2.6 |
| 28 | Machinery and equipment manufacturing | -8.9 | 7 | -8 | 5.6 |
| 29 | Other manufacturing | -4.8 | 3.6 | -4.3 | 2.9 |

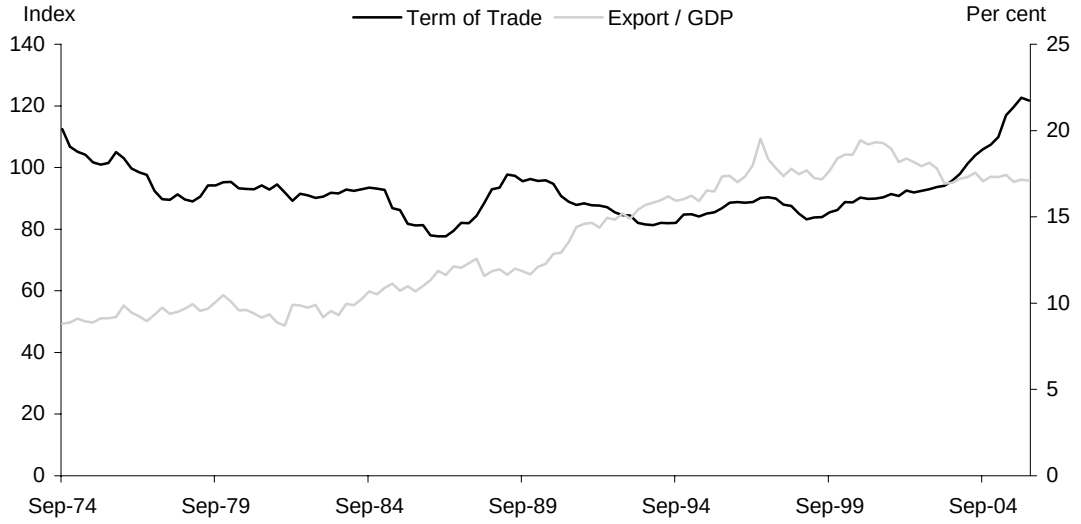
Source: Robyn Swift, "Measuring the Effects of Exchange Rate Changes on Investment in Australian Manufacturing Industry", *Economic Record*, Vol 82, September 2006.
Note: The estimates are calculated using period averages of export share, imported input shares and mark-ups for each industry, combined with the relevant coefficients from Table 1.

Bank of Australia (RBA) intervention. The benefits to the Australian economy caused by the change from a fixed to a floating exchange rate in 1983 are clear and any return to a fixed or managed float would be harmful to the Australian economy.

Even in the absence of an exchange rate appreciation, the manufacturing sector would have difficulty in maintaining its current hold on the resources of the economy as noted by Ken Henry[19]:

19 Ken Henry (2006), *The Fiscal and Economic Outlook*, Address to the Australian Business Economist, Sydney, 16 May.

**Figure 22**
**Terms of Trade and Exports as a Proportion of GDP**




Source: RBA, *Statistical Bulletin*, G10 Gross Domestic Product, RBA, Statistical Bulletin, H03 Exports and Imports of Goods and Services.

> Many Australian manufacturers would be thinking that the reason they are feeling the squeeze from our higher terms of trade is that the exchange rate has appreciated. But even if the exchange rate were not to appreciate, they would eventually feel the squeeze because they would find it increasingly difficult over time to compete with the construction and resources sectors for the economy's factors of production.

While exports as a proportion of GDP have fallen in recent years it is difficult to attribute all of the reduction to the mining sector crowding out non-mining exports (see Figure 22). Much of the decline in exports can be explained by the drought and subsequent fall in rural exports.

As stated previously it is difficult to forecast the period over which the terms of trade will continue to exert a positive effect on Australia's income and a drain on the competitiveness of our manufacturing export industries. In fact, the non-resources sector of the Dutch economy recovered reasonably quickly, after suffering from the early to mid sixties from the discovery of oil and gas.

It is argued that volatile markets increase uncertainty tending to hurt exporters and foreign investment. 'Dutch Disease' is said to increase the volatility of exchange rates. While Australia experienced some volatility after the dollar floated Australia now has a mature foreign exchange market. In fact, the dollar is less volatile than many other currencies and assets. Volatility does not appear to be a problem in Australia's case.

"Dutch disease" is also said by some economists to cause lower productivity growth because the non-traded services sectors productivity is constrained by the nature of work (i.e. deindustrialisation, or reduction in the manufacturing sectors share of the economy, leads to lower overall productivity growth for the nation). Nonetheless, in Australia's case many service sectors have experienced higher productivity growth since the mid 70's than the manufacturing sector (see Figure 23).

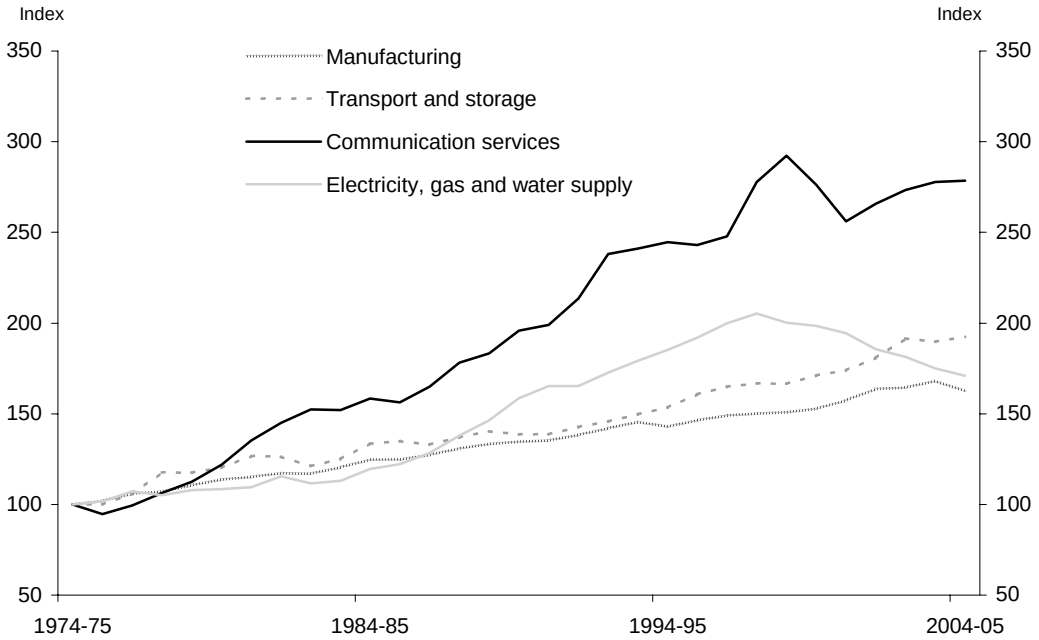
The PC has noted:

> The shift to services may not therefore have adverse implications for overall productivity performance. Greenhalgh and Gregory (1998) have reached similar conclusions about the UK — indicating that assumptions based on assuming uniformly poor productivity performance in services are not borne out by the evidence.

While the Australian manufacturing sector is facing a difficult trading environment it does not mean that deindustrialisation (identified as symptom of 'Dutch disease') is having a negative effect on Australia's welfare or that Australia is losing ground in areas where it has a comparative advantage in manufacturing. In fact, as noted in the last chapter, while manufacturing as a proportion of GDP and the labour force has been declining in relative terms, output has been increasing. Australia has also sustained 15 years of economic growth and remains one of the worlds best performing economies.

Many developed countries while experiencing a decline in the relative importance of the manufacturing sector

**Figure 23**
**Multifactor Productivity**




Source: Productivity Commission, 2006, *Productivity Estimates to 2004-05*, March.

have continued to experience strong rates of growth as investment in R&D continues. It is not immediately obvious that strong economic growth requires that manufacturing plays such an important role in the economy as it did previously. Economic structures of countries change over time and this should not be seen as creating a problem that needs to be solved. As noted by the PC:

> Australia is also typical of other high income countries in that most economic growth is accounted for by growth in the services sector, rather than manufacturing.[20] Generally, the richer the country, the more that the service sector dominates economic growth […] — confirming the pattern found by Quah (1997) using earlier data.
>
> For manufacturing, however, there appears to be no relationship between income per capita and the manufacturing contribution to growth. There are several rich countries (Sweden, Finland, Singapore) where manufacturing has remained a more significant source of economic growth. On the other hand, Australia is one of several high income countries (UK, France, Norway, Netherlands and the US) that have experienced small contributions by manufacturing to economic growth over the last few decades. This pattern dispels the notion that a large manufacturing sector is required for economic prosperity.[21]

Australia does not necessarily require a large manufacturing sector relative to GDP in order to produce high incomes per capita (see Figure 3) but it does require an efficient and competitive manufacturing sector that is supported by appropriate government policies.

20 With an average contribution of 70 per cent among rich countries in the sample described in Figure 3.

21 Productivity Commission (2003), *Trends in Australian Manufacturing*, Commission Research Paper, Aus Info, Australia.

# Chapter 4
# Government Support and Manufacturing

# GOVERNMENT SUPPORT AND MANUFACTURING

## MANUFACTURING ASSISTANCE

Australian industry receives budgetary and taxation assistance totalling $4.6 billion of which $1.8 billion was directed towards the manufacturing sector. Maintaining tariffs is estimated to cost the Australian economy $7.5 billion, and the manufacturing sector accounts for $7.3 billion of that assistance.[22]

Historically, Australian manufacturers produced goods for the domestic market. They operated behind a wall of tariffs and other assistance protecting Australian companies and workers from international competition.

However, over the years the economic consensus has been that developed countries should reduce their tariffs in line with policies highlighting the benefits of liberalising trade.

Providing assistance to industries can be justified for a number of reasons, however, Government programs are not always analysed rigorously. ACCI supports thorough cost/benefit analysis being applied to all government programs and initiatives so as to increase transparency and predictability of funding.

Government assistance due to market failures should be 'targeted' as widely as possible to incorporate all industry sectors. Governments must carefully justify additional assistance to specific industries above those of the general economy.

Raising revenue to fund government outlays is in itself costly. Not only are there direct costs involved in the collection and administration of tax obligations, but there are broader unseen economic costs that result from the distortion of economic decision making. Both may be difficult to measure precisely, but these costs are real, of a substantial magnitude and represent a loss to the economy.

Government must raise revenue in order to redistribute the community's wealth to specific sectors or members of the community. The raising of revenue through taxation, levies and fines imposes economic costs of greater than the revenue raised. Estimates of the shadow price – cost of raising each dollar – is greater than $1 for example:

- Diewert & Lawrance found that taxes on capital in Australia had an efficiency cost of 48 percent in 1994 – in other words, to raise $1.00 from capital taxes effectively costs $1.48 to the economy.[23]

- Feldstein estimated in 1999 that the efficiency cost of the US income tax was around 30%.[24]

- Leibritz and others found that "a 10 percentage point higher tax rate is accompanied by roughly ½ percentage point lower rate of growth."[25]

In fact, estimates range from $1.10 to $1.65.[26]

Including the cost of raising government revenue substantially alters the economic equation in terms of the benefits of assistance and intervention. ACCI believes that on the occasions assistance is required it should be transparent and rigorously costed. Headline figures of manufacturing assistance, given the cost of raising revenue, may seriously understate the economic costs.

## TARIFF ASSISTANCE

Manufacturing receives three-quarters of all its assistance from tariffs. Tariffs on manufactured items can impose significant costs on other sectors of the economy.

As effective tariff protection fell in Australia, accelerated by the 25 per cent general tariff reduction in 1973, the manufacturing sector declined in terms of its share of GDP. Today approximately half of all dutiable items are duty free with the remainder having a 5 per cent general tariff applied (although higher tariffs remain for Textile, Clothing and Footwear (TCF) and Passenger Motor Vehicles (PMV)).[27] Reductions in Australian tariff rates

22 Productivity Commission, 2004, *Trade and Assistance Review 2003-04*, Annual Report Series 2003-04, Productivity Commission, Canberra, April.

23 Diewert & Lawrance, *Deadweight Costs of Capital Taxation in Australia*, University of British Colombia Discussion Paper 1998-01 available at http://www.econ.ubc.ca/dp9801.pdf

24 Feldstein (1999) "Tax Avoidance and the Deadweight Loss of the Income Tax", *Review of Economics and Statistics*, Vol 81, Issue 4 pp. 674 – 680.

25 Leibritz, Thornton & Bibbee, *Taxation & Economic Peformance*, OECD Working Paper 176

26 Paul Kerin, "The Real Cost of Government", *Business Review Weekly*, 1 June 2006.

27 Productivity Commission, 2006, *Trade and Assistance Review 2004-05*, Annual Report Series 2004-05, Productivity Commission, Canberra, April, p3.1.

have not been in isolation, with international average tariff rates for industrial goods in developed countries falling from 40.0 per cent in the 1940's to approximately 4 per cent around 2001 (see Figure 24).

Reductions in tariffs and trade barriers have been supported by the Asia Pacific Economic Cooperation (APEC) initiatives' long term goal of implementing free trade between developed countries by 2010. While Australia has largely phased out tariff barriers (with the exceptions noted above) it has a number of non-tariff barriers such as the foreign investment review board and quarantine arrangements.

Non-tariff barriers restrict the importation of goods and services. Other examples of such barriers can include anti-dumping measures where they are mis-used to defeat trade liberalisation initiatives, such as those under the auspices of the World Trade Organisation.

However, we should note that ACCI considers that the proper application of restrictions such as anti-dumping and quarantine can be legitimate.

## BUDGETARY OUTLAYS

Australia provides assistance to manufacturers through direct and indirect measures including budget outlays and taxation concessions. Industry assistance comprises selective investment incentives, assistance for export marketing and industry specific programs.

Manufacturing accounts for the largest share, 42 per cent, of the initial benefits derived from budgetary assistance (see Figure 25). The total dollar amount of assistance in 2004-05 provided to the manufacturing sector, including budgetary outlays, was $1.8 billion out of approximately $96 billion, or 1.9 per cent, of Gross Value Added (GVA). Budgetary outlays accounted for $770 million of the $1.8 billion.

The level assistance to manufacturing has been steady, in real terms, over 15 years for both budget and tax concessions (see Figure 26).

Manufacturing assistance as a proportion of GVA and dollars per employee has also remained stable over the past decade (see Figure 27). While tariffs have continued to fall other forms of assistance to the manufacturing sector have remained in place.

While assistance to the manufacturing sector has remained stable, it still receives relatively more assistance than other industries (see Figure 28).

Over three decades government policies have been implemented which reduce protection from international competition. Tariff reductions in the manufacturing sector have occurred in concert with or behind that of other developed nations.

A recent PC study[28] noted that as well as being associated with rising business R&D investment, reductions in industry assistance had a highly significant positive impact on productivity.

> In the case of the R&D equations, the positive association between increased R&D investment and reduced industry protection was robust to controlling for Manufacturing's declining share of output. This suggested that the effect was more likely to be competition or incentive effect rather than reflecting a decline in technological opportunities in Manufacturing relative to other industries.[29]

Government must carefully consider whether 'assistance' in the long run does not weaken industry. ACCI recommends that government assistance programs are robustly and consistently analysed to ensure the original intent of the program is achieved.

## TAXATION CONCESSIONS

Taxation concessions account for 57 per cent of total budgetary assistance to manufacturing or $1.0 billion. Major taxation concessions include the Automotive Competitive Investment Scheme (ACIS) and the R&D tax concession (see Figure 29).

Many OECD countries use special taxation concessions both direct and indirect, such as immediate write offs and tax credits and allowances. Internationally Australia provides relatively favourable taxation treatment to both large firms and small and medium firms (SMEs) (see Figure 30).

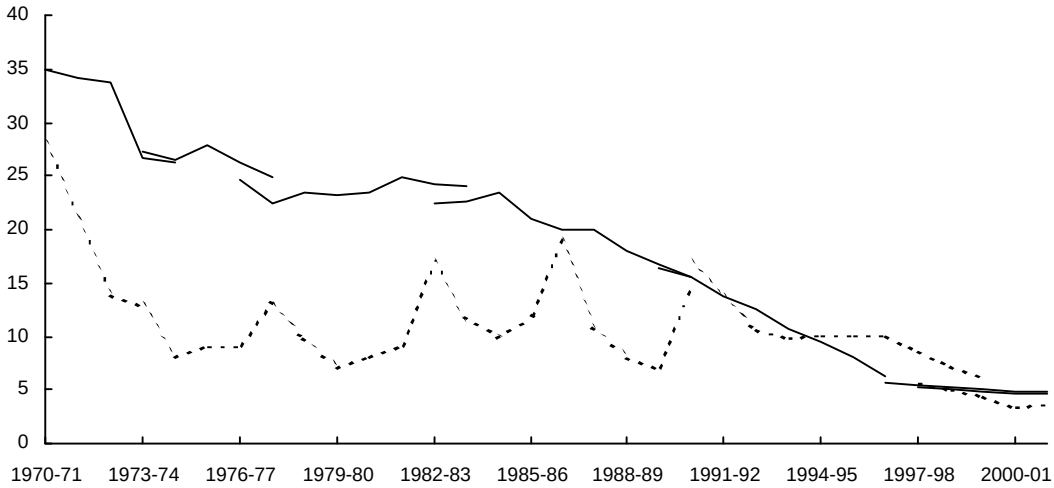
### R&D Support

The importance of innovation as a key driver of economic growth and the role of government in creating an environment in which innovation is fostered are increasingly being recognised by economic theories. The Productivity

28 Shanks, S. and Zheng, S., 2006, *Econometric Modelling of R&D and Australia's Productivity*, Productivity Commission Staff Working Paper, Canberra, April.

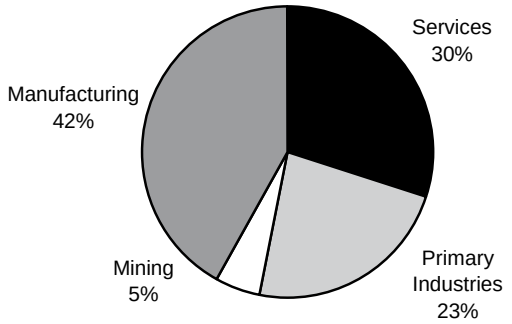
29 Ibid.

**Figure 24**
**Average Effective Rates[a] of Protection to Manufacturing and Assistance to Agriculture[b]**
**1970-71 to 2001-02**




Source: Productivity Commission, 2002, *Trade and Assistance Review 2001-02*, Annual Report Series 2001-02, Productivity Commission, Canberra, April, p3.1.
a: The effective rate of protection/assistance is the dollar value of measured protection/assistance divided by unassisted value added. Breaks in the series reflect the effects of periodic re-benchmarking to new reference data on industry inputs and outputs.
b: The effective rate of protection to manufacturing is not directly comparable with the effective rate of assistance to agriculture, due to differences in coverage, data and methodologies between the two sets of series. Among other things, the manufacturing series measures predominantly tariff and quota assistance (although selected budgetary assistance has been included in some series). The agricultural series measures tariff assistance, most budgetary assistance afforded agriculture and, the main component, assistance provided by domestic regulatory and pricing arrangements.

**Figure 25**
**Budget Assistance by Industry**




Source: Productivity Commission, 2006, *Trade and Assistance Review 2004-05*, Annual Report Series 2004-05, Productivity Commission, Canberra, April, p2.5.
Note: Sectors and industry groupings are not equivalent in size and there can be significant variations in assistance between firms within a sector or industry.

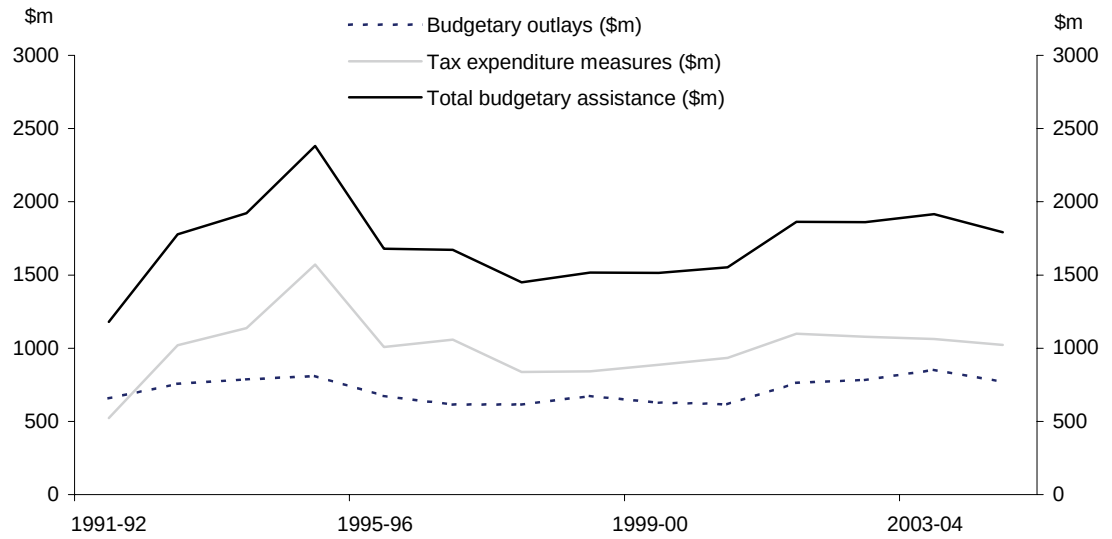
Commission[30] staff report entitled *Economic Modelling of R&D and Australia's Productivity* noted that while R&D does not 'drive' growth any more than other factors, the contribution of domestic R&D and the contribution of overseas R&D to Australian productivity is probably large (if hard to measure).

The Australian Government supports R&D through a number of different taxation and funding arrangements. Government support for the manufacturing sector ranges from the Automotive Competitiveness and Investment Scheme (ACIS) aimed at the automotive sector encouraging high-end R&D investment and the Certain Inputs to Manufacture Scheme (CIMS) providing import duty concessions to certain raw materials, intermediate goods and prescribed metal materials and goods.

The manufacturing sector also has access to more broadly targeted programs such as the 125 per cent R&D tax concession and the 175 per cent Incremental (Premium) Tax Concession and the R&D Tax Offset. Other broad

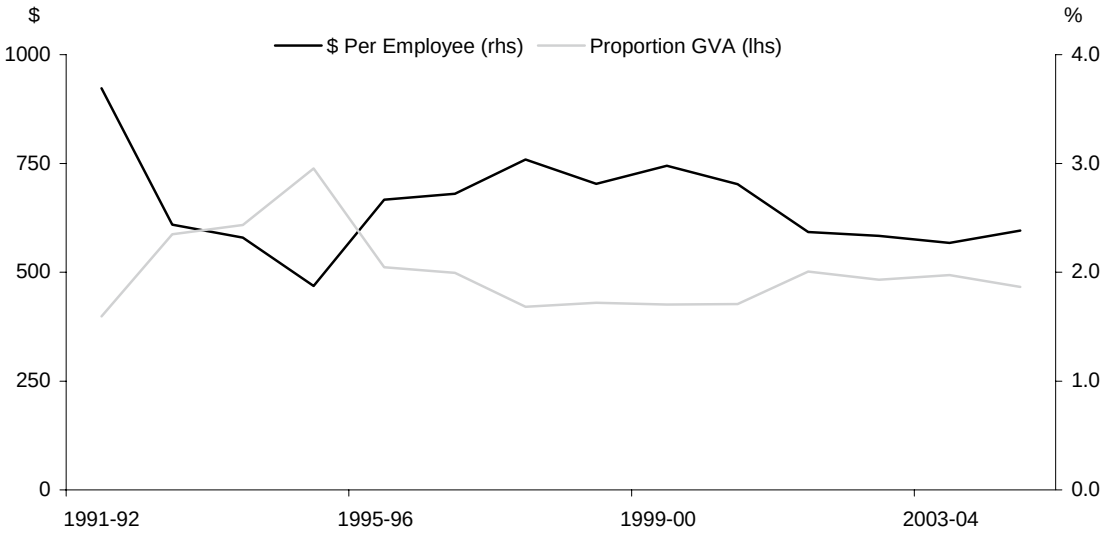
30 Shanks, S. Zheng, S. 2006, *Economic Modelling of R&D and Australia's Productivity*, Productivity Commission Staff Working Paper, Canberra, April.

**Figure 26**
**Total Budgetary Assistance to Manufacturing**




Source: *Australian Manufacturing: A Brief History of Industry Policy and Trade Liberalisation*, Economics, Commerce and Industrial Relations Group and Productivity Commission, *Trade & Assistance Review*, various publications.

**Figure 27**
**Assistance to Manufacturing Sector as a Proportion of Manufacturing GVA and per Employee**




Source: *Australian System of National Accounts*, Cat. No. 5204.0, ABS Canberra and Labour Force, Australia, Detailed, Quarterly, Cat. No. 6291.0.55.033, ABS Canberra, May 2006.

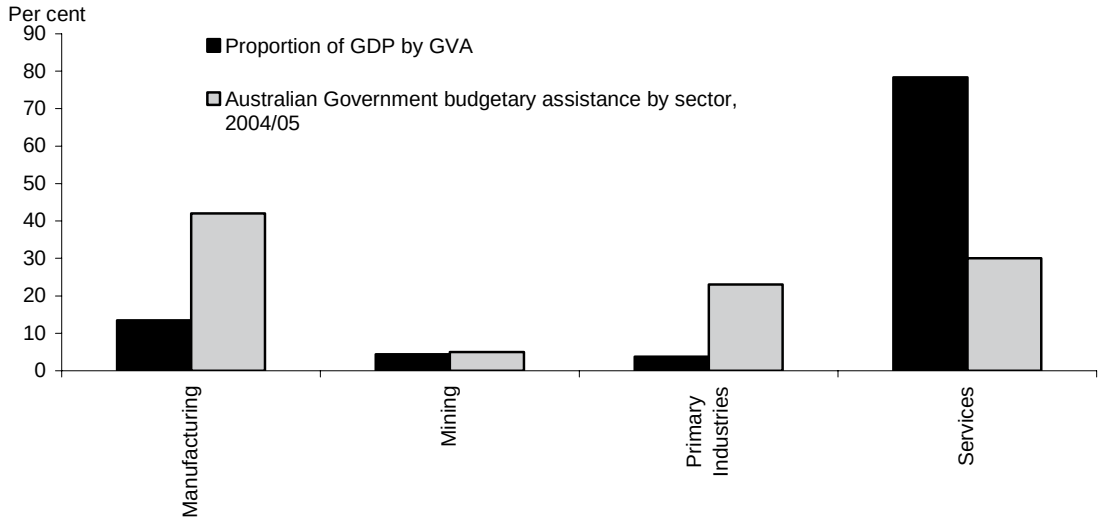
based programs include the Export Market Development Grant (EMDG), which reimburses up to 50 per cent of eligible export promotion expenses and the Commercial Ready program which is a merit-based program directed towards innovation and its commercialisation of small and medium sized enterprises.

## R&D Tax Concession

Since its introduction in 1985, the Research and Development (R&D) Tax Concession has been the principal government incentive to enhance and increase the level of business R&D undertaken within Australia. Business has supported the R&D tax concession as an effective policy instrument addressing market failures.

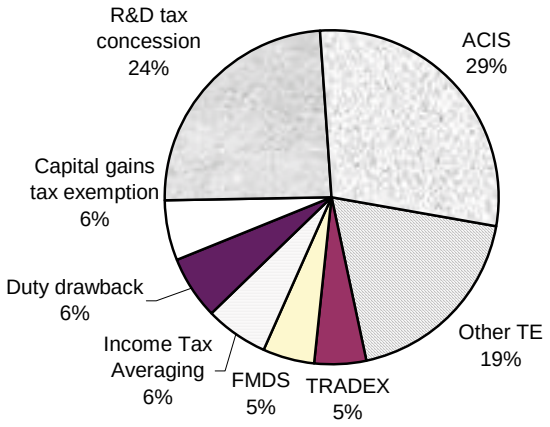
The R&D Tax Concession is a broad-based, market driven tax concession which allows companies to deduct up to 125% of qualifying expenditure incurred on R&D activities when lodging their corporate tax return (the benefit of the R&D tax concession has fallen along with the reduction in company tax). A 175% Premium (Incremental) Tax Concession and R&D Tax Offset are also available in certain circumstances. These programs form part of the $3 billion Innovation Statement, *Backing Australia's Ability*.

**Figure 28**
**Comparison of GVA and Budgetary Assistance by Sector**




Source: *Australian National Accounts: National Income, Expenditure and Product*, Cat. No. 5206, March 2006, ABS Canberra and Productivity Commission, Trade & Assistance Review, 2005.

**Figure 29**
**Major Australian Government Tax Concessions**
**2004-05**




Source: Productivity Commission, 2006, *Trade and Assistance Review 2004-05*, Annual Report Series 2004-05, Productivity Commission, Canberra, April, p2.3.

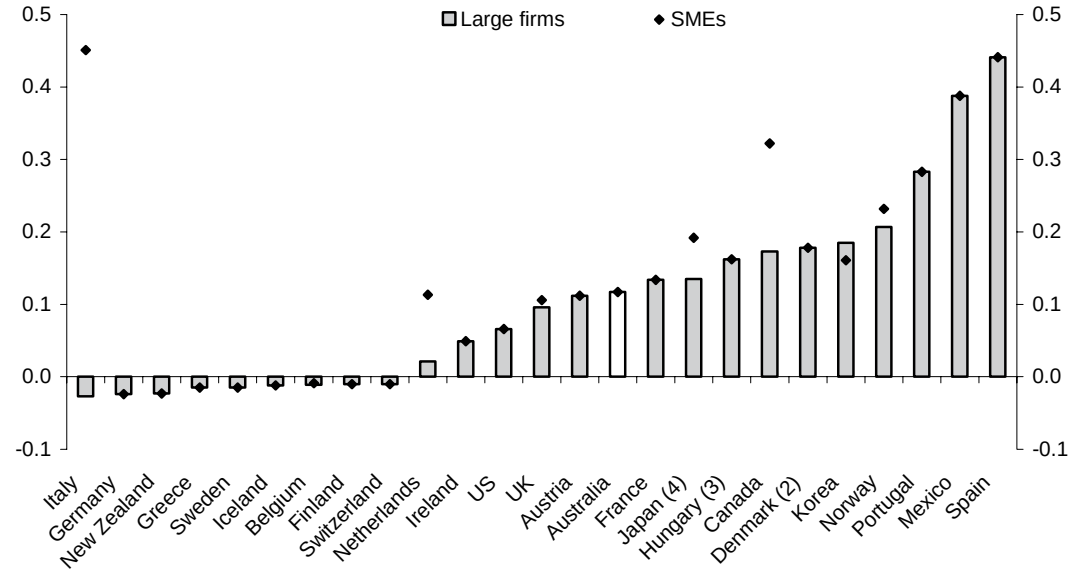
The objective of the R&D tax concession is to make Australian businesses more internationally competitive through improving innovative skills in Australian industry by:

- increasing investment in R&D;
- encouraging better use of Australia's existing research infrastructure;
- improving conditions for the commercialisation of new processes and product technologies developed by Australian companies; and
- developing a greater capacity for adaptation of foreign technology.

The concession does not target any particular industry or technology but has a number of specific eligibility requirements. It is market-driven with each company controlling the direction and thrust of their R&D.

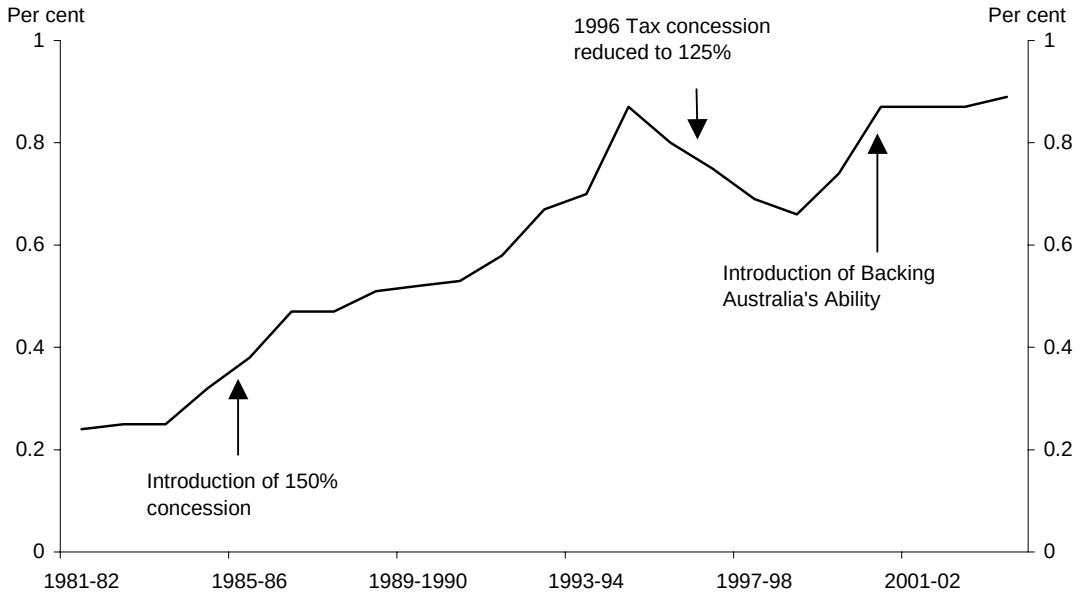
With respect to the inducement effect of programs for business expenditure on R&D, the Bureau of Industry Economics (BIE) found that the 150% R&D tax concession induced up to 17 per cent additional R&D expenditure. A further study by the PC noted that while the magnitude of the effect was uncertain there was a significant positive association between R&D subsidies and R&D expenditure

**Figure 30**
**Rate of Tax Subsidies for R&D**
**by OECD Country, 2004**




Source: OECD, STI/STP Division, April 2005.

**Figure 31**
**Business Expenditure at Current Prices as a Proportion of GDP**




Source: Australian Government, *Australian Science and Technology at a glance 2005*, Department of Education, Science and Training, December 2005.

growth.[31] Business believes that this extra expenditure contributes to economic growth and is warranted foregone revenue by governments to achieve benefits for the wider economy (see Figure 31).

Work done by various working groups in the lead up to the Government's Innovation Summit in 2000 and reports from the Prime Minister's Science Engineering and Innovation Council and the Department of Industry, Tourism and Resources highlight that there are a variety of R&D tax measures in place around the world. They fall into the following broad categories:

- Lower level of benefit with broad access and eligibility (Australia).
- Higher level of benefit with restricted access and eligibility (the UK program is targeted at SMEs with an expenditure on R&D over about AUD$65,000 with a

31 Revesz, J. and Lattimore, R. 2001, *Statistical Analysis of the Use and Impact of Government Business Programs*, Productivity Commission Staff Research Paper, AusInfo, Canberra, November.

maximum annual turnover of about AUD$64.5m).

- Benefits paid only on additional or incremental R&D (USA, Japan, France and Taiwan).

- Two-tier programs that provide differential benefits depending on features of the firm - a 20% tax credit is provided for all qualified expenditures (net of government grants, contract payments and equivalent non-government assistance); and an enhanced tax credit of 35% is provided for Canadian controlled private companies in respect of the first C$2million of qualified expenditure per annum. Within all of these broad categories, there are a number of countries that provide tax credits or cash payments.

Business supports the restoration of the concession to 150 per cent. In 1996 ACCI opposed the reduction in the then R&D tax concession of 150% to 125%, and has since called for the restoration of the 150% concession. However, this would be at a cost to the budget. We believe at the very least that the value of the concession should be maintained (in recognition of the changes to corporate tax rates under the new taxation system); and that R&D that would otherwise not have occurred but for the concession should be encouraged.

The key issues to address are:

- providing certainty in the policy and legislative environment which impacts on businesses ability to plan and invest in large R&D projects;

- trying to minimise the subsidy that is provided to R&D that would have occurred without the concession; and

- providing incentives to invest in R&D that are broad in application and accessibility.

These issues should be considered in the context of:

- cost to revenue;

- compliance costs for firms;

- an appropriate definition of eligible expenditure; and

- minimising the risk of abuse of the concession.

The OECD studies and overseas experience suggests that there is economic justification for higher rates of R&D tax concessions.

## BACKING AUSTRALIA'S ABILITY MARK II

Public support of private commercial activities stems from the often-significant pecuniary and non-pecuniary benefits that flow to third parties as a result of the research, namely externalities. A range of other market imperfections inherent in research activity also mandate a role for government funding.

Explicit recognition of such imperfections will aid in program design, especially with respect to the formulation of eligibility criteria, the assessment process and selection of performance indicators.

Public support of private commercial activities is underlined by the national innovation strategy, *Backing Australia's Ability Mark I* (BAA Mark I), announced in January 2001 following two years of public debate amongst industry, researchers and government. Since the announcement of *Backing Australia's Ability* in January 2001 business expenditure on R&D has increased by 8% in real terms. One of the benefits of BAA Mark I was that it showed the Government's commitment to supporting industry R&D (see Figure 32).

ACCI considers that the BAA Mark I strategy to have been successful. In the *Backing Australia Ability Mark II* (BAA Mark II) ACCI considered there was scope for improvement to the operation of programs with perhaps a greater focus toward commercialisation of public research. Under BAA Mark II, announced in 2004, the Government provided long term funding as well as increased commitments to important programmes such as Cooperative Research Centres (CRC), COMET, BITS, Research & Development Start and a number of industry-based Centres of Excellence.

## EXPORT MARKET DEVELOPMENT GRANT (EMDG)

The Export Market Development Grants (EMDG) scheme is the Australian Government's principal financial assistance program for aspiring and current exporters. Administered by Austrade, the purpose of the scheme is to encourage small and medium sized Australian businesses to develop export markets. EMDG reimburses up to 50 per cent of eligible export promotion expenses above a threshold of $15,000.[32]

Recent changes to the EMDG were welcomed by business which included:

32 Australian Government, Austrade Website, Export Market Development Grant, www.austrade.gov.au.

**Figure 32**
**Business Expenditure at Current Prices as a Proportion of GDP**

| BAA Key Elements | Funding ($m) | Percentage of BAA Funding |
|---|---|---|
| Research and Development | 5277.6 | 59.6 |
| Commercialisation | 2355.6 | 26.6 |
| Skills Development | 1227.8 | 13.8 |
| **Grand Total** | **8861.0** | **100** |

Source: The Parliament of the Commonwealth of Australia, *Pathways to Technological Innovation*, House of Representative Standing Committee on Science and Innovation, Canberra, June 2006.

- reducing the annual income ceiling for participating firms;
- reducing the maximum grant;
- reducing the time period a firm can remain in the program; and
- removing the availability of grants for firms entering additional markets.

All of these meant more assistance for new and smaller exporters.

In 2005-06 3485 grants totaling $137 million were paid to small and medium sized enterprises, at an average of $38,935. Small business accounted for around 79 per cent of recipients. The Parliament passed a number of changes to the EMDG scheme including extending the program until 2010-11, increasing the daily allowance to $300/day, removing the export earnings test and increasing flexibility of the 'principle status' test.

The largest users of EMDG by industry come from manufacturing (accounting for around 40 per cent of all payments by value), followed by property and business services (20 per cent) and then wholesale trade and cultural and recreational services (each with just under 10 per cent).

Research conducted by Austrade and by the Centre for International Economics (CIE) also indicates the EMDG is hitting the mark in assisting new and aspiring exporters, in particular smaller firms, to get into exporting.

According to an Austrade survey of EMDG participants, the Scheme helped them overcome the single largest barrier to engaging in exporting - namely access to the necessary operating capital to fund their export promotion work.

On a 0 to 10 scale (0 meaning of no importance and 10 meaning of greatest importance), program participants ranked lack of capital at some 6.5 index points, followed by the company tax rate and risk and uncertainty of exporting each at just under 4 index points. Other noteworthy constraints on export performance included foreign trade barriers (around 3.5 index points) as well as lack of market opportunities and government regulation (both around 3 index points). Cultural barriers and concerns over intellectual property laws in foreign markets each recorded 2.2 index points.

Micro-econometric (firm-level) modelling undertaken by the CIE for the 2004 Jollie Review into the EMDG bears out these issues and the greatest dividends from EMDG appear to be enjoyed by the most financially constrained firms.

For these firms, every $1 of EMDG funding induces between $1.30 and $1.90 in additional export promotional funding, which could convert into as much as $20 in additional export income over the future life of the grant-recipient firm.

Commerce and industry supports: the two-pronged recommendation by the Jollie Review to maintain current levels of program funding; indexing the EMDG budget to inflation to preserve its real value; and introducing a smoothing arrangement, where funds not expended in one year of the program can be retained and made available elsewhere over the life of the Scheme (especially in unexpectedly high demand years).

# Chapter 5
# Global Supply Chains and Manufacturing

# GLOBAL SUPPLY CHAINS AND MANUFACTURING

## WHAT ARE GLOBAL SUPPLY CHAINS?

Previously design, sourcing of materials and manufactured goods remained largely contained within the confines of national borders. Today this process, like the market and competition, has broadened to seeking out opportunities that exist internationally. Design of goods is increasingly taking place in developing countries such as India, while materials are brought on international markets from countries such as Brazil for transformation in factories located thousands of miles from head offices or across multiple countries.

These changes have been brought about by increasing competition and consumer demands, firms now have to seek out new ways of lowering costs, innovating and raising standards. Research and development is becoming increasingly collaborative driven by cost and risk sharing involving ever more complex product design and manufacture.

Australia is now firmly entrenched in the global market and to remain competitive must take full advantage of the global supply chain. Developing efficient local supply chains no longer means firms are competitive. A larger and more complex network must be grappled with in order to maintain and expand output.

Outsourcing has become a necessity for business to maintain a competitive edge, high cost structures make it impossible to be successful domestically or internationally as trade increasingly finds less resistance. However, outsourcing is not just a one way street, international firms seeking better opportunities come to Australia to develop products for world markets. Australian firms are now acting as suppliers not just end manufacturers to other companies and countries.

Not only has the greater international integration of the product supply chain benefited Australian firms but international R&D undertaken in Australia is associated with increasing R&D by local firms. As noted in a recent PC report:

> International investment in R&D should have a large impact on the incentives facing Australian businesses to invest in R&D through a combination of the provision of new areas of technological opportunities, knowledge spillovers and competition effects.
>
> Foreign R&D is strongly positively associated with increased domestic own financed business expenditure on R&D.[33]

The Commonwealth Government has an important role in making Australia an attractive destination for global manufacturing companies looking for a location to invest based on taxation, skills, research and development capabilities, regulation, energy and infrastructure. The primary objectives of the Government must be to provide domestic manufacturers with the most efficient economic environment and thereby develop an economic environment which is internationally competitive for international firms to invest.

33 Shanks, S. and Zheng, S. 2006. *Econometric Modelling of R&D and Australia's Productivity*, Productivity Commission Staff Working Paper, Canberra, April.

# Chapter 6
# International Trade and Manufacturing


2006
AUSTRALIAN
EXPORTAWARDS

2006
AUSTRALIAN
EXPORTAWARDS

2006
AUSTRALIAN
EXPORTAWARDS

2006
AUSTRALIAN
EXPORTAWARDS

# INTERNATIONAL TRADE AND MANUFACTURING

## THE BENEFITS OF FREER TRADE

Multilateral trade liberalisation has delivered substantial benefits to the community of nations over the past half-century. Average tariff rates have fallen from more than 40 per cent in the late 1940s to just 5 per cent today and the value of world trade has multiplied a phenomenal 22 times.

The measurable economic dividends of multilateral trade liberalisation under the former General Agreement on Tariffs and Trade (GATT) and now the World Trade Organisation (WTO) are not inconsequential. The long-running Uruguay Round (1986 to 1994) delivered liberalisation in the trade in agricultural products and in manufactures which economists estimate added some A$4.4 billion annually - or 0.5 per cent - to Australia's real national output. A bold and comprehensive outcome from the Doha Development Round could potentially be worth another A$7 billion a year in economic dividends to Australia or another 0.8 per cent in extra real economic growth annually.

Neither figure takes into account the gains from reforms in areas like services, intellectual property and investment or the important benefit of cementing the rule of law in international trade and commerce, in particular the creation of effective laws for handling trade disputes that enable the smallest country to challenge the protectionist measures of the largest countries on equal terms - and when they win, to secure enforceable remedies.

## AUSTRALIA'S TRADE NEGOTIATIONS

Internationally countries are engaged in a number FTAs and preferential trade agreements (PTA).

While the Australian Government and ACCI regard multilateral negotiation of freer trade through the WTO as the first, best option the pursuit of Free Trade Agreements (FTA) is seen as a key policy strategy.

Australia has signed bilateral agreements with New Zealand, Singapore, Thailand and the USA while seeking agreements with a number of other countries including China, Malaysia, ASEAN and prospectively Japan, the Gulf States in the Middle East, Indonesia, Chile and South Korea.

The signing of such bilateral agreements can deliver benefits to Australia as long as they are 'WTO-plus' - that is, deliver outcomes greater than can be obtained from the existing WTO suite of agreements and their related commitments (see Figure 33). Agreements currently being examined for feasibility have the potential to profoundly alter the manufacturing sector.

An Australia-China FTA in particular has caused some debate on its potential benefits to the manufacturing sector, although any final analysis must necessarily await the completion of negotiations, and a holistic approach to the agreement reached.

Nevertheless, an Australia - China FTA represents an opportunity to increase access to one of the world's largest and most dynamic markets. China is the single largest source of economic growth in the world today.

For the Australian manufacturing sector the greatest opportunity may come from greater investment opportunities in China.

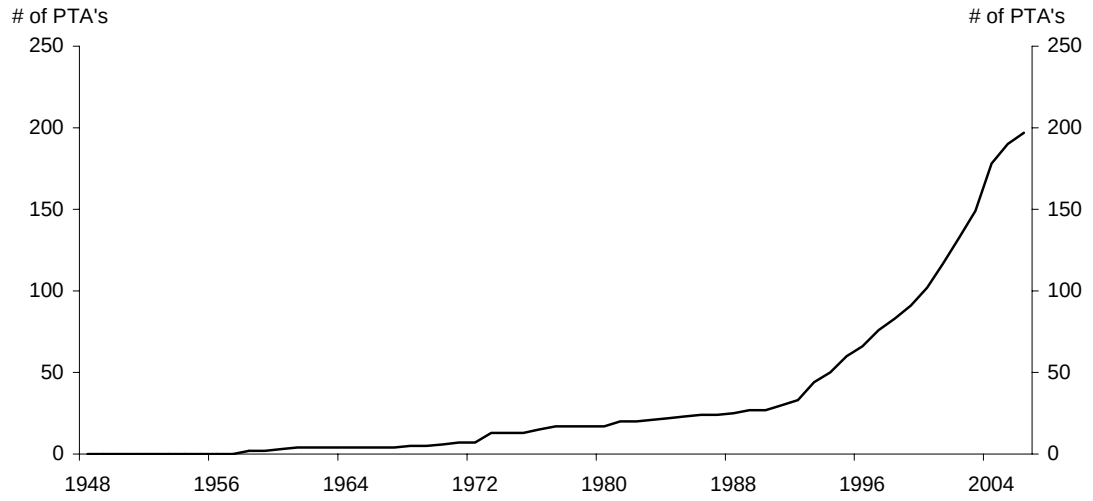
A report prepared by the Australian Department of Foreign Affairs and Trade and the Chinese Ministry of Commerce entitled The Australia-China Free Trade Agreement Joint Feasibility Study observed "In aggregate terms, the [economic] modelling indicates that the annual average real GDP growth rate for both countries could increase by around 0.4 per cent over the period 2005-2015 - in present value terms." This would mean Australia's real GDP would be higher by US$18 billion over the 2006-2015 period. A short discussion on the validity of the modelling can be found in the 2004-05 Trade and Assistance Review.[34]

ACCI recognises Australia's negotiations of trade liberalisation initaitives such as bilateral FTAs contain a range of challenges, across a number of thematic areas of international trade and commerce. These include tariffs; quotas; protection of intellectual property rights; rules of origin; investment; recognition of professional and skilled qualifications; import licensing; customs procedures; quarantine laws and policies; and dumping regulations.

While China has reasonable 'black letter' intellectual

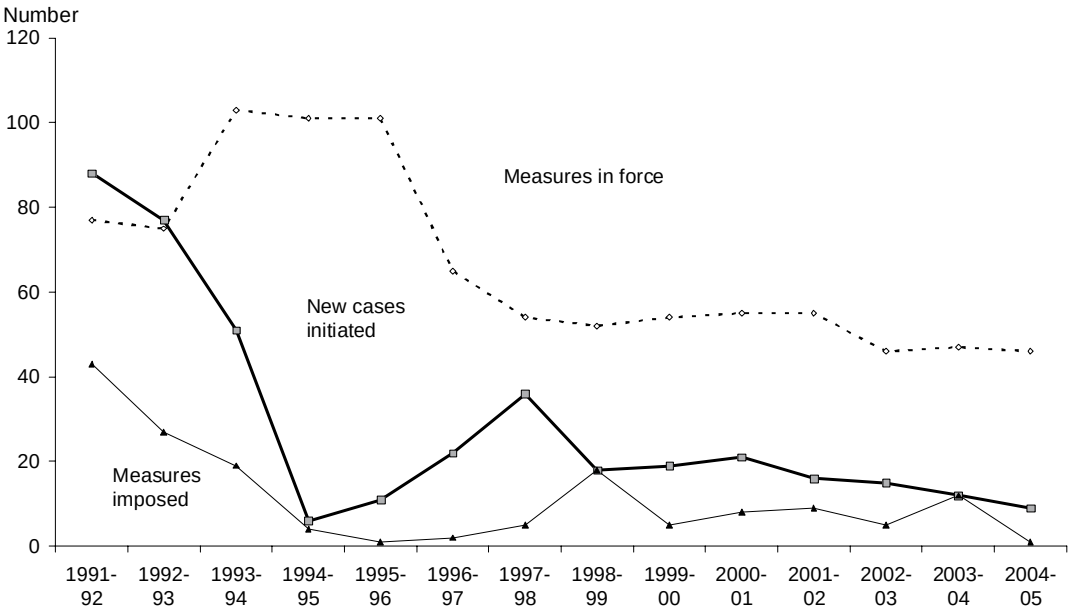
34 Productivity Commission (2004), *Trade and Assistance Review 2003-04*, Annual Report Series 2003-04, Productivity Commission, Canberra, April.

**Figure 33**
**PTAs in Force by Date of Entry into Force**




Source: World Trade Organisation, *Regional Agreements Facts and Figures*, http://www.wto.org/english/tratop_e/region_e/summary_e.xls, accessed 30 June 2006.

**Figure 34**
**Anti-Dumping and Countervailing Activity**
**1991-92 to 2004-05**




Source: Productivity Commission, 2004, *Trade and Assistance Review 2003-04*, Annual Report Series 2003-04, Productivity Commission, Canberra, April.

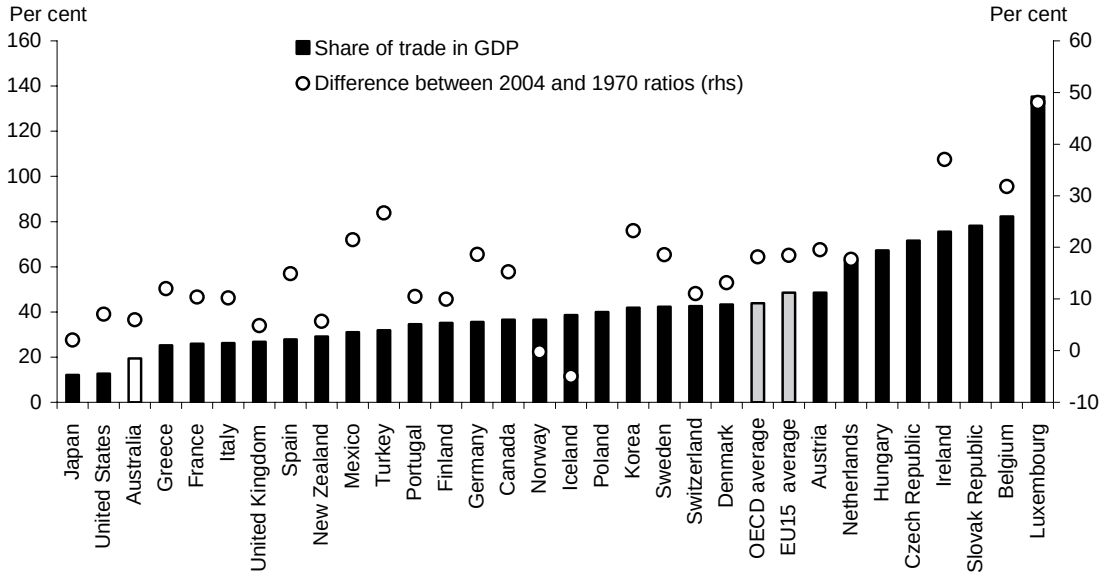
property laws, the consistency and effectiveness of the enforcement of these laws leaves much to be desired. Australian negotiators can help our exporters, particularly manufacturers, and indeed the world trading community, by delivering outcomes in the Australia-China FTA that realise a stronger intellectual property law regime in China.

While Australia has increased the number of preferential trade agreements the number of anti-dumping and countervailing power cases have remained stable (see Figure 34).

Developing a comprehensive free trade agreement with China must be seen as providing both challenges and opportunities. China's quickly expanding economy has provided Australia's economy with a number of economic benefits.

In line with increasingly fluid borders, Australia's trade as a share of GDP has risen, however, it remains well below those of other industrialised countries (see Figure 35). A low ratio does not necessarily imply high tariffs, as other factors, such as geographic remoteness and size may influence trading patterns and productivity.

**Figure 35**
**Import and Exports as Share of GDP**




Source: OECD, 2006, OECD Factbook 2006, *Economic Environmental and Social Statistics*, OECD Publishing.
Statlink: http://dx.doi.org/10.1787/354323508453.

A recent Treasury working paper[35] noted that Australia's trade performance was good or slightly better than expected given its geographic isolation. Furthermore, relative to the Treasury model predictions Australia has improved. Conversely, isolation may provide some protection to domestic industries as demonstrated by Australia's open trade regime but relatively very low import penetration.

ACCI is firmly and unequivocally committed to the cause of free trade.

The ACCI strongly supports continuing removal of international trading barriers, but believes that reductions in Australian tariffs must be considered in the context of a whole of government industry policy.

Cuts in the level of protection must be part of a wider package of comprehensive, domestic reform to taxation, workplace relations, other regulatory compliance and microeconomic reform.

In assessing the possible outcomes of any reductions in assistance to industry, full account should be taken of the economic, strategic and social impacts.

## AUSTRALIAN EXPORT AWARDS

The Australian Export Awards are acknowledged by the business community as one of Australia's most prestigious industry awards. ACCI has been involved with the Australian Export Awards since their inception in 1963. 2006 was the 43rd year that these awards have been showcasing and promoting Australian exports and in 2007 ACCI is again co-sponsoring them, with Austrade.

This year categories include:

- Agribusiness Award;
- Arts, Entertainment and Design Award;
- Education Award;
- Emerging Exporter Award;
- Information and Communications Technology Award;
- Large Advanced Manufacturer Award;
- Minerals and Energy Award;
- Regional Exporter Award;
- Services Award;
- Small to Medium Manufacturer Award;
- Small/Micro Business Award; and
- Sports, Events and Tourism Award.

35 Bryn Battersby and Robert Ewing 2005, *International Trade Performance: The Gravity of Australia' Remoteness*, Treasury Working Paper 2005-03, June.

- The Australian Exporter of the Year Award.

Recent winners of the Large Advanced Manufacturer Award have been:

- ResMed 2006.
- Caterpillar Elphinstone Pty Ltd 2005.
- Mayne Pharma Pty Ltd 2004.
- Cochlear 2003.
- ResMed Limited 2002.
- Austal Ships 2000.

Recent winners of the Small to Medium Manufacturer Award have been:

- aussieBum 2006.
- Rofin Australia Pty Ltd 2005.
- Muir Engineering Pty Ltd 2004.
- Mt Romance Australia Pty Ltd 2003.
- Q-MAC Electronics Pty Ltd 2002.
- Compumedics Limited 2001.
- Bishop Steeling Technology 2000.

We also note that ResMed won the Exporter of the Year Award in 2006 and 2002 while Austal Ships won in 2000.

# Chapter 7
# Research and Development and Manufacturing




# RESEARCH AND DEVELOPMENT AND MANUFACTURING

## THE IMPORTANCE OF RESEARCH AND DEVELOPMENT

Technological progress and commercial innovation lie at the heart of ongoing productivity growth in modern economies. New and better methods of production and service provision allow business to improve the quality of their product while reducing the resources consumed in their creation. Higher productivity in turn sustains real wages growth and long run growth in living standards.

The Government has noted that, 'around 98 per cent of the world's science and technology developments occur outside of Australia'. With this in mind it is clear that efforts to enhance technology diffusion will be key to ensuring Australian business remains competitive internationally.

Over time, Australia's isolation has and will continue to diminish particularly through the adoption of Information and Communication Technology (ICT). Our distance from markets provides us an opportunity to export more cheaply into foreign markets than foreign markets can import domestically. Furthermore, Australian manufacturers have a greater incentive than our competitors to be the first to introduce technologies that reduce our geographical isolation.

## AUSTRALIA'S R&D PERFORMANCE

Australia rates relatively low on the scale of international expenditure on R&D as a proportion of GDP. In 2004-05 Australia's R&D expenditure measured $15.8 billion a 19.4 per cent increase on the previous year. Investment in R&D by business recorded $8.4 billion, up 21.5 per cent, while government spending remained relatively flat at $2.55 billion. Underlying headline R&D Government expenditure on R&D ranks more highly than business expenditure on (see Figure 36). However, the PC has noted:

> Australia's R&D effort has increased about fourfold in real terms over the past three decades. By far the biggest increase has been in R&D undertaken in the private business sector, which now accounts for around one in two dollars spent.
>
> With the increase in business R&D, Australia's R&D effort has become much more commercially oriented. Business R&D is more skewed toward experimental development and applied research than is R&D activity in the other institutional sectors.[36]

Since 2000-01 Australia has increased its Gross Expenditure on R&D (GERB from 1.51 per cent to 1.76 per cent while the OECD average over the same period has risen from 2.23 per cent to 2.26 per cent.

Internationally China has committed to lifting R&D expenditure as a proportion of GDP to 2.5 per cent by 2020, having already doubled R&D from 0.6 per cent to 1.2 per cent of GDP from 1995 to 2002. The European Union has a target of 3.0 per cent by 2010. Australia's Business Expenditure on R&D (BERD) has trended upward recently, increasing for the last six periods, with the latest statistics showing R&D increasing to 0.95 per cent of GDP. The ABS has noted:

> BERD increased as a proportion of GDP between 2003–04 and 2004–05, moving from 0.91% to 0.95%. This continued a period of growth dating back to 1999–2000, when the ratio fell to 0.64%.
>
> Although Australia recorded one of the largest increases in BERD/GDP ratio of all OECD countries between 2003–04 and 2004–05, it remained below the OECD average of 1.53%.[37]

Australia's BERD has increased from 0.72 per cent of GDP in 2000-01 to 0.95 per cent in 2004-05 while the OECD average has declined from 1.55 per cent to 1.53 per cent. The PC also found that the drivers of business R&D were associated with a lower and stable cost of capital; lower industry protection; government financing of R&D performed by business and high government R&D.

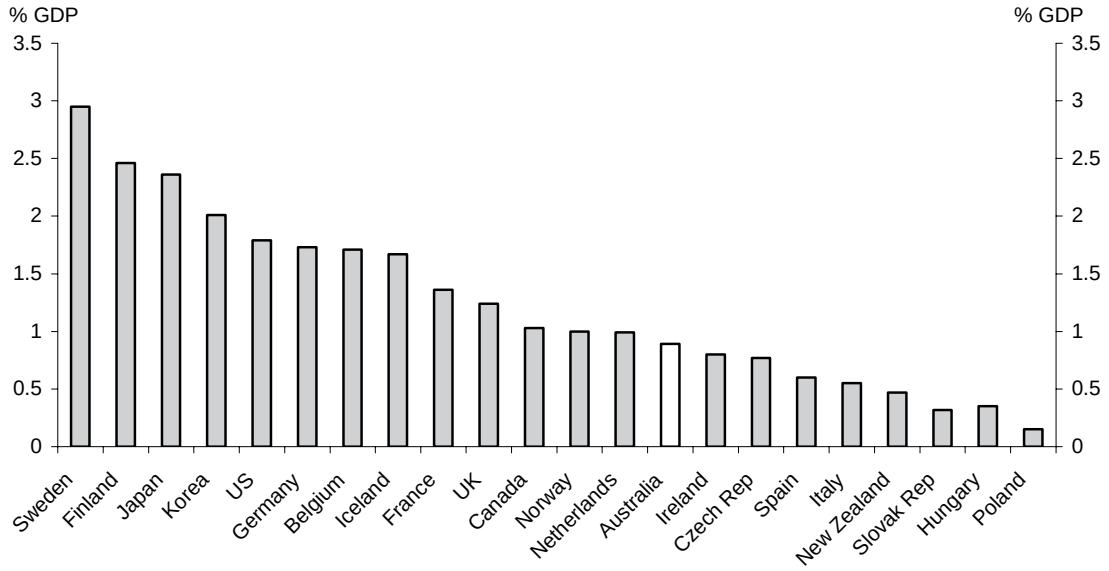
Manufacturing is the largest contributor to BERD accounting for 49.3 per cent or $3,451.1 million. Furthermore, manufacturing accounted for 45.3 per cent of all Capital expenditure on R&D, at $237.4 million, in 2004–05.[38]

36 Shanks, S. and Zheng, S., 2006, *Econometric Modelling of R&D and Australia's Productivity*, Productivity Commission Staff Working Paper, Canberra, April.

37 Australian Bureau of Statistics (2004-05), *Research and Experimental Development*, Businesses, Australia, Cat. No. 8104.0, ABS, Canberra.

38 Ibid.

**Figure 36**
**Business Expenditure on R&D as a Proportion of GDP**
**2003-04**




Source: Australian Bureau of Statistics, 2005, *Research and Experimental Development*, Businesses, Australia, Cat. No. 8104.0, ABS, Canberra.

The fall of manufacturing R&D expenditure as a share of GDP since 1994-95 is mainly due to manufacturing's decline relative to GDP. What is encouraging is the fact that the manufacturing sector has increased R&D intensity since 1999-2000 as a share of output from 2.83 per cent to 3.41 per cent in 2004-05 (see Figure 37).

The importance of innovation to the Australian manufacturing sector is also highlighted by an ABS publication[39] identifying that 45.5 per cent of businesses, during the period January 2001 to December 2003, undertook innovation. Overall, 34.8 per cent of firms undertook innovation. Human resources devoted to R&D were 18,000 person years. Of the $3.2 billion in R&D undertaken by the manufacturing industry, motor vehicle and parts and other transport equipment contributed 26 per cent, petroleum, coal and chemical and associated product manufacturing contributed 18 per cent and metal product manufacturing contributed 11 per cent.

An ABS study found that a firm's propensity to innovate is increased by exposure to overseas market influences. For example, the proportion of exporters undertaking technological innovation was almost 70% compared to only 25% for non-exporters. Larger businesses, regardless of export exposure, are more likely to innovate than small businesses. However, while the difference between exporters and non-exporters in the proportions of businesses innovating is around 40 percentage points for small businesses, it drops to 20 percentage points for large businesses. It appears that exporter status has less influence on the propensity to be innovative as employment size increases.[40]

Funds for manufacturing R&D were overwhelmingly sourced from own funds (91.0 per cent) with Commonwealth Government and Overseas sources comprising 4.0 per cent.

In order to remain competitive businesses have needed to invest in capital and skilled employees. Developing high technology or niche products for export and domestic consumption has provided a lifeline to some manufacturers. While other OECD exporters are focusing more on high value added products, Australia mostly remains a medium-low to low technology exporter (see Figure 38).

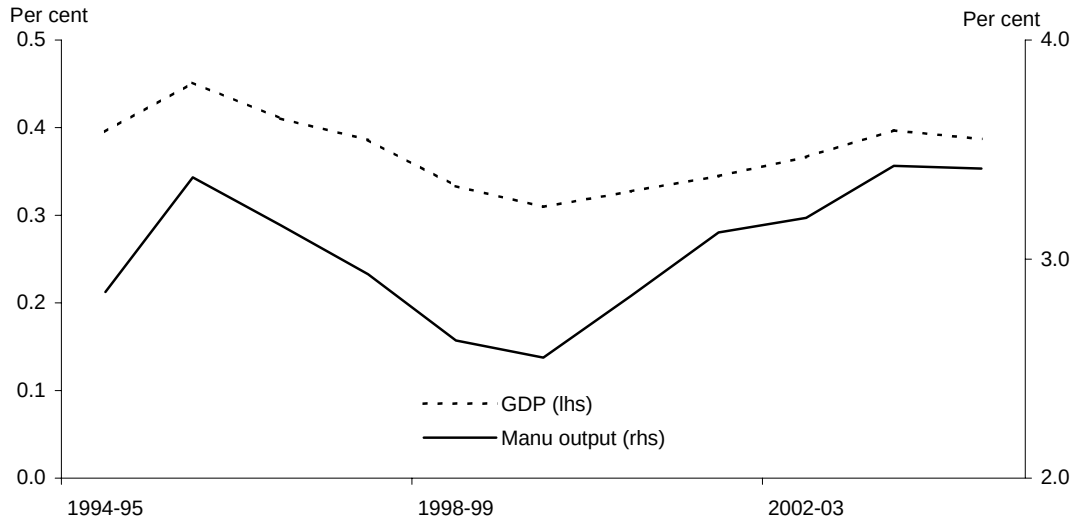
The OECD has noted "that technology-intensive exports, and high technology exports in particular, accounted for much of the growth in trade over the past decade. In all OECD countries, they grew more rapidly than total manufacturing exports. Japan is the only country in which total manufacturing exports grew faster over the 1994-2003 period than high-technology exports."[41]

39 Australian Bureau of Statistic, 2006, *Year Book Australia*, Cat. No. 1301, ABS, Canberra. For the purposes of the survey, innovation is defined as the process of introducing new or significantly improved goods or services and/or implementing new or significantly improved processes.

40 National Manufacturing Summit 2005, *Innovation in Manufacturing*, Workshop discussion paper, December.

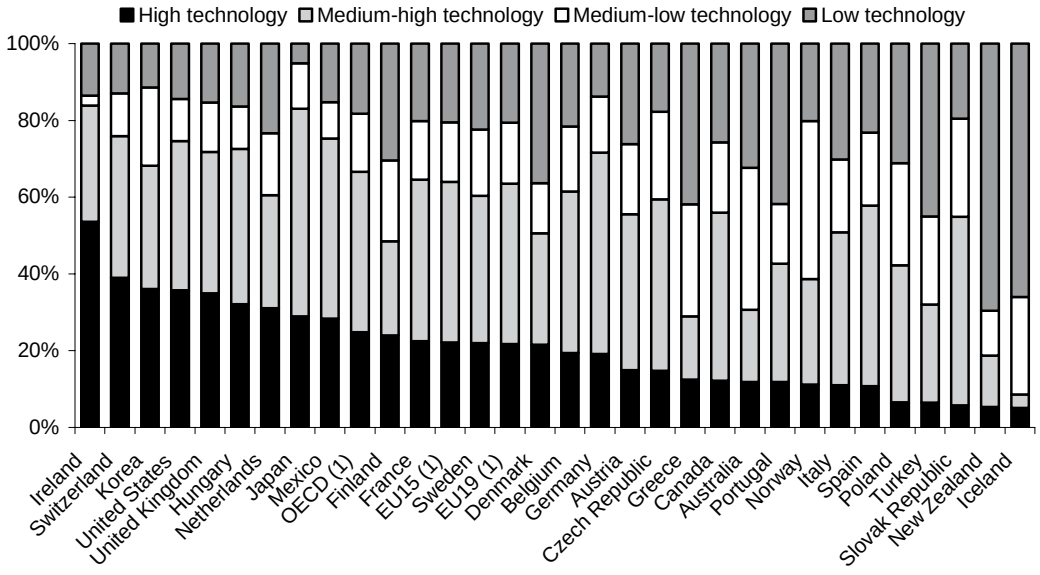
41 OECD, 2005, *OECD Science, Technology and Industry Scoreboard 2005*, *Towards a Knowledge-based Economy*.

**Figure 37**
**Manufacturing R&D as a Share of GDP and Manufacturing Output - Current Prices**




Source: Australian Bureau of Statistics, *Research and Experimental Development*, Businesses, Various Issue, Australia, Cat. No. 8104.0, ABS, Canberra, and Australia Bureau of Statistics, *Australia System of National Accounts*, 2004-05.

**Figure 38**
**Share of Technology Industries Manufacturing Exports**
**2003**




Source: Australian Bureau of Statistics, 2005, *Research and Experimental Development*, Businesses, Australia, Cat. No. 8104.0, ABS, Canberra.

Australia's growth rate for high and medium-high technology exports from 1994-2003 has been well below that of the OECD average (see Figure 39).

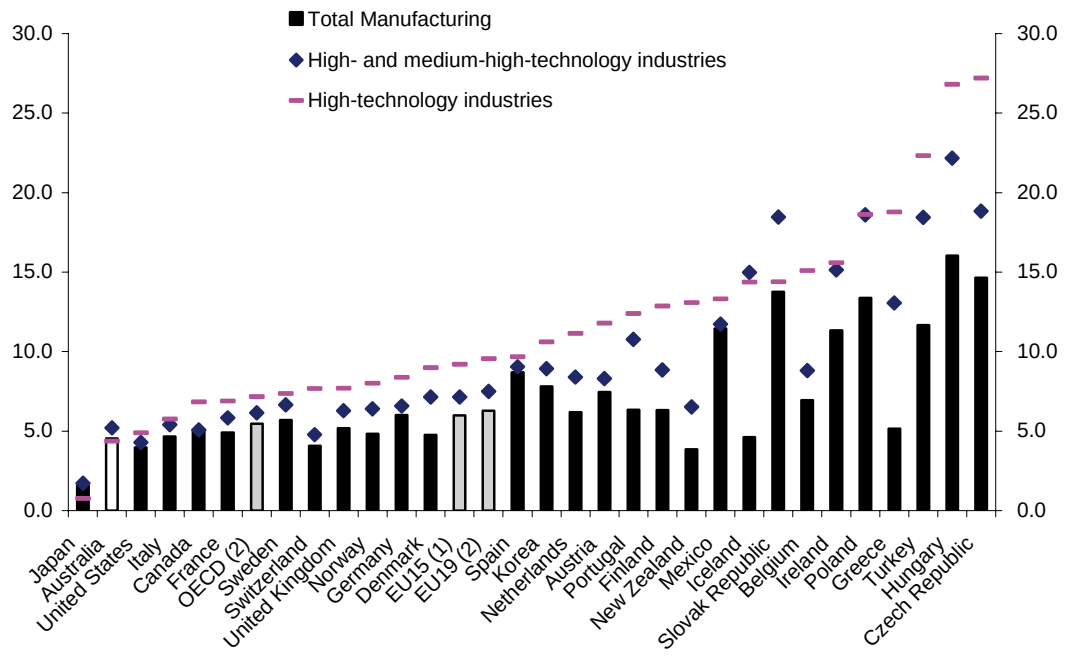
A recent report[42] identified a number of causes for declining Elaborately Transformed Manufacturers (ETM) exports out of Victoria including a lack of access to capital to support business R&D and commercialise innovation; a lack of adequate local supply chains and gaps in industry collaboration to support manufacturing; a lack of sales and export marketing skills; and more generally the competition from China as an emerging manufacturing powerhouse.

Although many manufacturing exporting problems have been identified, Australia's share of total OECD high and medium technology exports has remained stable at 0.4 per cent over a decade (see Figure 40).

In the more competitive international environment Australia will need to compete in areas where its competitive and

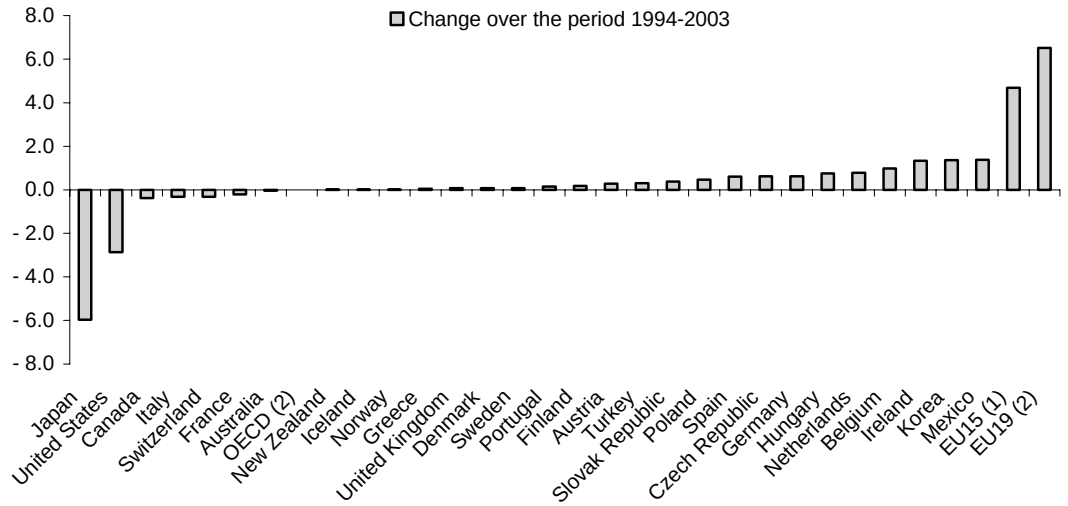
42 Allen Consulting, 2005, *Growing Global Niches: Positioning Victorian Elaborately Transformed Manufactures for Future Growth*, Final Report to the Department of Innovation, Industry and Regional Development, February.

**Figure 39**
**Growth of High and Medium-High Technology Exports, 1994-2003**
**Annual Average Growth Rate**




Source: OECD, STAN Indicators database, March 2005.

**Figure 40**
**Share in Total OECD High and Medium-High Technology Export, 1994-2003**
**Percentage Change of Export Growth Shares over the Period**




Source: OECD STAN Indicators database, March 2005.

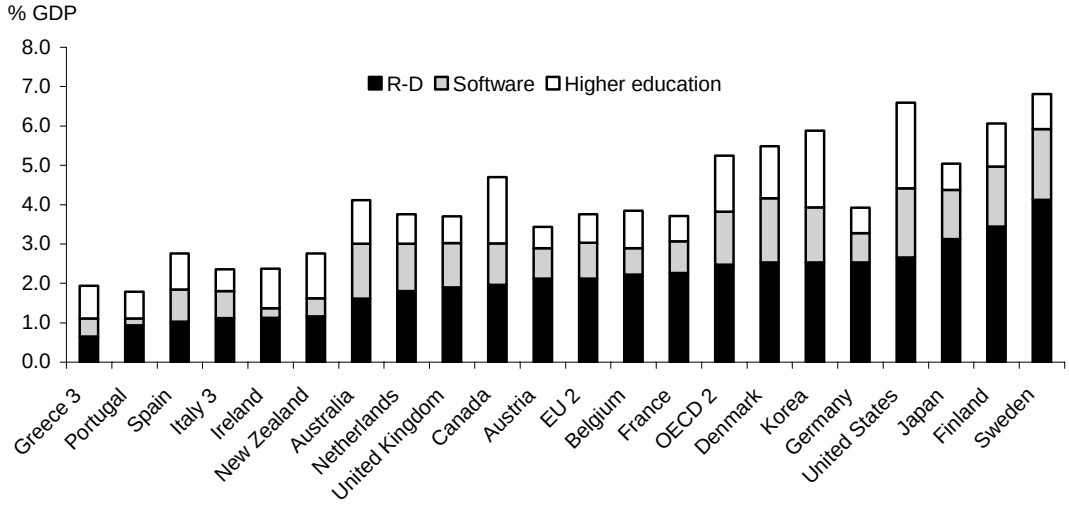
comparative advantages are greatest. Australia compared to India, China and many other developing nations does not have a large pool of low-skilled employees. As international economies become more integrated Australia will no longer be able to competitively produce labour intensive and simply transformed manufactures. We must compete on products that embody capital and highly skilled labour.

Although Australia ranks relatively highly in investment in knowledge, the sum of expenditure on R&D, on total education (public and private) and on software, it invests less in knowledge than many of the 'high tech' economies such as the US, Sweden, Finland and Korea (see Figure 41). However, Australia's investment in R&D as a proportion of GDP is the seventh lowest, at 1.76 per cent, and well below the OECD average of 2.5 per cent.

Other OECD countries are increasingly channelling resources into knowledge-based investments as noted by the OECD:

> The United States and Japan are moving more rapidly

**Figure 41**
**Investment in Knowledge**
**2002**




Source: OECD (2006), *OECD Factbook 2006*, Economic Environmental and Social Statistics, OECD Publishing.
Statlink: http://dx.doi.org/10.1787/554030183064.
Note 1: 1994-2001 for Greece and Italy, 1995-2002 for Korea, EU figure excludes Belgium, Greece and Italy. OECD figure excludes Belgium, Greece, Italy and New Zealand.
Note 2: Exclude Greece and Italy.
Note 3: 2001 data.

> towards a knowledge-based economy than the EU: since 1994, their investment in knowledge-to-GDP ratios have grown at a higher rate than that of the EU. For all countries, except Ireland, the ratio of investment in knowledge-to-GDP was higher in 2002 than in 1994.[43]

A strong driver of innovation is R&D. Australian businesses in order to manufacture higher up the value added chain will need to focus more on smart solutions and products. Increasing international trade has expanded to a point where R&D is now considered a tradeable commodity. Australia must be prepared to take advantage of international capital looking for quality R&D centres.

R&D undertaken in Australia is largely directed towards medium-low and low technologies. Countries with a higher proportion of R&D in high technology include the US, Korea, Sweden and Finland (see Figure 42).

Exports of ETM are undertaken by countries which invest more broadly and more heavily in knowledge R&D, software and education and where the manufacturing sector focuses on technology intensive R&D (see Figure 43).

ETM are not inherently 'better' than other types of manufactures if firms believe they can compete internationally over the long term. Small firms without access to large R&D departments may only be able to export relatively less technologically intensive products, however, this does not diminish their importance.

If Australia is to move up the value adding chain and into niche products that take us further away from directly competing with China and other developed countries, Australia's R&D policy must be to encourage investment in technology intensive industries, however, this should not be at the expense of broader R&D.

Many multi-national companies are choosing to set up R&D laboratories in foreign countries providing Australia with an opportunity to become a major research hub in the Asia Pacific. The OECD noted this trend in one of its recent publications:

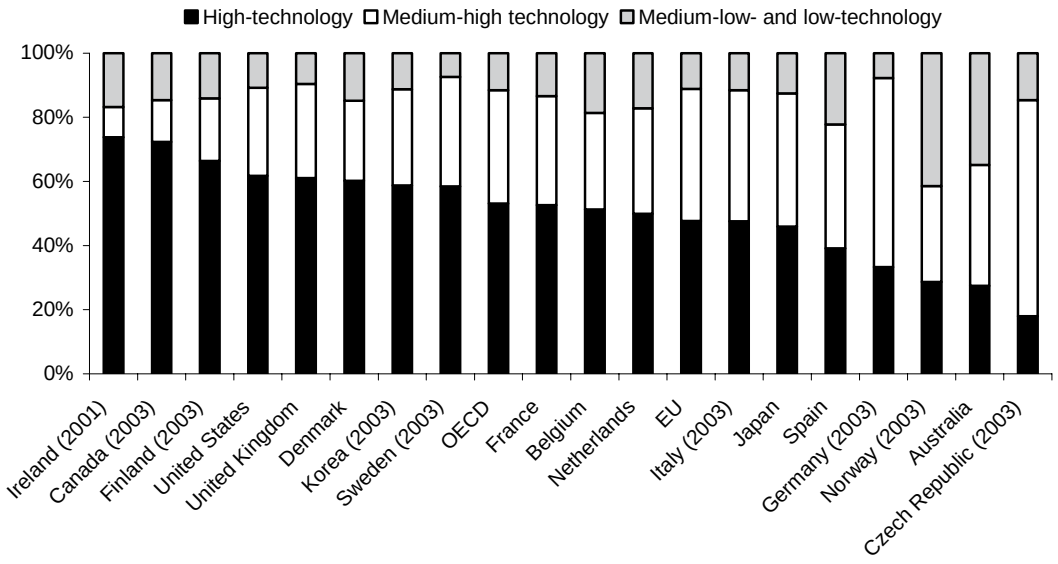
> More multinationals are setting up offshore R&D laboratories, and many R&D activities have become more internationalised and more closely linked to production abroad. Still, there are differences in foreign affiliates' shares in total R&D manufacturing expenditure compared to their shares in total manufacturing turnover. Countries such as Portugal and Germany seem to be more attractive for R&D investments than for production activities and vice versa.[44]

There is also a trend towards co-operation between

43 OECD, 2006, *OECD Factbook 2006 Economic Environmental and Social Statistics*, Science and Technology, OECD, Paris, p130.

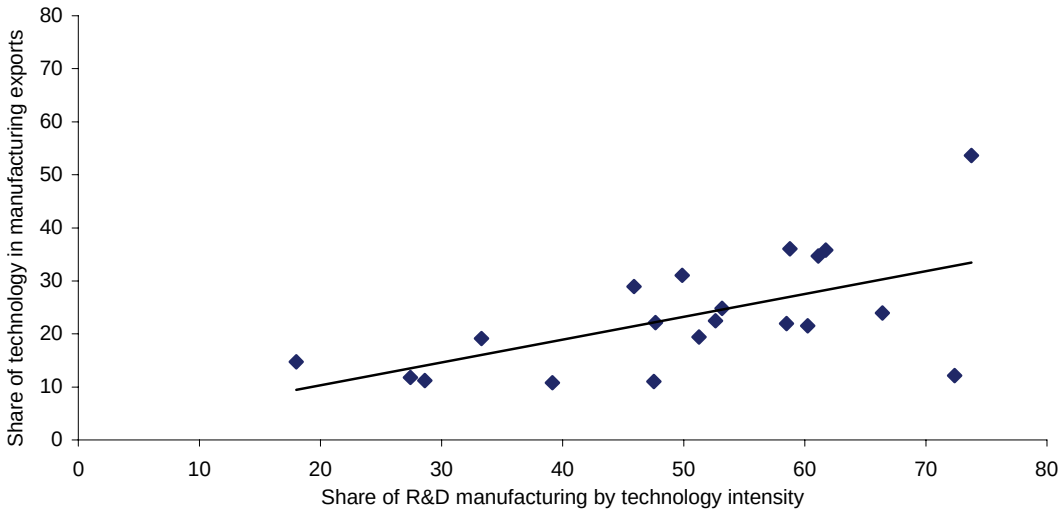
44 OECD, *OECD Science, Technology and Industry Scoreboard 2005, Towards a knowledge based economy, R&D and innovation: creating and diffusing knowledge*, OECD Paris 2005.

**Figure 42**
**Share of Business R&D in the Manufacturing Sector by Technology Intensity**
**2002**




Source: OECD, ANBERD database, April 2005.

**Figure 43**
**Share of Technology in Exports and R&D in Manufacturing**




Source: OECD, ANBERD database, April 2005.

companies forming international networks between each other, governments and universities. The OECD notes that this trend is not confined to multi-national firms but includes all innovation intensive businesses.

Any government R&D funding must take into consideration the issue of additionality. This is most effectively addressed once consideration has been made of market imperfections that the program is designed to remedy. If externalities provide the rationale for government support, then an emphasis in the merit criteria on the broader benefits of a particular project will best maximise the desired additionality.

The issues of economic rationale, additionality and merit criteria are closely related and the programs can be further strengthened by elaborating upon the linkage between the latter two issues with the first.

The aim of encouraging behavioural additionality gives rise to different considerations. Emphasis in this case should be upon building the national 'innovation infrastructure' that can assist business to innovate. Networks of expert advisors and service providers and information distribution services will be key in providing such a notional infrastructure.

## Commercial Ready

As part of the *Backing Australia's Ability Mk II* the Commercial Ready program will provide more than $1 billion over five years from 2006-07 to industry in high and emerging technology sectors. The program defines small and medium enterprises as businesses with a turnover of $50 million or less.

ACCI was supportive of the move to consolidate the R&D Start program, the Biotechnology Innovation Fund and the Innovation Access Program. A single overarching program, in the form of Commercial Ready has the potential to reduce both administrative costs and the extra compliance burden associated with grant applications made to more than one program.

ACCI's submission to the Department of Industry, Tourism and Resources in June 2004 noted that:

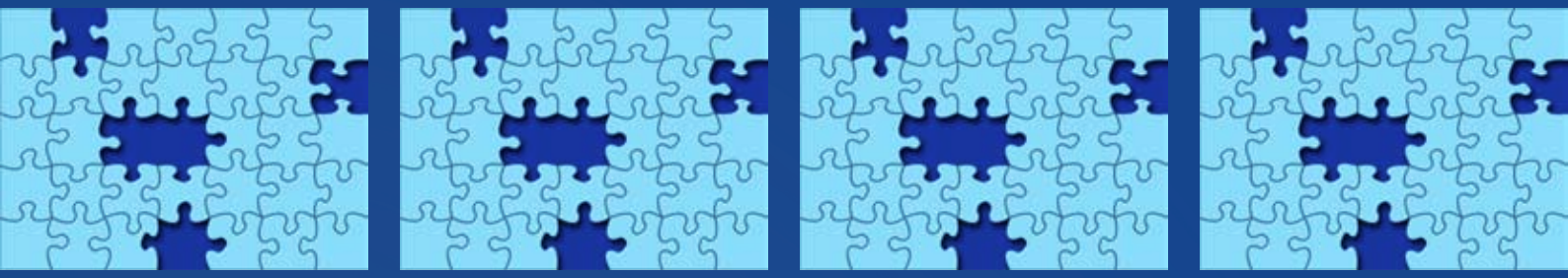
- the definition of small and medium-sized business according to a turnover threshold of $50 million is potentially too low;
- whatever turnover threshold is used, it should be indexed; and
- some flexibility should be applied to the issue of imposing a limit on grant funds. If a limit is considered necessary it should be no smaller than the current $15 million applying;

While SMEs require funding to undertake research it is not clear that the reasons for public funding of private activity should be arbitrarily removed. Larger firms which have the same public benefit characteristics and therefore the same public benefits should not excluded without due consideration.

Removing thresholds can also remove the incentive for companies to create artificial subsidiary companies in order to qualify for funding. Similarly, other forms of legal artifice, such as joint ventures between ineligible firms and smaller eligible entities, designed to bypass the threshold for eligibility can be guarded against.

On the issue of capping of expenditure of Commercial Ready program funds on overseas activity, there is no prima facie reason to believe that even where a vast majority of the research takes place offshore that a project could not still provide substantial national benefits to the Australian economy. Any mandatory capping on the proportion of program funds that can be used to carry on research overseas will actively discourage projects involving international collaboration that could nevertheless render substantial benefits in Australia.

# Chapter 8
# Skills Development and Manufacturing



# SKILLS DEVELOPMENT AND MANUFACTURING

## WHY SKILLS DEVELOPMENT IS VITAL

To undertake world class R&D Australia's manufacturing sector will rely on employees undertaking tertiary level education in areas such as engineering, maths and science. Nevertheless, a skilled workforce not only relies on higher-level education but is also underpinned by trainees and apprentices.

Expenditure on education both public and private (see Figure 44), along with the number of years at school are considered partial indicators of educational quality (see Figure 45), other indicators include student to staffing ratios and international examination comparisons.

While expenditure on education may provide some indication of the stock of human capital, the quality of education as measured by the comparative results of international examinations in science, maths and reading provides another metric of educational quality.[45]

> Spending is not necessarily a guarantee of higher quality in terms of education, though: Australia, Belgium, the Czech Republic, Finland, Japan, Korea, the Netherlands and New Zealand all have moderate expenditure on education per student at the primary and lower secondary levels but are among the countries where 15-year-olds perform strongest in key subject areas.[46]

While Australia has a skilled workforce by international standards it is important to recognise that partnerships between government and industry are vital in extracting the full benefits of our educated labour market.

## SKILLS SHORTAGES IN AUSTRALIA

Through strong economic growth Australia is now faced with a skills shortage. Many firms are unable to hire suitable employees (see Figure 46).

With record low unemployment and high participation rates the manufacturing sector has to compete with other industries for scarce resources. This phenomenon across the economy results in both skills gaps and skills shortages. A skills gap highlights the difference between those skills obtained by the employee and those required by the employer, while a skills shortage refers to a lack of specialised or experienced workers.

Industry requires a system that retains incentives to choose education and training options which meet specific industry needs. This is crucial in meeting the short and long term economic goals of Australia and provides business with a competitive edge to compete in the global economy.

Training and re-training programs must be flexible in providing marketable skills to employees, to adjust to changing economic and industry structures. The total number of persons in training has fallen by 3.3 per cent in the year 31 March 2006 while the number of commencements has increased by 3.2 per cent over the same period.

The number of completions increased by 5.5 per cent while cancellations increased by 6.4 per cent over the year ending 31 March 2006 (see Figure 47). The most popular enrolled qualification is Australian Qualifications Framework certificate level III (see Figure 48).

While not all skills gaps and shortages can be addressed through training and education, particularly allowing for lags, they do provide a number of solutions. Due to Australia's ageing population competition for employees is likely to be greater in the future. Although Australia's ageing population is a real concern competitor countries are also facing the same issue and many have larger problems than us. In fact, China will see a dramatic rise in the number of elderly residents as a proportion of the population by 2050, mainly due to its one-child policy.[47]

To support the manufacturing sector become more competitive Australia must not only focus on domestic skills development but also internationally skilled persons. The numbers of migrants arriving under the Skill Stream has risen from 71,240 in 2003-04 to 77,880 in 2004-05.

> The manufacturing sector has particular skills shortages in the area of engineering, employing approximately

45 Comparisons of international test scores have been subject to some discussion on their validity as a measure of quality, culture bias and a number of other criticisms. In recent years a number of measures have been taken to address these concerns.

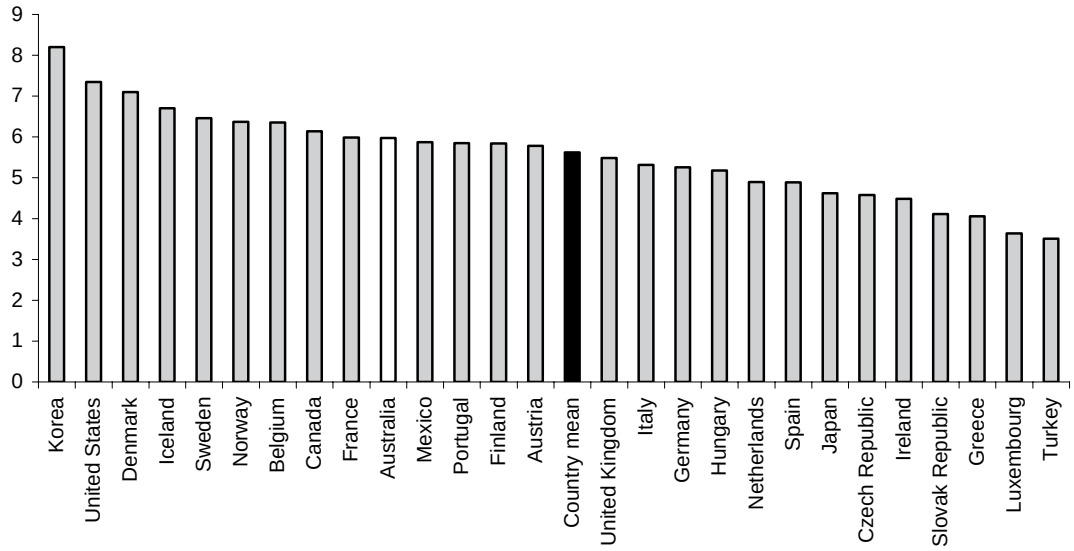
46 Education at a Glance, "OECD calls for broader access to post-school education and training", Media Release, 2005.

47 OECD Observer (1999), China, a demographic time bomb, *Observer*, No 217-218, Summer 1999.

**Figure 44**
**Distribution of Persons Aged 25-64 Years by Educational Attainment**

| Country | Below Upper Secondary Education | Upper Secondary and Post-Secondary Non-Tertiary | Tertiary Type B (Undergrad) | Tertiary Type A (Bachelor or Above) |
|---|---|---|---|---|
| Australia | 41 | 30 | 10 | 19 |
| Canada | 18 | 40 | 21 | 20 |
| France | 36 | 41 | 11 | 12 |
| Greece | 49 | 33 | 5 | 12 |
| Indonesia | 77 | 18 | 2 | 3 |
| Italy | 55 | 35 | 0 | 10 |
| Japan | 17 | 49 | 15 | 19 |
| Korea | 32 | 44 | 7 | 17 |
| New Zealand | 24 | 47 | 15 | 14 |
| Sweden | 19 | 49 | 15 | 17 |
| United Kingdom | 17 | 57 | 8 | 18 |
| USA | 13 | 50 | 9 | 28 |

**Figure 45**
**Expenditure on Educational Institutions - Public and Private (%GDP)**




Source: OECD, 2004, *Education at a Glance - OECD Indicators 2004*, OECD Paris, 2004: Statlink http://dx.doi.org/10.1787/650383071321.

100,000 more engineers than any other sector. A recent report[48] identified that engineering professionals will have an average annual replacement rate of 5.0 per cent; the national average replacement rate for Science, Engineering and Technology (SET) is 3.2 per cent.

## DEALING WITH SKILL SHORTAGES

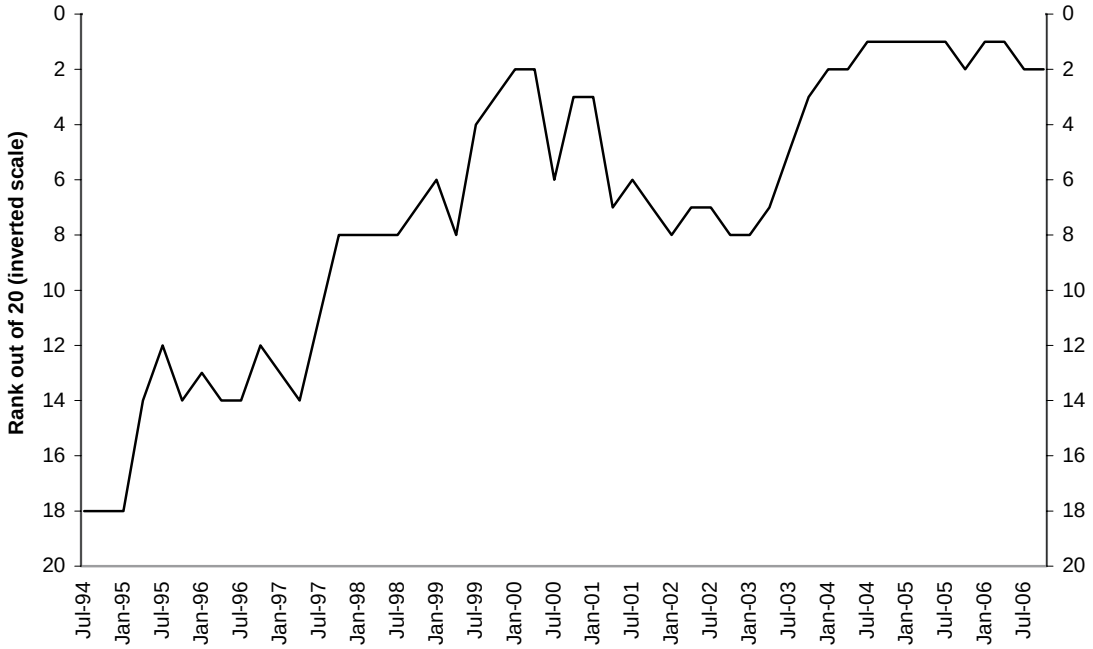
A number of common elements contribute to skills shortages including:[49]

- The ageing of the Australian population means that across a wide range of industries, a significant number of skilled workers have either retired, or are about to retire.
- Career moves, where skilled workers have moved to other roles within industry or moved into other industries ("going off the tools").
- New and emerging technology has put many existing workers at a disadvantage because they have not been trained to use these technologies and in some cases are resistant to change or to undertaking training.

48 Australian Government, 2002, *Audit of Science, Engineering and Technology Skills*, Department of Education, Science and Training, p 7.

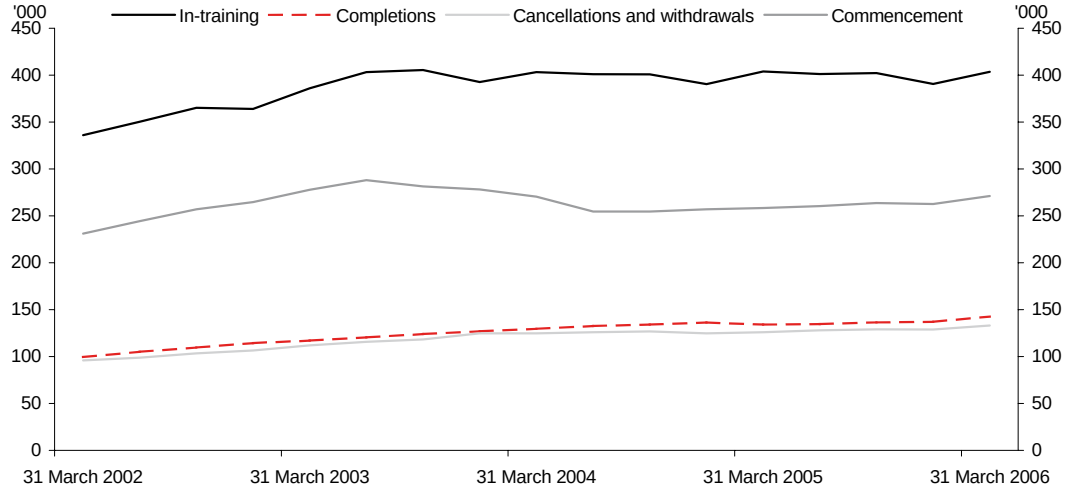
49 *ACCI Review*, Number 134, April 2006.

**Figure 46**
**Availability of Suitable Employees**




Source: OECD, 2004, *Education at a Glance - OECD Indicators 2004*, OECD Paris, 2004.
Statlink: http://dx.doi.org/10.1787/650383071321.

**Figure 47**
**Apprentice and Training Activity 31 March 2002 to 31 March 2006**




Source: National Centre for Vocational Education and Research Ltd, *Australian Vocational Education and Training Statistics – Apprentices and Trainees June Quarter 2005*, Australia Tables.

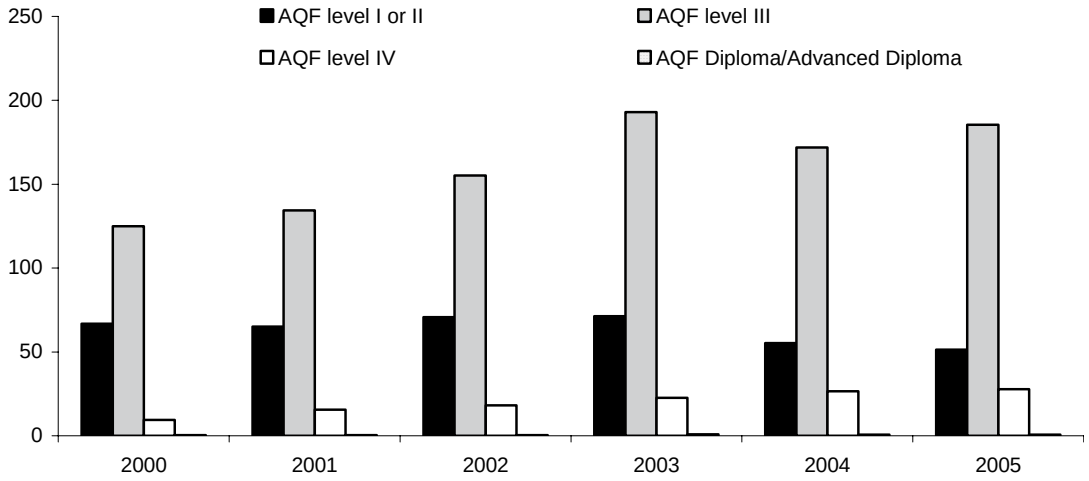
- Many young people, and their parents, have outdated perceptions of some industries that do not encourage school leavers to seriously consider a career in those industries and these perceptions are not always accurately addressed by the career counselling services available to them.

- A training regime and delivery system that does not meet the needs of employers and potential employees and does not reflect realities of the modern workplace or workplace practices.

- The complex and complicated structure of, and information about, the Vocational Education and Training system and the New Apprenticeships program that discourage employers from engagement.

- The different career expectations of Generation X and Y compared with those of previous generations, meaning that they do not necessarily expect to remain in the one occupation or with the one employer for extended periods of time. Consequently, employers may be reluctant to invest in training when there is a

**Figure 48**
**Course Enrolments by Qualification June 2000 to June 2005**




Source: National Centre for Vocational Education and Research Ltd, *Australian Vocational Education and Training Statistics – Apprentices and Trainees June Quarter 2005*, Australia Tables.

realistic possibility that the employee will note remain with them long enough for them to achieve a return on their investment in the training.

While there are common underlying factors influencing skills development across a number of different industries, effective strategies to provide solutions will in many cases needed to address the issues on an industry to industry basis.

ACCI believes that solving skills and labour shortages will not be easy and that any long-term solution will have to include the following three elements:

- Training more Australians in occupations in shortage. This includes young Australians and providing people with opportunities and incentives to move from income support into employment.

- Convincing more people to move to regions where skill and labour shortages exist or encouraging people to utilise their existing skills in more critical areas of the labour market.

- A targeted skilled and semi-skilled migration program.

It is vital that the progress towards implementation of COAG initiatives continues to involve strong partnerships between industry and government so that any developments meet industry needs and so will result in effective action by industry with government support.

Furthermore, there is a need for many industries to look beyond the traditional sources of new recruits (usually school leavers) and consider women, mature-age people, Indigenous Australians and up-skilling existing workers.

Training outcomes do not always meet the needs of employers and employees, and many employers are providing their own non-accredited training or encouraging employees to leave training once they have acquired a skill set the employer needs, or making other arrangements to cover shortages to meet short term needs. There is a need for improvements to the national training system, the Training Packages for their respective industry and the delivery of training.

While these are common factors across a range of industries, effective strategies to provide solutions will in many cases need to address the issues on an industry to industry basis.

## TRAINING AND EDUCATION POLICY

Employers seek quality outcomes from the VET sector.

Reforming the national training system, particularly to give the manufacturing sector a better ability to compete and to meet future productivity and workforce participation challenges, must be of paramount importance to government. In order to undertake the necessary reform the national training system will need to include a broader workforce development approach.

### The COAG Reform Agenda

On 16 February 2006 COAG agreed to work towards reforms in the training system to achieve an improvement in Australia's human capital formation through the national

training system.

COAG has targeted areas such as outcomes based auditing for Registered Training Organisations (RTOs), licensing, mutual recognition of qualifications, intermediate qualifications, the recognition of competency-based rather than time served progression in apprenticeships and removing barriers to Australian School-based Apprenticeships (ASBAs). Further reforms have been foreshadowed with the Ministerial Council on Vocational and Technical Education (MCVTE) to report by 31 December 2006 on options.

Adult literacy has been identified as an ongoing issue with ACCI members including those within the manufacturing sector. However, a greater level of demonstration needs to be evidenced that the use of funding is specifically addressing this issue. The evidence needs to be apparent with successful outcomes of programs such as Workplace English Language and Literacy (WELL), not just participating in innumerable surveys to measure workplace literacy.

## Regulation of the VET Sector

Support for the shift to an output/outcome based funding model is strongly supported by ACCI rather than a model that focuses on delivery hours. The current regulation has been viewed by industry as inflexible and as over regulatory, focussing on process rather than outcomes. Any review of the regulatory arrangements needs to focus on the right regulation to ensure quality and an outcome based approach.

In principle, industry supports a quality based auditing system, however, ACCI urges that there is a need to sufficiently consult with industry, as any consideration for a quality based auditing system must meet the requirements of industry and not simply training providers.

## Performance Information

Industry recognises that there are dubious Registered Training Organisations (RTOs) that provide poor training and there are those that provide exceptional training and support. It is essential that appropriate performance indicators be identified by industry. Areas where this data may be useful is:

- financial data is transparent and integrity assured;
- the issue/range of any qualifications on offer; and
- where training is delivered, whether it leads to employment (NB - this may be a difficult area to track and become a burden on the RTO).

Any proposal to publicly publish data cannot contribute to an administrative burden on business activities. It needs to be clearly outlined, consistently applied across the system and most importantly efficiently resourced.

## Stronger Relationships Between Firms and Providers

Research carried out through the NSSS strongly suggested that the relationship between firms and training providers was what made the training system work. The interplay between the on the job training component and off the job trade training component of trade training and apprenticeships enabled this relationship to be built and to be a successful one. It was the number one reason that employers gave that the training system was working for their business.

Research also shows that, the cost of training an apprentice in building and construction for a four-year period is $132,000. This is obviously a very serious and strong commitment from industry.

## Adult Literacy

Adult literacy has been identified as an ongoing issue with ACCI members, including those within the manufacturing sector. We note the Workplace English Language and Literacy (WELL) program, and seek increased focus on this issue by both Commonwealth and State governments.

## Resourcing

In the current COAG Review, resource funding and investments has been identified by the Department of Education, Science and Training as a high priority issue and this involves areas such as: taxation; investment by firms; investment from individuals; investment from governments; the impact of delivery models and infrastructure and reviewing current arrangements.

Businesses are moving away from institutionalised training to in-house training, as TAFEs were failing to deliver the needs of industry. There is a strong case that TAFEs should operate on a commercial basis and be responsive to the demands of the market place.

The Australian Apprenticeships program currently caters

for a range of formal workplace training arrangements with one set of incentives and regulatory arrangements applying. Over the past six years the underlying concept of an apprenticeship, that is structured learning in a work based environment, has become well established outside the trades.

ACCI believes that there is an opportunity for a new strategic positioning of the New Apprenticeships program in the VET system to revitalise its role in meeting the skills needs of those entering the labour market, those already in the existing workforce or those who are on income support.

It is imperative that the incentive arrangements, which currently apply across all industries, be maintained. However, it would be timely to extend the arrangements to cover all levels of New Apprenticeship pathways, including at the higher levels of Australian Qualification Framework levels V and VI.

The National Skills Shortages Strategy (NSSS) has funded a range of industry developed and managed projects that have identified significant issues regarding the recruitment, training and retention in occupations in shortage of suitably skilled workers across a range of industries.

The Australian Technical Colleges will provide an innovative approach to encouraging young people to merge employment and learning options during their secondary senior years and will further help to raise the esteem of VET pathways in the community. Clearly identifiable industry leadership will be important to the success of the Colleges.

ACCI believes that further sites for Australian Technical Colleges should be investigated, especially in regional areas experiencing skill shortages.

ACCI members support the policy directions of the Government in the broad area of welfare reform and are particularly interested in programs that connect the various government agencies dealing with a specific issue taking a whole of government approach. There is also strong support for initiatives that address Australia's skill and labour shortages.

As such, ACCI believes that the concept of providing Job Network clients with an opportunity to take up a New Apprenticeship is therefore critical in providing unemployed persons with dual opportunities of work and gaining skills, and providing targeted interventions to address the supply of skills problems.

Also, the Institute of Trade Skill Excellence (ITSE) became operational in 2006.

ITSE will concentrate on promoting excellence in traditional trades, a key focus of the manufacturing sector. It includes a number of industry reference groups in the manufacturing sector to advise on the improvement of the status of the trades in those industries. ACCI fully supports ITSE and is a co-founder of the Institute.

# Chapter 9
# Foreign Direct Investment and Manufacturing

# FOREIGN DIRECT INVESTMENT AND MANUFACTURING

## THE BENEFITS OF FOREIGN DIRECT INVESTMENT

Globalisation of the manufacturing sector provides not only opportunities and challenges for maintaining market share but also receiving foreign capital. Australia's national savings does not provide industry with resources sufficient for capital accumulation and investment therefore we require overseas savings in the form of foreign investment.

Foreign Direct Investment (FDI) has helped to finance Australia's capital needs leading to faster economic growth and higher living standards than would otherwise have been the case. It has also increased employment, stimulated exports, improved consumer welfare and given Australian business access to an improved technological and knowledge base so providing a more diverse economy.[50]

Foreign investment is split between foreign equity and debt borrowings. The commercial and economic dividends of greater foreign direct investment for the recipient country are generally well known in commercial and trade policy circles.

Firstly, foreign investment can provide a stimulus to the host country's business sector, through its positive impact on productivity growth and enterprise development, which in turn can enhance competition in previously sheltered markets.

Secondly, foreign investment can deliver positive spillovers to domestic enterprises, especially in the form of newer and relatively more advanced technologies, and human capital (such as management skills). In essence all firms rather than just those firms receiving foreign capital will have higher productivity.

The latest figures from the OECD show that FDI jumped substantially over the past year:

> Foreign direct investment (FDI) into OECD countries jumped 27% to reach USD 622 billion in 2005, up from USD 491 billion in 2004 and USD 465 billion in 2003, according to the latest estimates from the OECD. These are the highest inflows since 2001 and the near-term outlook for FDI remains strong, with OECD economies forecast to stay buoyant for the rest of 2006.[51]

International experience has shown foreign investment tends to lift employment and environmental conditions, especially in developing-host countries, as such firms tend to apply performance standards above those of the local community.

A vast bulk of international FDI flows is directed towards and emanates from developed counties although this is beginning to change as globalisation increases (see Figures 49 and 50).

Australia is positioned near Asia, where both outward and inward FDI is experiencing particularly strong growth.

> The Asia and Oceania region is also emerging as an important source of FDI. In 2004 the region's outward flows quadrupled to $69 billion, due mainly to dramatic growth in FDI from Hong Kong (China) but also to increased investments by TNCs from other parts of East Asia and South-East Asia. Most of these investments are intraregional, taking place especially among the economies of East and South-East Asia. However, interregional investment from Asian economies also increased. For example, a key driver of Chinese outward FDI was the growing demand for natural resources.[52]

Over the past decade Australia has been a major recipient of FDI, proving the fifth largest destination for net outflows from 1996-2005 (see Figure 51). A high component of this FDI is directed towards manufacturing with 34.5 per cent of value added being foreign owned, well above the average across industry of 22.9 per cent. Also the figures show that for Australian manufacturing foreign owned firms' share of exports is 63.6 per cent, again well in excess of the average across the industry of 49.8 per cent (see Figure 52).

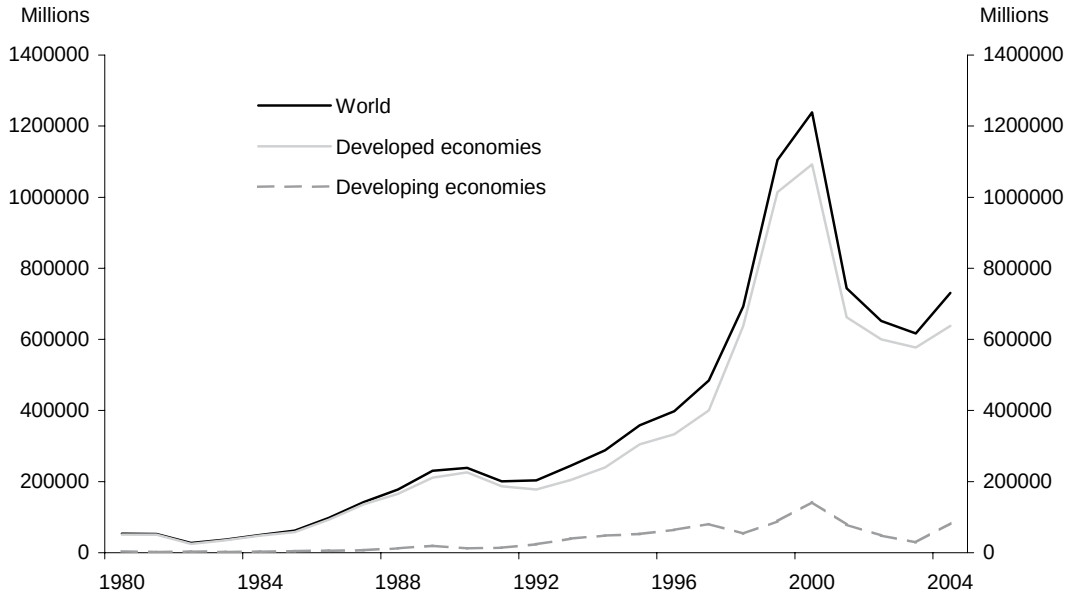
Australia requires an investment framework that encourages international businesses to provide capital and skills to Australia. The manufacturing sector is particularly dependent and benefited by governments improving Australia's attractiveness as a source of foreign capital.

50 Blackburn Report (2001), *Winning Investment: Strategy, People and Partnerships, A Review of the Commonwealth's Investment Promotion and Attraction Efforts*, A report to the Prime Minister, August.

51 Hans Christiansen and Ayse Bertrand (2006), *Trends and Recent Developments in Foreign Direct Investment*, Investment Division, OECD

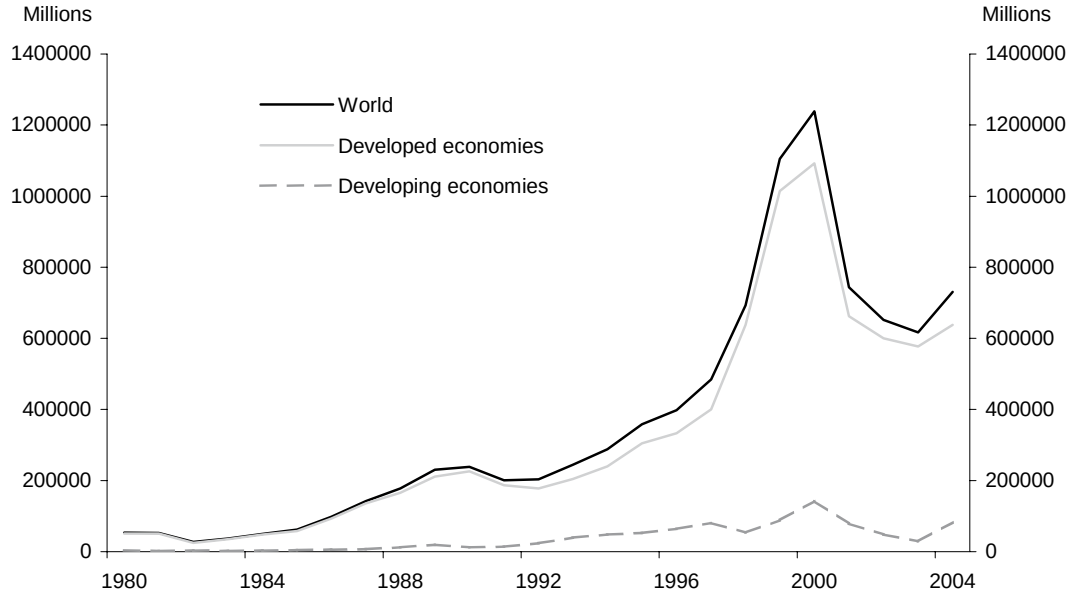
52 Ibid.

**Figure 49**
**Foreign Direct Investment Inflows**




Source: UNCTAD, FDI/TNC database.
Note: See United Nations, *World Investment Report 2005*, Transnational Corporations and the Internationalization of R&D, United National Conference on Trade and Development, United National New York and Geneva, 2005 for discussion of FDI data issues, Box 1.1.

**Figure 50**
**Foreign Direct Investment Outflows**



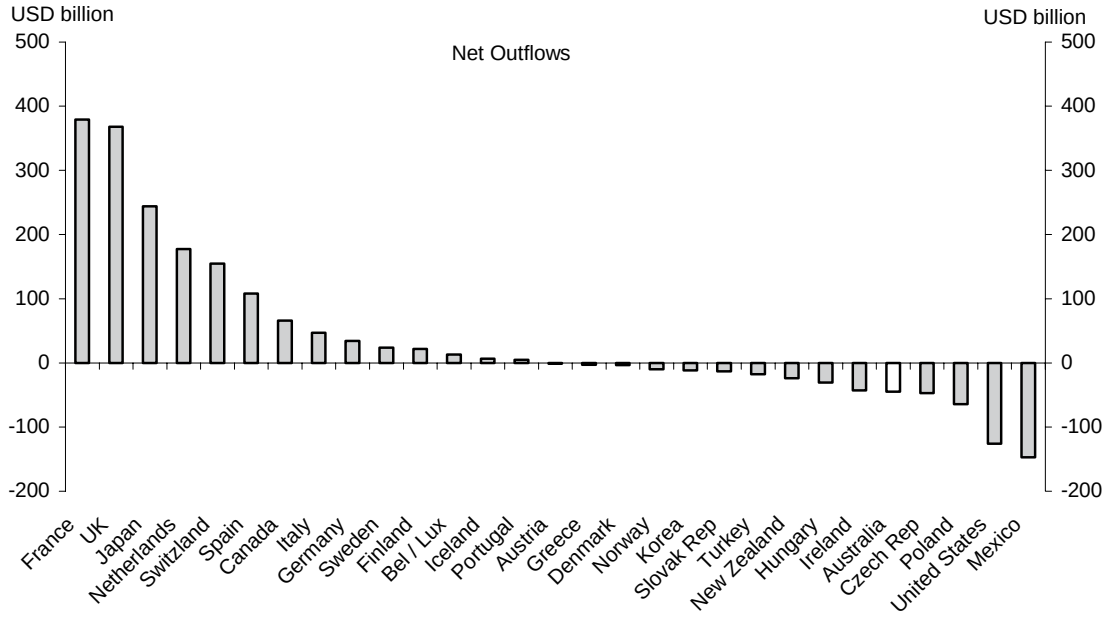

Source: UNCTAD, FDI/TNC database.
Note: See United Nations, *World Investment Report 2005*, Transnational Corporations and the Internationalization of R&D, United National Conference on Trade and Development, United National New York and Geneva, 2005 for discussion of FDI data issues, Box 1.1.

The central question with regard to FDI is, do net capital inflows, which provides greater domestic capital accumulation improve the economy's overall productive capacity and how much does it raise Australia's living standards?

A recent report[53] found that foreign-financed capital generated additional real national income gains each year for the past decade. While the total cumulative income gain in 2003-04 prices was $23.3 billion or $2500 per employee.

53 Tony Makin, 2006, "Has Foreign Capital Made Us Richer?", *Agenda: A Journal of Policy Analysis and Reform*, Volume 13, Number 3, p 225-237.

**Figure 51**
**Cumulative FDI Flows in OECD Countries 1996-2005**




Source: Hans Christiansen and Ayse Bertrand, 2006, *Trends and Recent Developments in Foreign Direct Investment*, Investment Division, OECD.

**Figure 52**
**Foreign Owners Share of Value Added and Exports**

| Industry | Foreign Owned Firms' Share of Value Added | Foreign Owned Firms' Share |
|---|---|---|
| Agriculture, Fishing and Forestry | n.a. | 13.7 |
| Mining | 44.9 | 43.3 |
| Manufacturing | 34.5 | 63.6 |
| Electricity, Gas, Water Supply and Construction | 20.9 | 38.1 |
| Wholesale Trade | 31.1 | 37.7 |
| Retail Trade | 7.5 | 38 |
| Accommodation, Cafes and Restaurants | 7.4 | n.a. |
| Transport, Storage and Communications Services | 12.9 | 47.1 |
| Finance and Insurance | n.a. | 44.8 |
| Property and Business Services | 17.8 | 56.6 |
| Cultural and Recreational Services | 1.2 | 24.5 |
| Personal and Other Services | 6 | 33.6 |
| **Total** | **22.9** | **49.8** |

Source: Australian Bureau of Statistics, *Foreign Ownership of Australian Exporters and Importers*, Cat. No. 5496.0.55.001, 2002-03, Canberra.

It is important to remember that not only does the manufacturing sector rely on foreign income but Australia's broader prosperity and living standards are equally tied to Australia's competitiveness as a destination for foreign capital.

# Chapter 10
# Workplace Relations and Manufacturing

# WORKPLACE RELATIONS AND MANUFACTURING

## THE NEED FOR REFORM

Over the decades manufacturing has suffered more than most sectors of the economy from dysfunctional industrial relations arrangements.

The reforms to industrial relations implemented over the years, starting with the Keating Labor Government, but significantly advanced by the Howard Coalition Government, have lead to significant positive changes to the labour market environment, not least the shift to enterprise based bargaining and individual agreement making.

The manufacturing sector has been a major beneficiary of these overall changes. However, it has not fully utilised the opportunities available to it to increase the shift to enterprise based bargaining and individual agreement making.

## STATE OF PLAY

Industrial relations in Australia is often categorised into the different types of agreement making that occurs across industry and in the workplace. This might be through the Award system; by enterprise based collective agreements; or through individual agreements in the form of Australian Workplace Agreements (AWA's) or common law agreements.

In this chapter we give a snapshot of the manufacturing sector's relative use of those different types of agreements before proceeding with a discussion of other industrial matters.

### Award Employment

The Award system is a set of legally enforceable determinations that set out pay, minimum employment conditions by jurisdiction, industry occupation, level of skills and duration of employment amongst other criteria. The determinations are made through Federal, State and Territory industrial tribunals, which operate on a court model in which applicants and respondents argue the merits of their case and the tribunal acts as final arbitrator.

During the four year period since 2000 there has been a 3.5 per cent point shift to award only employment from agreement based employment.

Interestingly manufacturing has become more award dependent while staying relatively low compared with the high award dependent sectors of Accommodation, Cafes, and Restaurants and Retail Trade divisions.

Having said that only 14.9 per cent of employees in the manufacturing sector are award dependent and as we will see below most employees are covered by either individual agreements or enterprise based collective bargaining (see Figure 53).

### Collective Agreements

Collective agreements are written employment agreements that can cover one employer, a group of employers or several employers and a large number of employees throughout the different businesses. These agreements can override award provisions that apply to the industry except in the areas of occupational health and safety, workers' compensation and training arrangements.

For the manufacturing sector collective agreements cover 35.8 per cent of employment (see Figure 54).

### Individual Agreements

Individual agreements can be made through a common law contract or through an Australian Workplace Agreement (AWA). These agreements are made between employers and employees but in the case of common law agreements these agreements must encompass the terms set out in awards. That is, the agreements are the award standards plus additional features sought by employers and employees.

Australian Workplace Agreements (AWA's) have been available to employers since 1997 and were introduced in a bid to allow firms to tailor employment conditions to their own working environments. Further enhancements to the AWA system have been introduced with the *WorkChoices* legislation, which passed the parliament in March 2006.

In total, individual agreements cover 49.3 per cent of manufacturing employment. Most of these are common law individual agreements.

Mining has made the greatest use of AWA's with 40.8 AWA's made per 1000 employees in the June 2006 quarter while

**Figure 53**
**Proportions of Award Only Employment**

| | 2000 EEH* | 2002 EEH** | 2004 EEH*** |
|---|---|---|---|
| Accommodation, Cafes, Restaurants | 64.7 | 61.2 | 60.1 |
| Retail Trade | 34.9 | 34.2 | 31.3 |
| Health & Community Services | 37.4 | 30.3 | 26.6 |
| Personal & Other Services | 27.1 | 22.2 | 23.5 |
| Property & Business Services | 20.7 | 18.1 | 19.7 |
| Cultural & Recreational Services | 18.9 | 10.9 | 17.7 |
| Construction | 15.0 | 17.1 | 15.2 |
| Manufacturing | 11.4 | 12.5 | 14.9 |
| Wholesale Trade | 12.1 | 11.7 | 14.9 |
| Transport & Storage | 18.4 | 16.4 | 14.4 |
| Education | 13.6 | 7.8 | 8.9 |
| Finance & Insurance | 5.6 | 4.9 | 4.5 |
| Mining | 5.9 | 5.9 | 1.9 |
| Electricity, Gas & Water Supply | 1.4 | 1.1 | 1.7 |
| Communication Services | 1.5 | 2.4 | 2.1 |
| Government Admin & Defence | 15.3 | 6.0 | 0.8 |

Source: EEH data.
Note: Some of the lower figures may be subject to higher standard errors.
* ABS, EEH, May 2002, Table 2000, Table 25.
** ABS, EEH, May 2002, Table 2002, Table 24.
*** ABS, EEH, May 2002, Table 2004, Table 15.

**Figure 54**
**Proportions of Collective Bargaining Employment**

| | 2000 EEH* | 2002 EEH** | 2004 EEH*** |
|---|---|---|---|
| Government, Admin & Defence | 77.9 | 86.6 | 89.3 |
| Education | 77.1 | 83.5 | 83.5 |
| Electricity, Gas & Water Supply | 76.5 | 78.1 | 79.9 |
| Communication Services | 69.4 | 69.1 | 62.6 |
| Health & Community Services | 43.5 | 49.5 | 54.8 |
| Personal & Other Services | 42.8 | 42.6 | 45.7 |
| Finance & Insurance | 49.9 | 50.0 | 43.7 |
| Transport & Storage | 40.1 | 40.3 | 41.9 |
| Mining | 39.7 | 40.5 | 38.8 |
| Cultural & Recreational Services | 33.3 | 31.2 | 38.7 |
| **Manufacturing** | **37.0** | **37.5** | **35.8** |
| Retail Trade | 28.7 | 30.3 | 33.4 |
| Construction | 23.8 | 23.1 | 24.1 |
| Wholesale Trade | 10.8 | 7.9 | 16.0 |
| Property & Business Services | 11.1 | 11.7 | 12.8 |
| Accommodation, Cafes, Restaurants | 6.7 | 6.8 | 11.7 |

Source: EEH data.
Note: Some of the lower figures may be subject to higher standard errors.
* ABS, EEH, May 2002, Table 2000, Table 25.
** ABS, EEH, May 2002, Table 2002, Table 24.
*** ABS, EEH, May 2002, Table 2004, Table 15.

**Figure 55**
**Proportions of Individual Agreements (including AWA's)**

| | 2000 EEH* | 2002 EEH** | 2004 EEH*** |
|---|---|---|---|
| Wholesale Trade | 77.1 | 80.4 | 69.1 |
| Property & Business Services | 68.2 | 70.1 | 67.5 |
| Construction | 61.2 | 59.8 | 60.8 |
| Mining | 54.3 | 53.6 | 59.3 |
| Finance & Insurance | 44.4 | 45.1 | 51.8 |
| **Manufacturing** | **51.6** | **50.0** | **49.3** |
| Transport & Storage | 41.4 | 43.3 | 43.7 |
| Cultural & Recreational Services | 47.8 | 57.8 | 43.5 |
| Retail Trade | 36.5 | 35.4 | 35.3 |
| Communication Services | 29.1 | 28.4 | 35.3 |
| Personal & Other Services | 30.1 | 35.3 | 30.8 |
| Accommodation, Cafes, Restaurants | 28.6 | 32.0 | 28.3 |
| Health and Community Services | 19.1 | 20.1 | 18.6 |
| Electricity, Gas & Water Supply | 22.1 | 20.9 | 18.4 |
| Government Admin & Defence | 6.8 | 7.4 | 9.9 |
| Education | 9.3 | 8.7 | 6.7 |

Source: EEH data.
Note: Some of the lower figures may be subject to higher standard errors.
* ABS, EEH, May 2002, Table 2000, Table 25.
** ABS, EEH, May 2002, Table 2002, Table 24.
*** ABS, EEH, May 2002, Table 2004, Table 15.

manufacturing made 5.3 AWA's per 1000 employees.

Nonetheless there has been a significant increase in the take up of AWA's, in manufacturing, as shown in Figure 55. As of September 2006 there were 114,000 employees on AWA's in the manufacturing sector.

Despite the continued growth in the number of AWA's being made in manufacturing other industries have higher rates of individual bargaining. This has meant that manufacturing AWA's as a proportion of the total number of employees has fallen overall.

Using the proportion of employment as a basis for measuring AWA making removes the fact that some industries' workforce is growing at a faster rate than others. Thus, removing the differences in growth between sectors allows a comparison of the change in relative agreement making rates. A selection of industries is shown in Figure 56.

As can be seen in Figure 57 manufacturing AWA making has only grown slowly since the introduction of AWA's in 1997 and has slowed as a proportion of employment since September 2005.

## INDUSTRIAL ACTIONS

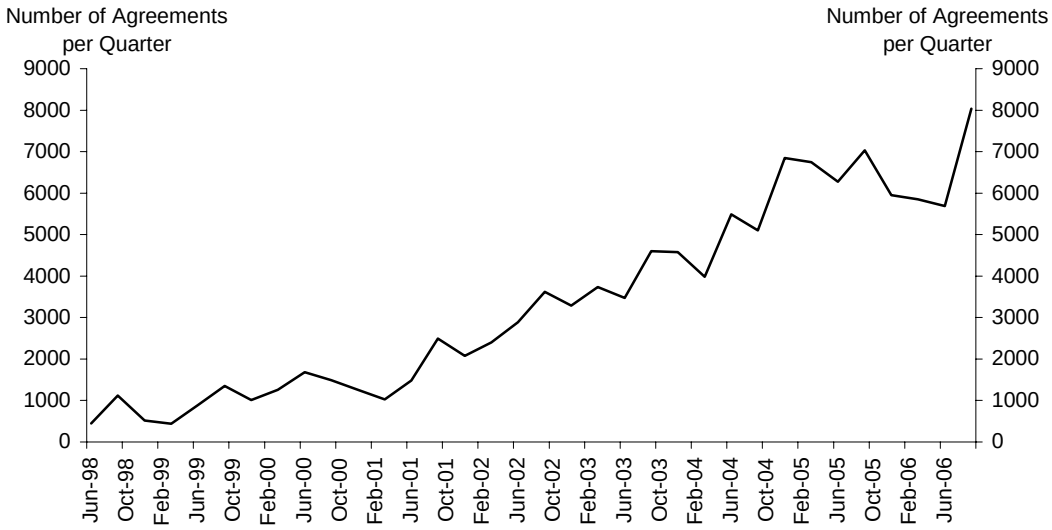
Industrial action in manufacturing has been relatively low since June 2004 and there has been a clear downward trend for over 10 years. This has been one of the most significant benefits of industrial relations reform for the manufacturing sector.

However, metal product, machinery and equipment manufacturing continues to have higher numbers of industrial action and may also have actions of longer duration. The higher number and possibly duration means that there is a higher rate of working day lost per employee than for the rest of manufacturing.

Metals, and machinery and equipment made up approximately 40 per cent of manufacturing employment as at June 2006. For example, other manufacturing had 0.9 working days lost per 1000 employees in the June quarter of 2006 while metals, and machinery and equipment had 13.2 working days lost per 1000 employees. The average rate of working days lost over the whole manufacturing sector was therefore 5.9 per cent (see Figure 58).

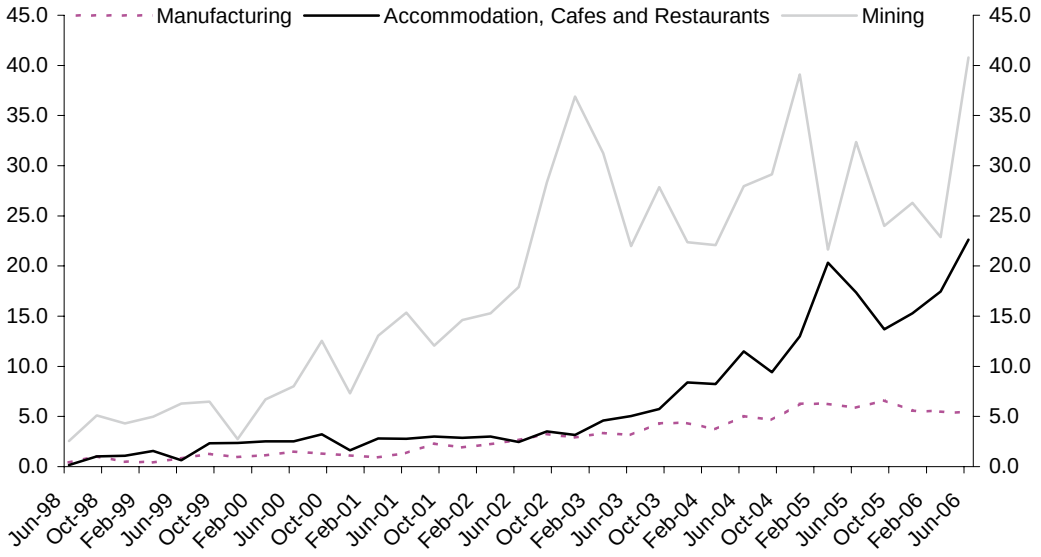
It is particularly noticeable that manufacturing continues to lose a greater number of working days due to industrial

**Figure 56**
**Manufacturing Australian Workplace Agreements**




Source: Office of the Employment Advocate, unpublished data.

**Figure 57**
**Australian Workplace Agreements as a Proportion of Employment**




Source: Office of the Employment Advocate, unpublished data.

action than the national average. The average number of working days lost in manufacturing in June 2006 was 5.9 per 1000 employees while the national average was up 3.1 per 1000 employees (see Figure 59).

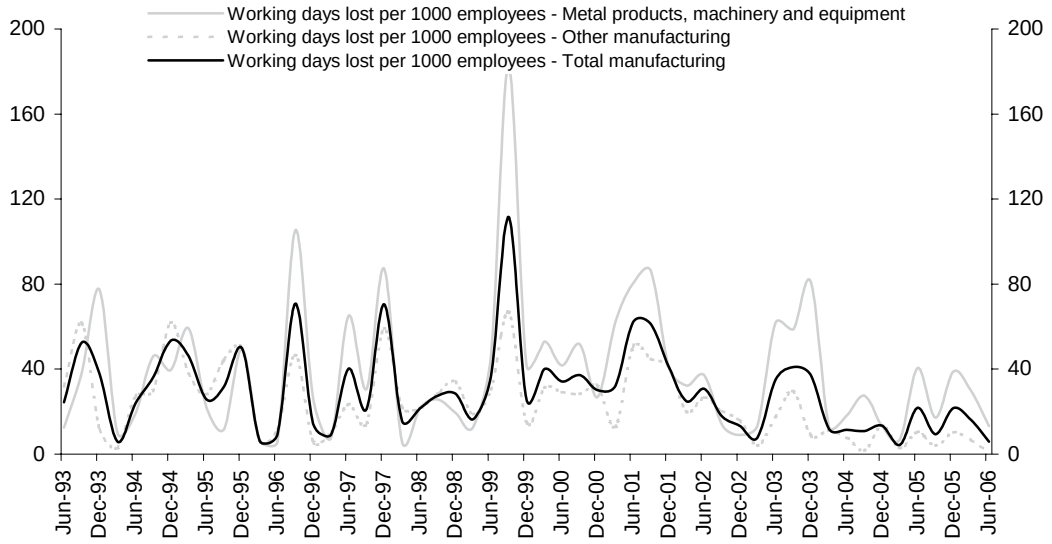
The higher figure for metal, machinery and equipment manufacturing may also be associated with higher rates of unionisation. In August 2005, which is the latest data available, 28.9 per cent of metal, machinery and equipment employees were union members compared with only 22.8 per cent in the rest of the manufacturing industry. Over the whole sector the figure was 25.0 per cent.

Much of this higher figure can be explained by the significant amount of pattern bargaining which still plagues the sector.

Pattern bargaining occurs because unions have been successful in negotiating similar collective agreements across a range of employers and therefore industrial actions tend to affect a larger group of employers than disagreements at a single firm level.

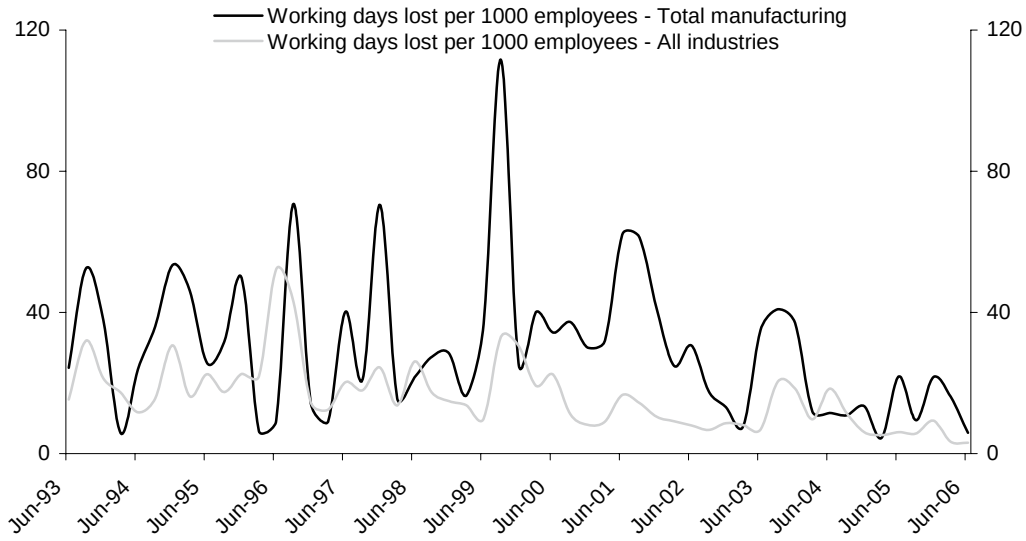
While illegal, loopholes have existed in the law that unions have exploited to continue with pattern bargaining. It is hoped that the new *WorkChoices* changes will help tackle these practices.

**Figure 58**
**Working Days Lost**




Source: ABS, 6321.0.55.001 Industrial Disputes, Australia Table 2a: Industrial Disputes Which Occurred During the Period, Working Days Lost, Industry; and 6291.0.55.003 Labour Force, Australia, Detailed Quarterly.

**Figure 59**
**Working Days Lost**




Source: ABS, 6321.0.55.001 Industrial Disputes, Australia Table 2b: Industrial Disputes Which Occurred During the Period, Working Days Lost per thousand employees, Industry.

## WORKCHOICES

In March 2006 the Australian Parliament passed the *WorkChoices* legislation, which represents the most comprehensive set of changes to workplace regulation laws in decades.

As a matter of priority, business has worked with the Australian Government and will continue to do so to ensure that these reforms are implemented smoothly as well as in accordance with the principles of our policy Blueprint *Modern Workplace: Modern Future* launched in November 2002.

The reform will kick start another round of productivity growth. We are confident this will mean lower unemployment than would otherwise occur and a continuation of real wage growth.

The changes through *WorkChoices* are long overdue and will help overcome the serious flaws and bad regulations that have hampered the capacity of Australian business to grow, compete and employ. Importantly, Australia has taken a massive leap toward the creation of a single national workplace relations system more suited to the 21st century. Also, the passage of *WorkChoices* will further the shift away from the centralised setting of wages and conditions to

a system based on genuine bargaining at the workplace level.

It has been workplace bargaining that has underpinned Australia's significant productivity improvement of the last fifteen years. By further emphasising the place of bargaining within the workplace relations system, *WorkChoices* will unlock the potential for further productivity gains and as a result, jobs growth and further increases in real wages. Manufacturing firms should seek to benefit from these opportunities as much as possible.

Employers and employees need to grasp the opportunities presented by *WorkChoices* to move away from reliance on awards and into workplace agreement making.

## OCCUPATIONAL HEALTH AND SAFETY

The OHS system in this country is in dire need of reform. The current system of regulation is seriously deficient.

Complex regulation is self-defeating and removes the incentive to invest in better OHS outcomes.

Just as tort (negligence) laws recently got out of hand and created major public liability problems, some OHS laws are now, for similar reasons, out of control and must be reined in. Some of Australia's OHS laws and court decisions are straight out of 'Alice in Wonderland'. They reek of employers being liable out of convenience or retribution, irrespective of commonsense.

There is excessive growth of OHS regulation and red tape. Many employers, especially small and medium businesses, find OHS laws and regulations to be complex, bureaucratic, difficult to understand and almost impossible to implement effectively.

There is a lack of balance in some existing legislation and court decisions. The trend across jurisdictions has been to broaden legal duties beyond reasonable limits, increase penalties, extend liability to individuals in the management and supply chain and seek to punish rather than prevent.

The ACCI Blueprint, *Modern Workplace: Safer Workplace* has been driven by three imperatives:

- the business community must take leadership on OHS issues at all levels;
- the current system of OHS law; and
- policy needs a comprehensive overhaul; and powerful common interests exist between employers and employees in achieving safer workplaces.

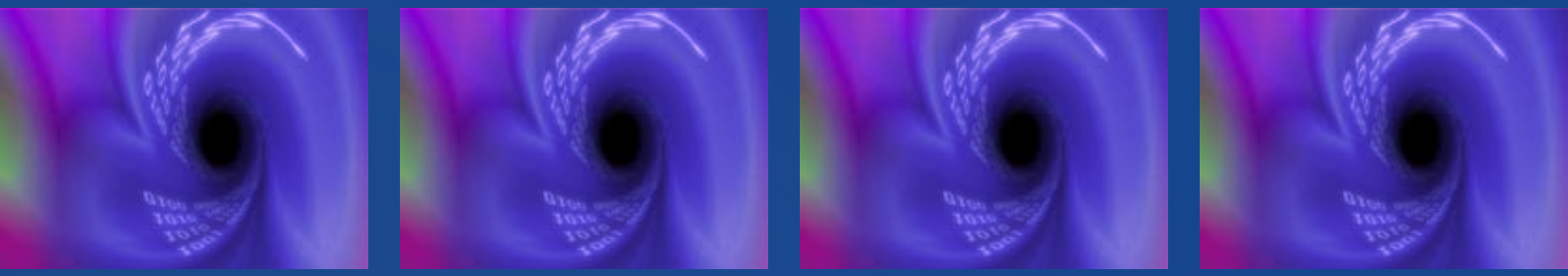
The Blueprint calls on all stakeholders to share the employers' national Vision for Australia's OHS System:

- Workplace culture drives outcomes more effectively than regulation;
- Mutual responsibilities exist, but should not be delegated to others;
- Active and ongoing OHS management plans and corporate leadership is required;
- There is a role for governments and regulation, but only where intervention drives improved outcomes;
- Australia's OHS performance is improving, but can and should be better;
- Commitment throughout the supply chain is needed, including early intervention through workplace design;
- The focus should be on risk management, not risk elimination where that is unachievable;
- The current system of regulation is seriously deficient;
- Complex regulation is self-defeating and removes the incentive to invest in better OHS outcomes;
- The duty of care based on reasonableness and foreseeablility has been distorted in some jurisdictions into impossible or unreal duties of care;
- Specific measures, such as a business advisors program, are needed to make OHS regulation workable for small and medium businesses;
- Alternative criteria for assessing the duty of care, such as compliance with a safety management system, should be pursued;
- National consistency of regulation is a desirable goal, whether or not there are national laws;
- State and Territory governments have a crucial role to play if OHS regulation in the private sector is to be improved;

- OHS communication activities by governments should be nationally coordinated;
- An imbalance exists in current enforcement and compliance practices. The focus is on prosecution of the few instead of prevention amongst the many;
- Alternative penalty options, such as enforceable undertakings, should be introduced;
- Proposals for new offences of industrial manslaughter breach fundamental principles of criminal responsibility and should not be pursued;
- Safety awareness should be built into community education; and
- Investment in OHS training needs to be increased.

ACCI has developed an OH&S Blueprint which is as relevant to the manufacturing sector as it is to the national economy.

# Chapter 11
# Taxation and Manufacturing



# TAXATION AND MANUFACTURING

## THE CASE FOR FURTHER REFORM

In recent times, policy makers have become more aware of the benefits of competition, efficiency and globalisation. There has also been increased awareness of the drivers of economic growth such as skills development, research and development, investment and education. Tax policy must provide an environment that encourages each to flourish within an international context. Economies that stagnate will be unable to maintain the living standards of contemporary generations. ACCI's taxation reforms create the incentives and structure that will deliver economic security and prosperity for all Australians.

This is just as important to the manufacturing sector as any other in the economy.

In the next ten years Australia's economy will continue to experience the long process of intergenerational change. Australia's future economic fortunes and wealth of its people will, in part, be determined by the decisions and actions taken today in reforming Australia's taxation system.

By addressing the challenges of tomorrow, today, through the creation of an efficient, simple and equitable tax regime, current policy makers will be building a strong foundation for productivity and economic growth. ACCI's Taxation Reform Blueprint represents a business case for further taxation reform by the year 2014.

Australia's economy has become more dynamic, efficient and productive over recent decades. However, the tax system has only adapted slowly to these changes. As a result, taxes have been a brake on Australia achieving its full potential and being as internationally competitive as it can be. These problems will continue and grow into the future, particularly as globalisation increases and major demographic changes occur.

While changes over the past ten years to Australia's taxation regime have improved equity, sustainability and efficiency, there is still much more room for improvement. Based on good tax design objectives, the main reasons for further reform of Australia's tax system include:

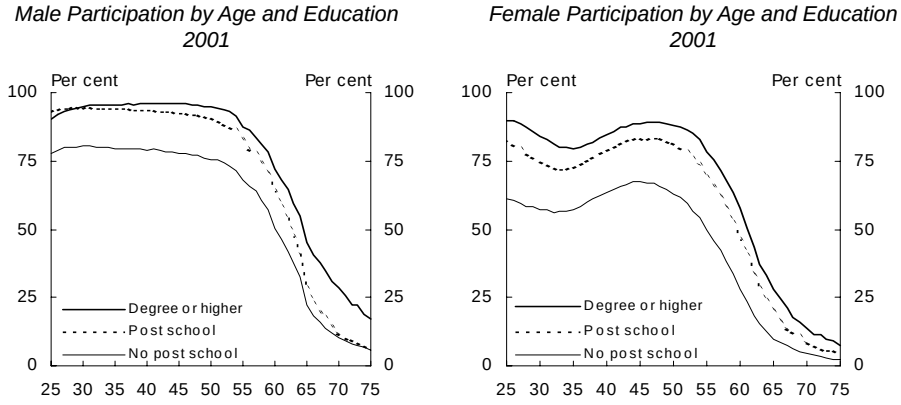
- improving the efficiency and international competitiveness of the Australian economy;
- continuing Australia's strong growth and productivity results;
- ensuring Australia can meet long term challenges, particularly demographic changes, in the most cost effective way;
- promoting innovation, risk taking and entrepreneurship;
- encouraging investment in human capital, for example through education and training;
- encouraging skilled migration and the retention of skilled people; and
- reducing tax avoidance and evasion, to improve the perceived and actual fairness of the tax system.

The ageing of Australia's population will become one of the great economic challenges faced by policy makers. Australia's ageing population will lower the supply of labour while placing significant fiscal pressure on Government budgets (see Figure 60). The choices faced by Government include: borrowing to fund the health and retirement services; raising taxation on those who remain in the workforce; reducing the benefits for those who are retired; or implementing taxation policies that promote growth and encourage participation.

Of all the choices available, the Government should undertake the strong pro-growth path. The alternatives, such as raising the average tax rate and deferring the tax burden to future generations, will reduce growth, create higher unemployment and reinforce the problems inherent in the current system. Therefore, they are not sustainable in the long-term.

Some policies to increase Australia's growth include: reducing taxation of savings; increasing incentives to invest; and reducing the compliance and administration costs on business and stimulating the supply-side of the economy by providing better incentives for people to enter the labour market.

**Figure 60**
**Participation Rates by Age, Educational Attainment and Sex**




Source: Steven Kennedy, David Hedley (2003), *Educational Attainment and Labour Force Participation in Australia*, Economic Roundup, Treasury, Winter.

Higher rates of growth in productivity and labour market participation will not be achieved by raising taxes or debt. The benefits of successful tax reform are clear. With higher productivity, participation rates and growth future generations and governments will benefit from our decisions today. The improved growth path will provide tax revenues to fund the necessary services for an ageing population. ACCI's *2004 Pre-Election Survey* of almost 1700 businesses highlights the case for tax reform showing that tax issues were the first, second, fourth and fifth highest concerns of business.

## AUSTRALIA'S COMPARATIVE TAXATION LANDSCAPE

If Australia's manufacturing sector is to compete internationally it is vital that the taxation regime does not disadvantage domestic firms. Corporation tax as a proportion of GDP in Australia is higher than other comparable OECD countries, although there are difficulties in using disaggregated data of this type (see Figure 61).[54]

Australia's high proportion of corporate income tax to total tax receipts and GDP, 5.3 per cent compared with an OECD average of 2.6 per cent, is likely related to strong profits growth in the mining and minerals industries. The *International Comparison of Australia's Taxes Report*, co-authored by ACCI's CEO Peter Hendy, highlights that the effective tax rates on various investments are very high and the majority of OECD-10 countries[55] have a more lenient treatment of losses, with seven providing for amortisation of goodwill.

The reduction in the corporate tax rate since 2000 (from 36 to 30 percent) is greater than the fall in the OECD and the OECD-10 and the statutory company tax rate of 30 percent is well below the average OECD corporate rate of 35.6 percent.

So the evidence on the company tax rate is mixed. ACCI does not consider that the priority for tax reform should be reducing the company tax rate. While a company tax rate reduction could be considered in the future, the priority for the moment is reducing the high rates of personal tax, the difference between the company and personal tax rates (16.5 percent) is below the unweighted OECD average of 17.8 percent. A reduction in the company rate without an equal or larger reduction in the top marginal tax rate would exacerbate this difference.

The Report also notes that the effective tax rates on various investments are very high and the majority of OECD-10 countries have a more lenient treatment of losses, with seven providing for amortisation of goodwill (Australia does not). While Australia's depreciation allowances are low compared to the OECD-10, many small firms can access better depreciation arrangements through the Simplified Tax System (STS). ACCI thinks the Government should examine the Report's findings on write offs and depreciation.

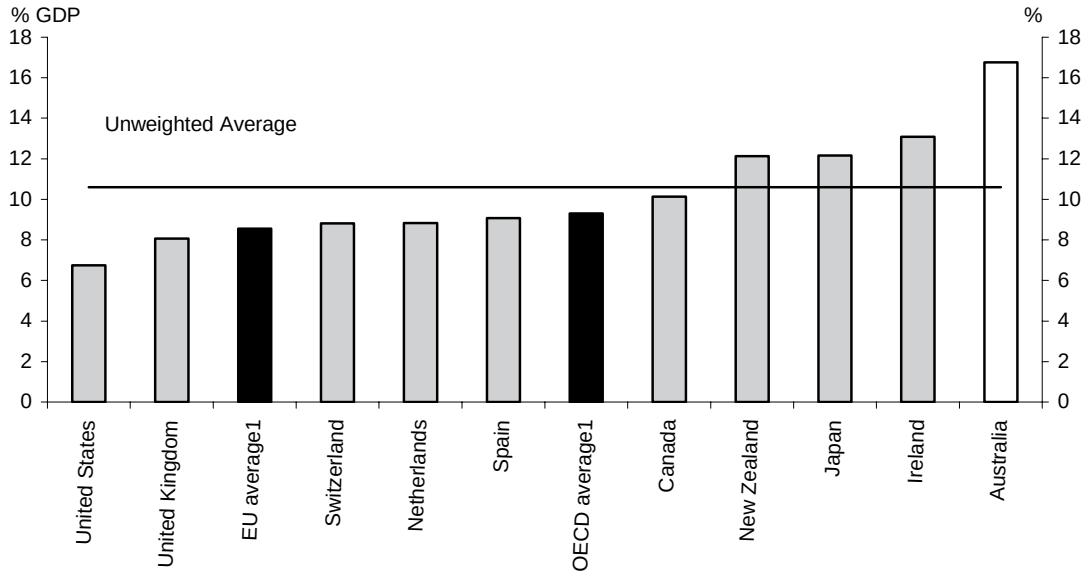
The 2006-07 Budget made some important changes to business taxes, particularly easing access to small business tax concessions and increasing tax depreciation.

For small business, the Government has announced that it will be easier to access the Capital Gains Tax (CGT)

54 For a brief discussion see Australian Government, 2006, *International Comparisons of Australia's Taxes*, Corporations Taxation Canberra, April.

55 OECD-10 countries: Australia, Canada, Ireland, Japan, the Netherlands, New Zealand, Spain, Switzerland, the United Kingdom, and the United States.

**Figure 61**
**Corporation Income Tax as a Percentage of Total Tax Receipts**
**2002**




Source: OECD, *OECD in Figures*, Taxation.
Note: Average does not include OECD or EU averages.
1: Unweighted.

**Figure 62**
**Tax Comparison with Hong Kong, Singapore and Taiwan**

| Tax | Hong Kong | Singapore | Taiwan | Australia |
|---|---|---|---|---|
| Top Personal Rate | 19% | 21% | 40% | 48.50% |
| Company Rate | 17.5% | 20% | 25% | 30% |
| CGT | None | None | Fully taxed, but shares exempt | 24.25% |
| VAT | 0% | 5% | 5% | 10% |

Source: ACCI, "Tax Reform Necessary in 2006 Budget", *ACCI Review*, April 2006.

concession, while various thresholds for Fringe Benefits Tax (FBT), the Simplified Tax System (STS) and the GST will be increased.

Also the Government has announced that it will increase the rate of depreciation from 150 per cent to 200 per cent for businesses using the diminishing value method. This means that businesses can increase depreciation expense in the early life of an asset. This measure should help maintain the strong levels of investment by business and promote a greater adoption of new technology.

These business taxation measures are welcome. But more needs to be done.

Due to Australia's location in the Asia-Pacific region, we are increasingly competing with these countries and the Report shows that in this respect we have a highly uncompetitive tax system.

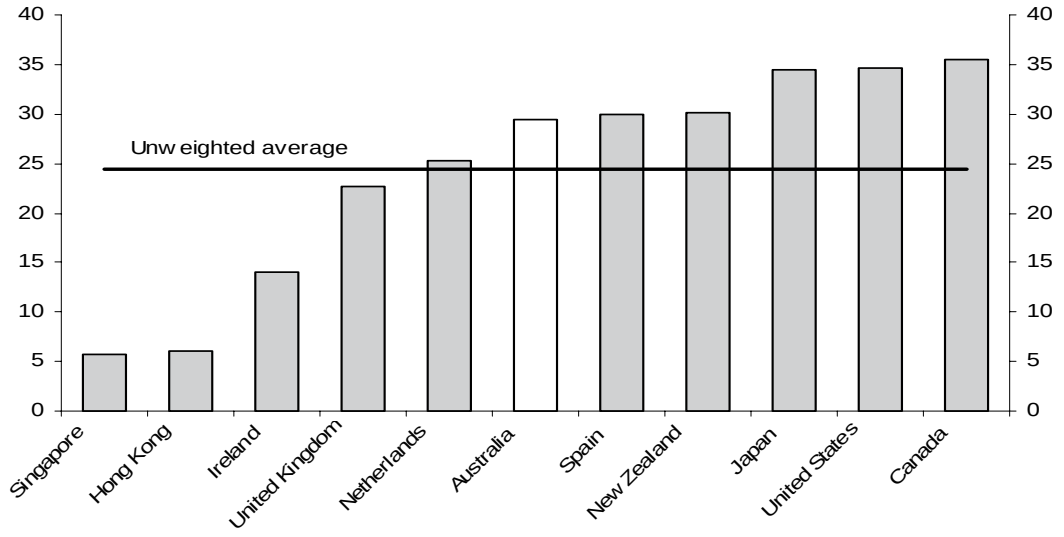
Over time, competition with Asia is becoming more and more relevant for Australia. Strong economic development in the richest Asian countries mean that they are able to compete directly with Australia on quality of life, meaning other factors such as tax become increasingly relevant.

The Report shows that Australia is losing highly-skilled people to Hong Kong and (until recently) Singapore, which may be evidence that we are uncompetitive. Some tax comparisons are shown in Figure 62 above.

A Canadian report finds that for Hong Kong and Singapore marginal effective tax rates on manufacturing investment are 5.8 and 6.1 per cent. Australia's effective tax rate on manufacturing is 29.4 per cent (see Figure 63).

One way to address this without resorting to specific tax concessions for manufacturing only is to reduce the general taxation on investment. That could include reducing the tax burden on capital gains.

**Figure 63**
**Effective Tax Rates on Manufacturing Investment**




Source: C.D. Howe Institute, *Commentary: The 2005 Tax Competitiveness Report*, September 2005.

**Figure 64**
**Possible Capital Gains Tax Stepped Rate Schedule**

| Time Asset Held | Proportion of Capital Gain Subject to Tax |
|---|---|
| Less than 1 year | 100% |
| 1-2 years | 50% |
| 2-5 years | 25% |
| 5-10 years | 10% |
| More than 10 years | 0% (i.e. tax free) |

Source: Australian Chamber of Commerce and Industry, *Taxation Reform Blueprint: A Strategy for the Australian Taxation System 2004-2014*, November 2004.

On capital gains, Australia's top personal rate is 24.3 per cent for assets held for greater than one year. Australia has the eighth highest capital gains tax (CGT) on shares held between one and two years (the OCED average is 15.2 per cent) and the seventh highest GCT on shares held for ten years (the OCED average is 14.0 per cent). The averages are low because eleven OECD countries do not impose CGT on shares.

ACCI considers that it is important to revisit and improve on the CGT reforms introduced in 1999. We believe that the Government should seriously consider introducing a stepped rate CGT, where the proportion of the capital gain that is taxed diminishes over time. A possible steeped rate schedule is shown in Figure 64 above.

# Chapter 12
# Energy and Manufacturing




# ENERGY AND MANUFACTURING

## THE IMPORTANCE OF RELIABLE ENERGY

Throughout the world, the importance of energy is paramount. For OECD countries it is the foundation of manufacturing industry and the key to maintenance of high living standards. For developing countries, universal access to low-price reliable energy is an indispensable driver for realising economic potential and improving quality of life.

In Australia, the energy sector contributes significantly to our economic prosperity and standard of living. The reliable availability of competitively priced energy is fundamental to the international competitiveness of Australian industries, particularly those that are energy intensive. Indeed, Australia's manufacturing sector is based on it. Exports of energy commodities, technologies and resources have also contributed to wealth and job creation. Put simply, the nation's economic prosperity is determined by access to energy at competitive prices.

The key issues are the continued reliable supply of energy products including coal, liquid fuels, electricity and natural gas at competitive prices for industry, commerce and households; and the continued removal of impediments to ongoing reform of the energy sector.

Australia is well endowed with conventional energy resources. It is to be expected that Australia will remain substantially reliant on its fossil fuel supplies for the foreseeable future. However, it is important that the opportunity for the development of reliable and competitively priced supply of energy from other sources, including renewables and nuclear, is available. This is because of the potential contribution such energy sources can make in reducing overall greenhouse gas emissions. However, as with all energy options, consideration should be subject to full cost benefit analysis, including examination of relevant economic, technical and environmental issues.

The pervasive nature of energy means that energy policy decisions will impact throughout the economy. Energy policy is concerned as much with broader economic, social and environmental issues as it is with simply energy supply and use. A government energy policy should underpin its policy response to many issues including investment, infrastructure, innovation, transport, regional development, and greenhouse issues.

## CLIMATE CHANGE

ACCI acknowledges global concern over possible changes to the earth's climate caused by the enhanced greenhouse effect and accepts that the weight of scientific evidence increasingly supports the enhanced greenhouse hypothesis.

ACCI accords a high priority to climate change policy. Although the economics and the science guiding policy makers on this issue is developing, and sometimes called into question, ACCI believes there is enough evidence to suggest that industry, governments and the community must continue to understand and systematically address this issue.

However, any balanced assessment of the various policy options for addressing the enhanced greenhouse effect will be impossible without further impartial and rigorous research on its climatic, environmental, social and economic ramifications. This research is fundamental to address uncertainty about the global effects of greenhouse gas emissions arising from human activities and the even greater uncertainty about their regional impacts.

Under the Kyoto Protocol, a global emissions trading mechanism has been identified as a potentially effective international framework for controlling emissions while fulfilling the overriding principle of minimising the social, economic and environmental costs of greenhouse policy.

While ACCI would be prepared to support a comprehensive international emissions trading scheme we are less convinced of the potential benefits of unilateral, domestic emissions trading within Australia. In particular, its benefits may be overstated because of our dependence on greenhouse gas producing fossil fuels.

Furthermore, ACCI is concerned that the domestic emissions trading agenda is being driven by organisations likely to gain financially from an emissions trading regime without proper consideration of the impact on those who would be required to pay. In the process, the key objective – achieving the least economic impacts in return for the greatest environmental benefits – could be given relatively low priority in the design of trading mechanisms.

An internationally comprehensive Emission Trading Scheme (ETS) can be an efficient mechanism for reducing greenhouse gases, however, this does not take account of other greenhouse gas taxes already present in the economy.[56] It is possible that a permit selling country will have a net welfare loss because the reduced use of the already taxed good may dominate the welfare gain from the permit-trading scheme. Therefore, any government policy must include the effects of pre-existing taxes and the introduction of an ETS, against removing pre-existing taxes on goods and introducing an ETS.

Whichever scenario a state emission-trading scheme adopts it cannot escape the fact that unilateral declarations constraining carbon are costly. More specifically the costs associated with reducing GHG emissions by 50% by 2050 as modeled by ABARE imply a 10% reduction in GDP, a 20% fall in real wages, a doubling of petrol prices and a 600% increase in electricity and gas prices. ABARE has also noted that:

> Unilateral action to achieve deep cuts in Australia's emissions is estimated to cost the Australian economy significantly more than not undertaking that action and offers no perceptible additional benefits to the rest of the world — neither in economic terms nor in terms of global environmental benefits (scenario 2d vs scenario 2a, table C).
>
> 'Late action', based on a plausible expectation that renewed emphasis on a technology solution to climate change would result in the development and diffusion of cleaner and more cost competitive technologies beyond 2050, is estimated to cost the global economy (as well as the Australian economy) substantially less than any 'early action'.[57]

ACCI supports a policy response which is focussed on technological solutions, international co-operation and involves business as part of the solution.

> The key to achieving such a desirable outcome would be to develop a well focused and internationally coordinated technology strategy for the enhanced development, adoption, diffusion and transfer of energy efficient, cleaner technologies. This would involve governments taking a proactive approach to pursue possible technology 'push' policy measures (such as research and development policies, setting industry technology standards, etc.) as well as to reinvigorate energy research through effective public–private partnerships. In the long run, both technology 'push' policies and technology 'pull' policies (such as carbon taxes, emissions trading schemes) would be needed to effectively address climate change related issues.[58]

The manufacturing sector is presently facing severe competition which will likely increase in the future. Increasing costs unilaterally will severely damage sections of the Australian economy which rely on low cost electricity as a source of competitive advantage.

Those States in which manufacturing plays a significant economic role will be the most disadvantaged.

56 Australian Bureau of Agricultural and Resource Economics, 'The Welfare Consequences of Emission Trading with Pre-Existing Taxes', 7th Annual Conference on Global Economic Analysis, Washington, D.C., June 17-19, 2004.

57 Ahammad, H., Matysek, A., Fisher, B.S., Curtotti, R., Gurney, A., Jakeman, G., Heyhoe, E. and Gunasekera, D. 2006, *Economic Impact of Climate Change Policy: The Role of Technology and Economic Instruments*, ABARE Research Report 06.7, Canberra, July.

58 Ibid.

# Chapter 13
# Regulation and Manufacturing




# REGULATION AND MANUFACTURING

## THE RED TAPE AVALANCHE

Australian manufacturers require an efficient regulatory framework in which to operate competitively.

ACCI believes that the aim of improving regulation can be achieved and has developed a position paper entitled *Holding Back the Red Tape Avalanche*, which addresses all regulation of economic significance affecting commerce and industry. Principles of good regulation policy are raised in this paper along with practical solutions.

The paper highlights ACCI is not opposed to regulation. ACCI acknowledges that regulation is not fundamentally or inherently damaging to society or business. In fact regulation provides many benefits for business including competitive advantages through improving economic stability, operating and governance arrangements. Such regulations increase public and investor confidence and provide operational certainty.

However, increasingly governments are pressured to regulate business activities in response to high profile cases, relating to safety, natural disasters, corporate collapses and other significant events.

Regulation imposes restrictions on businesses, individuals, volunteer groups and the community. While developing and applying a single regulation can be reasonably costless, multiple and overlapping regulations and the impact of those regulations on economic behaviour and processes can be very expensive.

Regulations affect all facets of business including inputs, prices, output and volumes all of which constrain the ability of business to provide the best product at the lowest cost. Taxes and regulations distort the allocation of resources within firms, limit flexibility of inputs and provide disincentives to increase output. In dynamic economies, the negative effects of regulation on business performance may be even more detrimental. Numerous changes to regulations (or the prospect of changes) might also adversely affect productivity and business performance.[59]

The regulation of all facets of business such as the exit, growth and entry of firms has detrimental effects on a number of macro-economic variables. "Once a firm is legally registered and allowed to operate, its decisions are conditioned by regulations on hiring and firing workers, taxes, safety standards, environmental regulations, interest rate controls, trade barriers, legal procedures, etc. Finally, a firm going out of business must again follow a sometimes costly and lengthy procedure."[60]

Regulatory bodies may have little incentive to reduce costs where cost recovery principles apply to those they regulate. They may set higher standards than risk analysis would consider prudent and given a culture of avoiding blame many regulators become risk adverse. Regulators may adopt a culture or view that this is a 'job for life', rather than facilitating the market through a period of change.[61]

ACCI considers responsibility for regulation must be afforded the highest priority by government. Accordingly, ACCI recommended that responsibility for regulation must be vested in the Department of Prime Minister and Cabinet.

The specific features of the ACCI approach are as follows:

- Tabling in Parliament an annual regulatory budget that provides a cost and benefit analysis of all business-related regulations as measuring the cost of regulation is the first step in controlling its growth.

- All regulatory budgets to be placed on a centralised website. This will help to inform the public of the amount of regulation being created and the amount of regulation required to be complied with.

- The ORR should be moved from the PC to the Department of the Prime Minister and Cabinet. The new body, to be known as the Prime Minister's Regulatory Reform Unit (PMRRU), should be headed by a Chief Executive chosen from the business community.

59 Ian Bickerdyke and Ralph Lattimore, *Reducing the Regulatory Burden: Does Firm Size Matter*, Staff Research Paper, Industry Commission, December 1997, p11.

60 Norman Loayza, Ana María Oviedo and Luis Servén, *Regulation and Macroeconomic Performance*, Parallel Session 5.2, EGDI and UNU-WIDER Conference, Helsinki, 17-18 September 2004.

61 Better Regulation Task Force, "Imaginative Thinking for Better Regulation", *Classic Regulation – Unintended Consequences*, September 2003, p19.

- A modelling unit located in the PC should be created to develop a standardised costing tool to be applied to all new regulatory proposals. Line departments will be required to apply this costing tool to objectively measure the compliance costs of their regulatory bids. We consider this initiative has been addressed through the development of the Business Cost Calculator.

- Regulation that does not pass the Regulatory Impact Statement (RIS) process as determined by the PMRRU must not be allowed to proceed.

ACCI has also proposed related initiatives which will ultimately reduce the amount of regulation faced by all businesses. These include:

- The Commonwealth offering financial assistance to the states for the simplification and alignment of state regulations. This is to deal with problems faced by businesses operating across state boundaries and dealing with inconsistent regulatory approaches.

- Governments should reduce the number of regulators across Australia.

- The PC should undertake the process of grading the significance, according to the economic impact of regulation. The areas regarded as most economically significant would then provide the 'beachhead' with which to begin a program to reduce the stock of regulation in that sector.

- A 'one in one out' approach to new regulation proposals should be adopted, whereby policy makers can only introduce new regulation if a redundant or superseded regulation is removed.

The full version of ACCI's *Holding Back the Red Tape Avalanche: A Regulatory Reform Agenda* can be downloaded from www.acci.asn.au.

# Chapter 14
# Infrastructure and Manufacturing




# INFRASTRUCTURE AND MANUFACTURING

## NOT A CRISIS BUT STILL A BIG CHALLENGE

Like all other sectors the future of the manufacturing sector is dependent on the maintenance and general provision of infrastructure.

Infrastructure development in Australia has in the past revolved around the government's provision of funds, expertise in building, owning and operating projects on behalf of the public. In recent years this paradigm has shifted to include a greater role for the private sector to operate, in some, if not all stages of infrastructure development. Although this trend is well established in many countries the primary responsibility for selecting the project and the method though which to fund infrastructure development implicitly rests with governments.

ACCI has argued in a number of submissions that there is no overwhelming infrastructure crisis, but there are areas where significant infrastructure investment is needed. Business concerns with infrastructure are more about pricing than access.

ACCI considers that:

- Infrastructure is vital to Australia. It is essential to improving Australia's economic performance; education and training; national security; social cohesion; and enhancing our built and natural environment.

- Infrastructure needs should be addressed by the private sector where possible, with the Government assisting investment through a facilitative tax and regulatory system.

- The private sector is generally more efficient at developing and operating infrastructure. Government investment should only be used when there is clear and demonstrated market failure and after a thorough cost benefit analysis has been undertaken.

- Where government involvement in infrastructure is required, governments should make full use of partnerships with the private sector to reduce costs.

- The tax and regulatory system should provide appropriate incentives to investment while restricting monopoly power.

- We do not support proposals for an independent National Infrastructure Council or similar to take over decision making on infrastructure projects, but we do support proposals for greater coordination in infrastructure regulation.

The people and organisations in a position to affect the direction of infrastructure policy should not underestimate its importance to the economic and social wellbeing of Australia. Infrastructure can enhance both public and private sector productivity when undertaken in a manner consistent with maximising efficiency both in the short-term and over the long-term. The private sector can bring commercial dynamism, innovation and efficiencies, through the harnessing its own capital, skills and experience.

Australia has a small economy in world terms but is large geographically, making many infrastructure projects very expensive. In addition, numerous studies suggest that public sector infrastructure increases private sector productivity irrespective of whether it is developed using public or private funds.

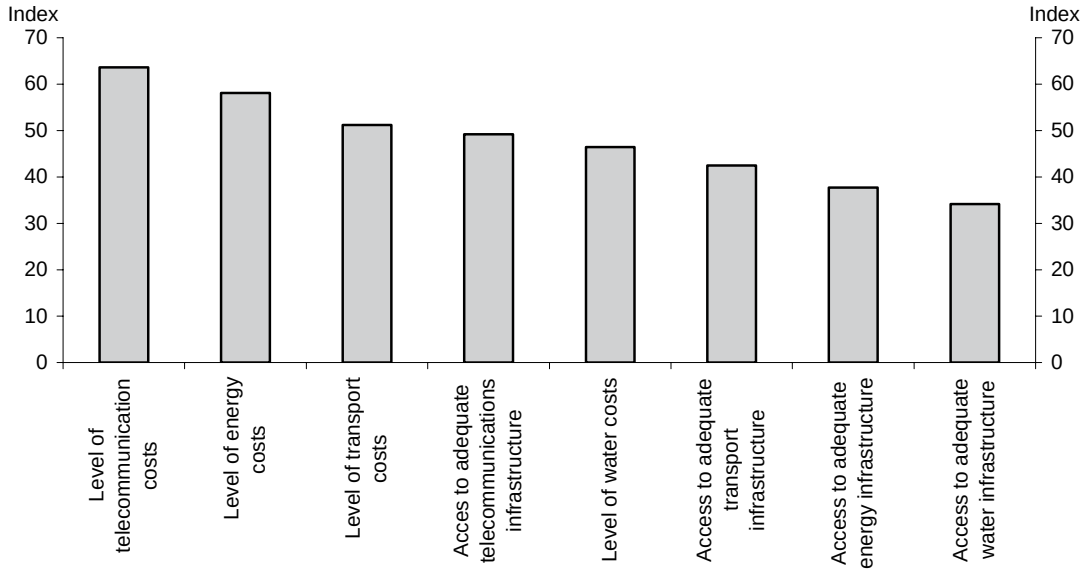
National infrastructure is defined and categorised in different ways, which serves to highlight the breadth of projects governments must consider. These include economic or physical infrastructure, social infrastructure and human capital infrastructure.

Economic infrastructure is required to produce services, which assist the economy to develop and grow for example, physical infrastructure refers to facilities such as utilities and transportation infrastructure.

Social infrastructure includes education, health, legal and correctional facilities. In contrast to economic infrastructure, the cost of providing social infrastructure is often skewed heavily to the operating phase of the project, although some facilities do, however, require significant capital outlays.

Human capital infrastructure comprises human knowledge and experience and the long-term health of the members of the community, which are as necessary for a productive economy as the facilities described in the other two

**Figure 65**
**Infrastructure**




Source: *ACCI Pre-Election Survey*, 2004.

categories.[62]

Of the different types of infrastructure there are some characteristics relevant and applicable to most forms. Once built, a development will generally have few alternate uses, infrastructure usually exhibits increasing returns to scale making provision of one facility optimal over duplication. Most infrastructure produces essential community services. Infrastructure also plays a key role in overall economic performance and development, influencing investment decisions, access to education and information, the ability to develop local small medium enterprises (SME) and generally enhances the ability of firms to participate in the globalisation process.

Business concerns with infrastructure are more about pricing than access as indicated by the 2004 *Pre-Election Survey* (see Figure 65).

COAG signed a Competition and Infrastructure Reform Agreement to provide for a simpler and consistent national system of economic regulation for nationally significant infrastructure, including for ports, railways and other export-related infrastructure. The reforms aim to reduce regulatory uncertainty and compliance costs for owners, users and investors in significant infrastructure and to support the efficient use of national infrastructure.

COAG must develop a tax and regulatory system that provides appropriate incentives to invest while restricting monopoly power. Reforms should continue under National Competition Policy, in line with the recommendations of a recent inquiry by the Productivity Commission.

62 Raphael Henry Arnat, *Getting a Fair Deal: Efficient Risk Allocation in the Private Provision of Infrastructure*, PhD thesis, Department of Civil and Environmental Engineering, The University of Melbourne.

# Chapter 15
# Australian Made Campaign


AUSTRALIAN MADE
AUSTRALIAN MADE
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AUSTRALIAN MADE

# AUSTRALIAN MADE CAMPAIGN

The Australian Made Campaign has been an important component of promoting Australian manufacturing.

Created in 1986 by the federal Government to 'make Australians more aware of their skills and to encourage the country to strive for its full potential', the famous green and gold 'Australian Made' logo has become Australia's most widely recognised and trusted country of origin symbol.

The logo is a registered certification trade mark that can be used on products that meet the country of origin provisions of the Trade Practices Act 1974 (TPA).

For the first 10 years after its launch in 1986 it was promoted and administered by the Advance Australia Foundation, a not-for-profit, public interest company. For a range of reasons, including uncertainties regarding the application of the TPA to country of origin claims, the Foundation went into voluntary liquidation in 1996 and the logo reverted to the federal Government.

ACCI then initiated discussions with the federal Government to re-launch the campaign and in 1999, in conjunction with the federal Government, established Australian Made Campaign Ltd (AMCL), a not-for-profit public company, and the Australian Made Logo Code of Practice. The Government meanwhile had moved to clarify the country of origin definitions in the TPA. Prime Minister Howard re-launched the Australian Made Campaign in September 1999, with the widely recognised logo remaining as the centrepiece of the new campaign.

AMCL's Foundation members are ACCI and its network of (9) major State and Territory Chambers of Commerce. The Campaign secretariat was located within the Canberra office of ACCI until early 2005 when it re-located to Melbourne to be closer to its manufacturing licensee base.

Buying Australian made is important to Australian consumers. When asked, almost half of all adults (aged over 14) claim to buy Australian made products whenever possible and another 21% say that they 'do so often'. The Australian Made logo is recognised by 96% of consumers according to research conducted by Roy Morgan Research.

The campaign in Australia is funded entirely by the licence fees businesses pay to use the logo (0.1% of sales) but in 2004 the federal Government approved a $2 million grant over 3 years to assist re-position the logo as an export brand. AMCL is required to provide matching funding and this project has involved research and promotional activities in both Bangkok and Los Angeles to test the effectiveness of the brand in assisting exports.

The theme adopted for this export project is 'Australian Made, global quality' and this coincided with the repositioning of the logo, both nationally and internationally, as a brand that is synonymous with innovation, quality and value. The domestic selling pitch now is that Australia produces quality products that are sold all over the world - buying Australian made is good for the purchaser, not just "for the kids, the country and the future".

AMCL's global focus has resulted in it recognising the need for Australia to have an official country of origin symbol which should be available to help exporters more easily identify their products as Australian. Very importantly, an official symbol would also enable the Government and its agencies to engage with the campaign to promote it - working constructively with the private sector, as part of its everyday activities the world over.

Australian manufacturing industry is facing increased import competition, particularly from China, and the imperative of pursuing export has never been more pronounced. An agreed country of origin symbol should be available to help Australian exporters sell their Australian made products.

# Chapter 16
# Survey of Manufacturing Companies

# SURVEY OF MANUFACTURING COMPANIES

Over recent years there has been an attempt by many sectional interest groups to put arguments to government on what is best for the Australian manufacturing sector.

Unfortunately a large amount of this advocacy is not much more than subjective opinion based on scanty empirical evidence. In this position paper ACCI has attempted, where at all possible, to use statistical sources to establish the validity of its arguments.

Likewise in this chapter ACCI presents findings from two key company surveys it undertakes to give an understanding of what manufacturing companies are actually saying to policy makers. The two surveys are the *ACCI – Westpac Survey of Industrial Trends* and the *SAI Global – ACCI Survey of Investor Confidence*. In particular we have extracted previously unpublished data from the Survey of Investor Confidence to examine what manufacturers are saying are the key constraints on their investment plans.

## ACCI – WESTPAC SURVEY OF INDUSTRIAL TRENDS

The *ACCI - Westpac Survey of Industrial Trends* is a regular quarterly survey of manufacturing. The survey provides a timely source of data of the actual and expected quarterly performance of the sector. The survey has been run continuously since 1966 and is Australia's longest running survey on manufacturing. The long history of the survey demonstrates the extended association between the manufacturing sector and ACCI.

The survey allows direct communications between ACCI and manufacturers as much of the survey research is conducted by interview. This ensures that direct communication channels remain open at all times.

The survey covers a diverse range of topics including:

- output, new orders and exports;
- investment and finance;
- labour market issues such as employment, overtime and the availability of labour;
- prices;
- wages;
- capacity utilisation; and
- profits.

The survey also provides data on the constraints on production to gauge the sources of any downturns in the industry.

The survey gives ACCI a firm grasp of the issues facing the manufacturing sector and allows for a constant monitoring of the industry. The survey goes on to inform policy and economic debates through its inclusion in many publications and briefing notes. For example, its regular inclusion within the quarterly *Reserve Bank of Australia Statement on Monetary Policy*.

The latest survey is attached in the following section and provides a current picture of the manufacturing industry. This picture is updated at the beginning of March, June, September and December of each year and those wishing to keep abreast of developments within the sector should periodically refer back to the latest survey. The latest data is available from www.acci.asn.au in the survey section of the website.

## SAI GLOBAL – ACCI SURVEY OF INVESTOR CONFIDENCE

The *SAI Global-ACCI Survey of Investor Confidence* fills an important gap amongst the surveys conducted within Australia by focusing on the direction of investment and the constraints placed on investment. The survey is released on a quarterly basis and was first conducted in July 1991. The length of time the survey has been conducted demonstrates ACCI's commitment to providing accurate and timely information on the Australian economy.

The survey covers a number of areas, which affect business decisions, and outlines the state of the economy. The survey also provides detailed coverage of expectations rather than just contemporary information. The survey includes questions, amongst others, on macroeconomic indicators:

- the climate for investment;

- expectations of business investment;
- expectations of price movements; and
- expectations of wage movements.

While asking respondents to detail broader macroeconomic trends it also asks respondents to detail their particular businesses situation. The survey includes questions, amongst others, on:

- current and future business conditions;
- current and future sales;
- current and future profitability;
- expected level of investment; and
- current capacity utilisation.

The survey also canvasses business as to the constraints on their investment from a list of twenty possible sources. Generally speaking the list of constraints is broken up by labour related, macroeconomic, financial and government related constraints. The full range of constraints are outlined in Figure 66.

## SURVEY FINDINGS

The most recent *ACCI – Westpac Survey of Industrial Trends* for the December quarter 2006 has confirmed that the general business sentiment in the manufacturing sector has deteriorated to a level below its decade average, probably reflecting uncertainty in the wake of the August and November 2006 interest rate increases, higher petrol prices and continuing negative media coverage on the economy during the period.

As well, profit expectations have declined over the last year, although they stabilised in the December quarter 2006.

Nonetheless, the Westpac – ACCI Composite Index which has a solid track record of predicting near-term economic growth in manufacturing, including picking turning points in the economic cycle, surged in the September quarter suggesting the renewed pick up in private final demand growth in the first half of calendar year 2006 can be sustained. The index edged back slightly in the December quarter but is still the second highest level since the December quarter 2004.

The index is now at a level consistent with trend growth above the decade average.

The Composite Index also has a leading relationship with business investment spending, particularly on plant and equipment, although the link has weakened in recent years with booming resource sector spending.

The rebound in the index suggests manufacturing investment is likely to add to the momentum in total spending underpinned by still strong mining expansion.

A backdrop of healthy company balance sheets and solid world growth is supportive of rising investment. Indeed, twelve month manufacturing investment plans for plant and equipment bounced back in the September quarter and were at their highest level since the June quarter of 2005. The story remains basically the same in the December quarter.

Spending plans for buildings and structures have also strengthened resulting in an historically firm outcome, on par with the decade average.

The reported level of capacity utilisation firmed again in the December quarter 2006 to its highest since the December quarter 2004 and the third highest since the June quarter 1989. The proportion of respondents who reported working above their normal capacity increased while those working below their normal capacity remained unchanged, resulting in a stronger net balance. Well over half of respondents reported working at normal capacity levels.

The labour market was much stronger in the September quarter 2006 and remained unchanged in the December quarter, the highest since the December quarter 2004. The December quarter recorded a doubling in the net overtime worked indicator.

On balance, production costs remained high and well above expectations. The pace of unit production cost increases was expected to remain strong, but ease, in the next three months.

Net forward projections for new orders for the next three months almost trebled in the September quarter, the strongest since the September quarter 2003. This has eased in the December quarter.

Interestingly, the US and Australian manufacturing cycles have an historical tendency to move broadly in tandem.

**Figure 66**
**Survey of Investor Confidence Constraints on Business Investment**

| | All Industries | | Services | | Manufacturing | |
|---|---|---|---|---|---|---|
| **Constraints** | **2005** | **2006** | **2005** | **2006** | **2005** | **2006** |
| Wage Costs | 5 | 4 | 4 | 3 | 5 | 11 |
| Non-Wage Labour Costs | 4 | 5 | 6 | 7 | 6 | 9 |
| Resistance to Workplace Change from Union | 18 | 20 | 18 | 18 | 19 | 20 |
| Resistance to Workplace Change from Employees | 15 | 19 | 14 | 17 | 20 | 18 |
| Availability of Suitably Qualified Employees | 2 | 2 | 2 | 2 | 3 | 6 |
| Availability of Training Facilities | 11 | 13 | 8 | 11 | 13 | 19 |
| Current Levels of Debt | 12 | 11 | 13 | 13 | 10 | 5 |
| Interest Rates | 13 | 12 | 12 | 14 | 14 | 7 |
| Charges by Lending Institutions | 14 | 14 | 15 | 11 | 15 | 12 |
| Raising Loans from Financial Institutions | 16 | 16 | 17 | 16 | 16 | 14 |
| Raising Equity | 19 | 17 | 16 | 15 | 17 | 15 |
| Insufficient Retained Earnings | 10 | 10 | 9 | 9 | 12 | 8 |
| Insufficient Demand | 8 | 8 | 11 | 10 | 4 | 1 |
| Local Competition | 7 | 6 | 7 | 6 | 2 | 2 |
| Import Competition | 17 | 15 | 19 | 19 | 7 | 4 |
| Exchange Rate too High | 20 | 18 | 20 | 20 | 10 | 16 |
| Federal Government Regulation | 6 | 7 | 3 | 5 | 9 | 13 |
| State Government Regulation | 3 | 3 | 5 | 4 | 8 | 10 |
| Local Government Regulation | 9 | 9 | 10 | 8 | 18 | 17 |
| Business Taxes and Charges | 1 | 1 | 1 | 1 | 1 | 3 |

Source: *SAI Global - ACCI Survey of Investor Confidence*, various publications.

So far in 2006 though, a divergent performance has been apparent, particularly in the September quarter with Australian conditions rebounding at a time of softening US conditions.

The US manufacturing ISM survey readings have eased through 2006. This softening likely reflects significantly weaker US housing indicators in recent months.

Finally, export deliveries doubled in the September quarter 2006 and increased again in the December quarter. The proportion of respondents reporting a rise in export deliveries rose. Predictions for the next three months remain high.

The *SAI Global – ACCI Survey of Investor Confidence* typically surveys around 770 companies quarterly. These companies come from both the manufacturing and non-manufacturing sectors of the economy.

For this position paper we have extracted previously unpublished data comparing the difference between manufacturing sector company investment decision-making and those of companies in other sectors.

The *SAI Global – ACCI Survey of Investor Confidence* seeks information from respondents on the importance of a list of twenty factors as constraints on the level of investment.

Figure 66 shows that in 2006 the top five constraints on investment across all business sectors were: (1) business taxes and charges, (2) availability of suitably qualified employees, (3) state government regulations, (4) wage costs, and (5) non-wage labour costs. The manufacturing sector and the services sector are included by way of comparison.

Interestingly, at the top of the list the manufacturing sector presents a different profile. Figure 67 shows that in 2006 the five top constraints on investment across the manufacturing sector were: (1) insufficient demand, (2) local competition, (3) business taxes and charges, (4) import competition, and (5) current levels of debt.

The survey material obviously shows that the level of demand for their product and the competitive environment weighs heavily on the future investment decisions of Australian manufacturers.

Nonetheless, business taxes and charges and debt levels are

**Figure 67**
**Survey of Investor Confidence Contraints on Business Investment (Manufacturing)**

| Constraints | 2006 | 2005 |
|---|---|---|
| Insufficient Demand | 1 | (4) |
| Local Competition | 2 | (2) |
| Business Taxes and Charges | 3 | (1) |
| Import Competition | 4 | (7) |
| Current Levels of Debt | 5 | (10) |
| Availability of Suitably Qualified Employees | 6 | (3) |
| Interest Rates | 7 | (14) |
| Insufficient Retained Earnings | 8 | (12) |
| Non-Wage Labour Costs | 9 | (6) |
| State Government Regulation | 10 | (8) |
| Wage Costs | 11 | (5) |
| Charges by Lending Institutions | 12 | (15) |
| Federal Government Regulation | 13 | (9) |
| Raising Loans from Financial Institutions | 14 | (16) |
| Raising Equity | 15 | (17) |
| Exchange Rate too High | 16 | (10) |
| Local Government Regulation | 17 | (18) |
| Resistance to Workplace Change from Employees | 18 | (20) |
| Availability of Training Facilities | 19 | (13) |
| Resistance to Workplace Change from Union | 20 | (19) |

Source: *SAI Global - ACCI Survey of Investor Confidence*, various publications.

in the top five constraints and when we examine the full top twenty constraints manufacturing faces the same key generic issues common across Australia's economy.

Thus major constraints on manufacturing investment continue to be: the level of business taxes and charges; the availability of suitably qualified employees; wage costs and non-wage labour costs; interest rates and current levels of debt; federal government regulations and state government regulations.

Government policy in a market economy cannot do much about addressing the level of demand for these companies' products nor should it restrict fair competition. Government can however, address a number of other constraints in the top twenty list.

The message is therefore clear from the survey material ACCI has gathered that the policy priorities for dealing with the issues facing manufacturing come back to securing the best possible outcomes on: industrial relations; taxation; skills; investment; and the regulatory environment.

There are two other observations in Figure 67 above worth commenting on.

First, the reader will see that 'resistance to workplace change from unions' is rated 20th in constraints on investment planning. This is an interesting result and may reflect two things. First that 75 per cent of employees in manufacturing are not union members and therefore the union presence in workplaces is lower than may be popularly understood. Secondly, that this is evidence that the ACTU's scare campaign against the *WorkChoices* industrial relations reforms are having little impact at the grassroots.

The second interesting observation is that in 2006 'exchange rate too high' only rates as the 16th highest constraint on investment planning for manufacturers. This runs counter to the claims continually argued by some sectional interest groups about this issue. Although we should acknowledge that in 2005 this category did rate 10th highest. And in fact what we have seen is the Trade Weighted Index (TWI) move from a high of 64.1 quarterly average in September 2005 - the second highest for 20 years - to 62.7 quarterly average in June 2006. Nevertheless, the TWI remains at near 20 year highs in 2006 and yet is only rated 16th on the list of constraints.

# Chapter 17
# Conclusion

# CONCLUSION

The Australian manufacturing sector has been facing challenging circumstances for many decades now.

The share of the Australian economy represented by manufacturing has been steadily declining. However, the important thing to note is that despite this long term decline of manufacturing as a share of the total economy the sector over the long term continues to grow.

Nonetheless the recent retraction in the manufacturing sector has caused concern.

Australian governments – both Commonwealth and State – must continue with economic reforms to help assist the manufacturing sector deal with the challenges it faces – not least the challenges of globalisation and the huge growth in Asian competitors like China and India.

ACCI is of the view that recent difficulties faced by manufacturing should not be the excuse to lead governments back to old, failed policies of protectionism and intervention.

Recent calls for a new manufacturing sector policy are in many cases simply a euphemistic call for the return to the past.

The future of manufacturing does not lie in raising tariff and non-tariff barriers nor the pursuit of large industry specific taxpayer funded grant schemes.

The survey material presented in the *ACCI - Westpac Survey of Industrial Trends* and the *SAI Global – ACCI Survey of Investor Confidence* shows that while the level of demand for their product and the competitive environment weighs heavily on the future investment decisions of Australian manufacturers, key generic issues common across Australia's economy are to the fore. Thus major constraints on manufacturing investment continue to be: the level of business taxes and charges; the availability of suitably qualified employees; wage costs and non-wage labour costs; interest rates and current levels of debt; federal government regulations and state government regulations.

The message is therefore clear from the survey material ACCI has gathered that the priorities to deal with the issues facing manufacturing come back to securing the best possible policies on:

- Industrial relations;
- Taxation;
- Skills;
- Investment, including in infrastructure and R&D; and
- The regulatory environment.

ACCI, as a major stakeholder on behalf of the Australian manufacturing industry therefore will continue to argue for reform in all these areas.

# Attachment A
# ACCI – Westpac Survey of Industrial Trends


ACCI-Westpac
Survey of Industrial Trends
Australian Chamber of Commerce and Industry & Westpac Banking Corporation
ACCI-Westpac
Survey of Industrial Trends
Australian Chamber of Commerce and Industry & Westpac Banking Corporation
ACCI-Westpac
Survey of Industrial Trends
Australian Chamber of Commerce and Industry & Westpac Banking Corporation
ACCI-Westpac
Survey of Industrial Trends
Australian Chamber of Commerce and Industry & Westpac Banking Corporation

# ACCI - WESTPAC SURVEY OF INDUSTRIAL TRENDS

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Net response or "balance" is calculated by the proportion of "ups" less "downs" on individual questions, thereby yielding the net balance. A positive balance indicates a net upward or improving trend and a minus balance a net downward or deteriorating trend. The 181st consecutive survey was conducted in the week ending 1 December 2006. A total of 252 responses were received, and provided a reasonable cross-section of Australian manufacturing in respect of industry groups and size of operation. The next survey will be conducted in March 2007.

# Key survey results

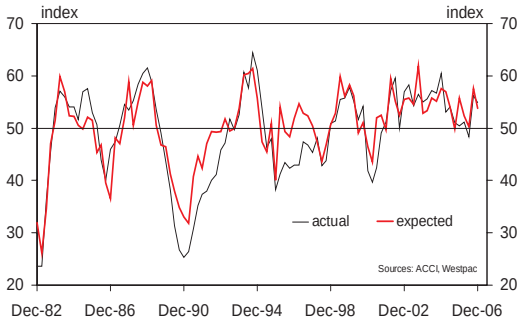
### Westpac-ACCI composites, seasonally adjusted

| | Q3 2006 | Q4 2006 |
|---|---|---|
| Actual – composite index | 56.2 | 54.9 |
| Expected – composite index | 57.6 | 53.8 |

- The Actual Composite index edged back in the December quarter, falling 1.3pts to 54.9 after a 7.8pt surge previously. This was the second highest since 2004Q4.
- With the index comfortably above its decade average (51.8), it suggests activity growth has continued at an above-trend pace. The dip in the Actual Composite was driven by smaller than usual seasonal gains in all five components, with the strongest improvement in orders.
- The Expected Composite index fell 3.8pts to 53.8 after a 7.3pt jump previously, but remains above its decade average (53.2). The dip was due to a greater than usual seasonal drop in all expectations, particularly new orders.

### Westpac-ACCI composite indexes

Actual & expected, sa

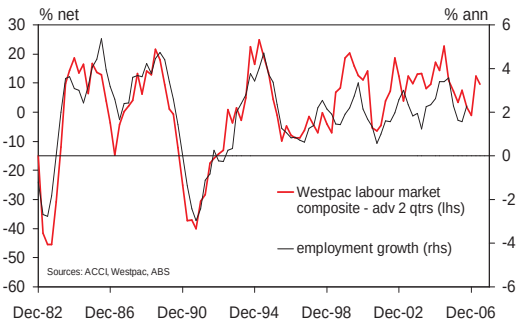



### Westpac-ACCI labour market composite

| | Q3 2006 | Q4 2006 |
|---|---|---|
| Net balance | 12 | 10 |

- Manufacturing labour demand eased marginally in the quarter with the net balance of the Labour Market Composite index easing 2pts to 10, the second highest since 2005Q1 and still above its decade average of 7.
- The index has provided a reliable guide to future employment growth and remains consistent with a firmer annual pace through 2007H1. The dip in the index was driven by expected overtime, expected and actual employment, partially offset by stronger actual overtime.

### Jobs growth to firm in H1 2007



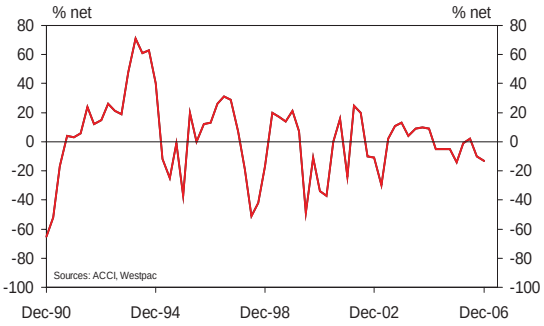

### General business situation

| | Q3 2006 | Q4 2006 |
|---|---|---|
| Net balance | –10 | –13 |

- There was a further weakening, on balance, in business expectations in the December quarter 2006. The proportion of respondents expecting an improvement in the general business situation in the next six months was lower (14% vs 19%). The proportion predicting a deterioration was marginally lower (27% vs 29%), resulting in a net balance of –13% (vs –10% in the previous quarter). Well over half the respondents (59% vs 52%) expected no change.

### General business situation

Next six months

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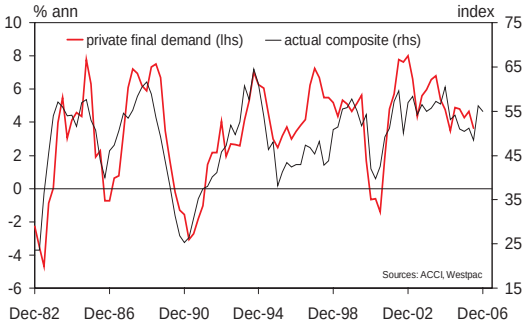
# The business cycle & economic outlook

### Westpac-ACCI survey & the business cycle

- The Westpac-ACCI Actual Composite index has a solid track record of predicting near-term economic growth, including picking turning points in the economic cycle.
- The minor dip in the composite index in the December quarter suggests firmer private final demand growth in 2006H2 after a relatively softer June quarter.
- At a level of 54.9 (vs 56.2 previously), the Actual Composite index remains consistent with above-trend growth in the December quarter, comfortably above its decade average of 51.8.

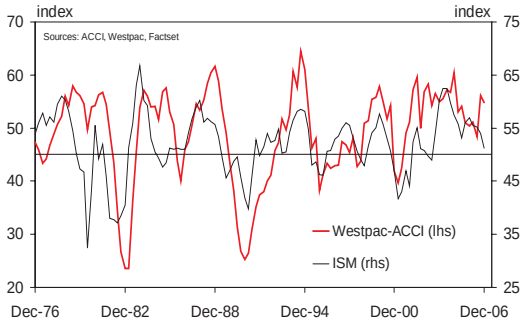
**Manufacturing & the business cycle**
Westpac-ACCI composite index & private demand




### Australian & US manufacturing surveys

- The US and Australian manufacturing cycles have an historical tendency to move broadly in synch. However, through 2006H2 a divergent performance has been apparent, with Australian conditions improving at a time of deteriorating US conditions.
- The US manufacturing ISM survey readings have softened through 2006. The ISM index fell from a 2006Q2 average of 55.2 to 54.0 in Q3, easing further in early Q4 to 51.2 in October (lowest since 2003Q2). This slowing is no doubt a reflection of a significant weakening in the US housing sector over the last year.

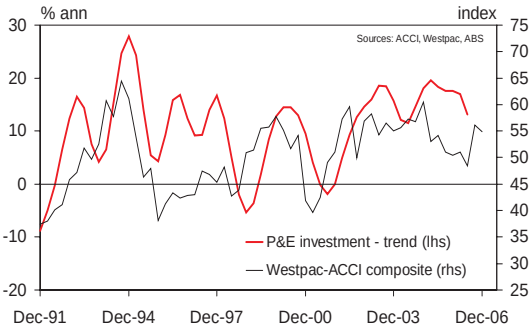
**Australian & US manufacturing surveys**
Westpac-ACCI & ISM composite indexes




### Westpac-ACCI survey & business investment

- The Actual Composite index also has a leading relationship with business investment spending, particularly on plant and equipment, although the link has weakened in recent years with the resources boom.
- The slight dip in the index implies a marginal softening in the manufacturing investment outlook, but total investment will remain supported by the mining sector.
- The level of the index remains comfortably in the territory associated with growing plant and equipment investment. The backdrop of healthy corporate balance sheets, firm global demand and tight capacity, also remains supportive of rising investment.

**Activity & capital investment**
Westpac-ACCI composite & plant & equipment investment

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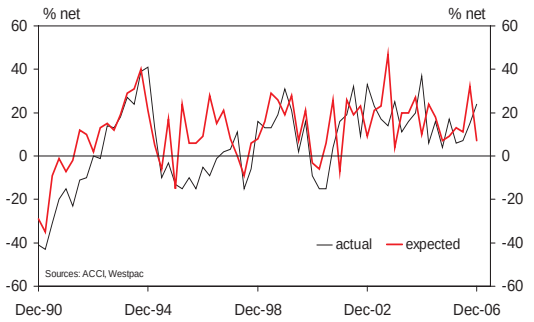
# Activity & orders

## Output

| | Q3 2006 | Q4 2006 |
|---|---|---|
| Actual – net balance | 15 | 24 |
| Expected – net balance | 32 | 7 |

- While well short predictions of three months ago, the net output indicator continued to strengthen in the December quarter 2006. The proportion of respondents reporting a rise was higher (40% vs 31%) while those recording a decline remained unchanged at 16%, resulting in a net balance of 24% (vs 15%). Expectations for next quarter remain positive but much more modest than three months ago (7% vs 32%) and close to June quarter 2006 levels.

**Output growth**
Actual & expected



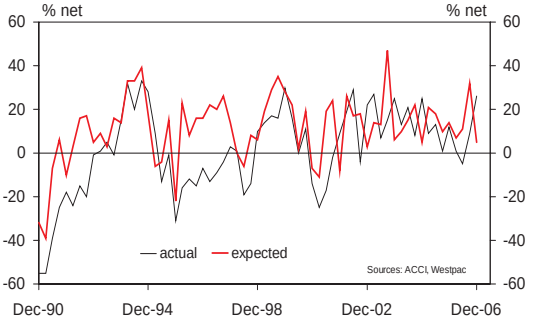

## New orders

| | Q3 2006 | Q4 2006 |
|---|---|---|
| Actual – net balance | 9 | 26 |
| Expected – net balance | 32 | 5 |

- A similar trend was reflected by actual and predicted outcomes for new orders. The proportion of respondents reporting an increase in new orders rose strongly from 27% to 41%. The proportion reporting a decline eased (15% vs 18%), resulting in a robust net balance of 26% (vs 9%). Net forward projections for the next three months declined sharply (5% vs 32%).

- Reflecting the much stronger outcomes for new orders, the net indicator for orders accepted but not yet delivered also strengthened in the December quarter 2006 (13% vs –5%). However, predictions for the March quarter 2007 have been sharply downgraded and turned negative (–16% vs 7%).

**New orders**
Actual & expected

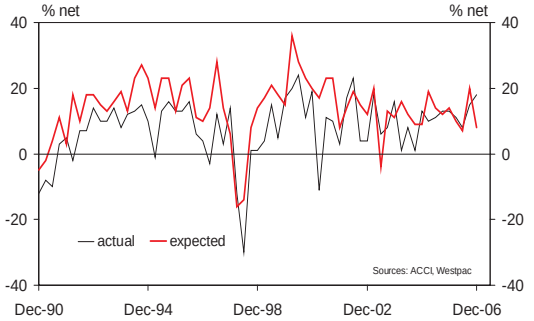



## Exports

| | Q3 2006 | Q4 2006 |
|---|---|---|
| Actual – net balance | 15 | 18 |
| Expected – net balance | 20 | 8 |

- Export deliveries improved, albeit modestly, in the December quarter 2006. The proportion of respondents reporting a rise in export deliveries rose (21% vs 18%). Those recording a decline remained unchanged at 3%, resulting in a net outcome of 18% (vs 15%). However, while remaining positive, predictions for the next three months have declined sharply (8% vs 20%), likely a reflection of the higher Australian dollar.

**Export deliveries**
Actual & expected

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# Investment & profitability

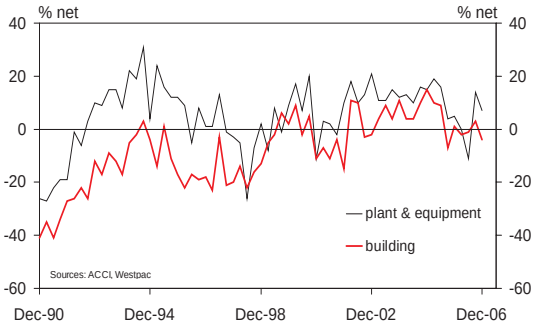
## Investment intentions

| | Q3 2006 | Q4 2006 |
|---|---|---|
| Plant & Equipment – net balance | 14 | 7 |
| Building – net balance | 3 | –4 |

- While still firm, manufacturers' plans for plant and equipment investment spending in the next 12 months were well below the very robust levels of three months ago. Of the manufacturers surveyed, 23% (vs 30%) reported plans to increase their spending. The proportion expecting a decline was unchanged (16%), resulting in a net balance of 7% (vs 14%). A higher proportion (61% vs 54%) expected no change.

- Spending plans for buildings also softened, with 13% (vs 18%) of the respondents predicting an increase and 17% (vs 15%) a decline, resulting in a net outcome of –4% (vs 3%). The outcome is on par with its decade average (–2%), but above its full history average (–11%).

**Investment intentions**
Next twelve months

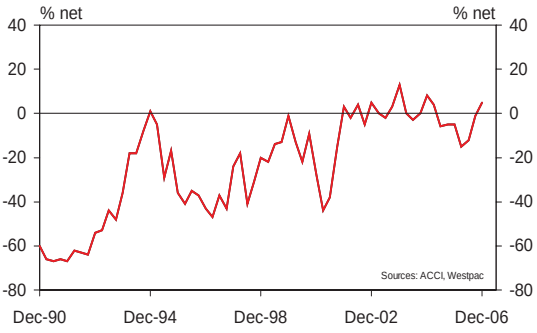



## Capacity utilisation

| | Q3 2006 | Q4 2006 |
|---|---|---|
| Net balance | –1 | 5 |

- The reported level of capacity utilisation increased again in the December quarter 2006. Almost one quarter of respondents reported working above their normal capacity (24% vs 18%). Those working below their normal capacity remained unchanged (19%), resulting in a net balance of 5% (vs –1%). This is the highest since 2004Q4 and the third highest since 1989Q2. Well over half the respondents (57% vs 63%) reported working at normal capacity levels.

**Capacity utilisation**

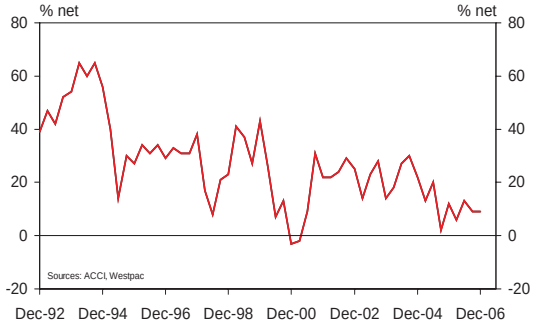



## Profit expectations

| | Q3 2006 | Q4 2006 |
|---|---|---|
| Net balance | 9 | 9 |

- Profit expectations were virtually unchanged in the December quarter 2006. The proportion expecting higher profits in the next 12 months eased further (27% vs 32%), but those predicting a decline was also lower (18% vs 23%), resulting in an unchanged net balance of 9%. This remains well below the decade average (20) despite strong actual output and orders, likely reflecting softer activity expectations and continued pressure on margins.

**Profit expectations**
Next twelve months

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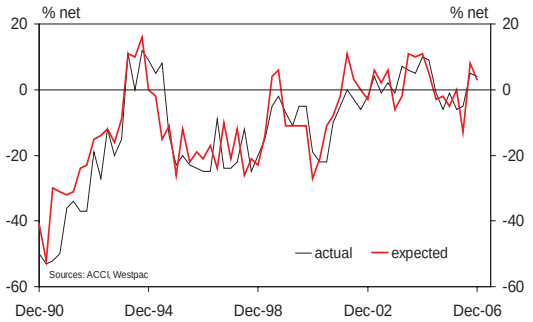
# The labour market

## Numbers employed

| | Q3 2006 | Q4 2006 |
|---|---|---|
| Actual – net balance | 5 | 4 |
| Expected – net balance | 8 | 3 |

- The labour market remained virtually unchanged in the December quarter 2006. The proportion of respondents recording an increase in numbers employed rose marginally (19% vs 18%). Those reporting a decrease also edged up (15% vs 13%), resulting in a net balance of 4% (vs 5%). The net outlook for the next three months softened (3% vs 8%), but remains positive and well above its decade average (–6%).

**Numbers employed**
Actual & expected

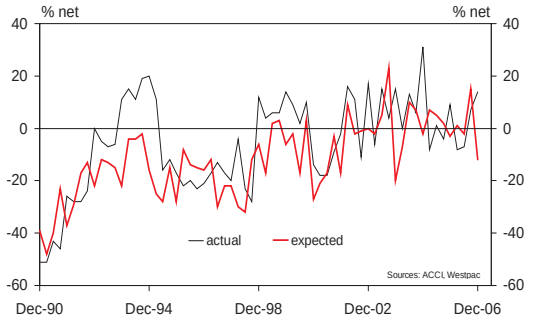



## Overtime worked

| | Q3 2006 | Q4 2006 |
|---|---|---|
| Actual – net balance | 7 | 14 |
| Expected – net balance | 15 | –12 |

- In line with predictions, the net overtime worked indicator doubled from 7% to 14%. A third of the respondents (32% vs 25%) reported higher levels of overtime worked while the proportion reporting a decline remained unchanged at 18%. Half the respondents (50% vs 57%) reported no change. However, a slump in overtime worked is predicted for the next three months (–12% vs 15%).

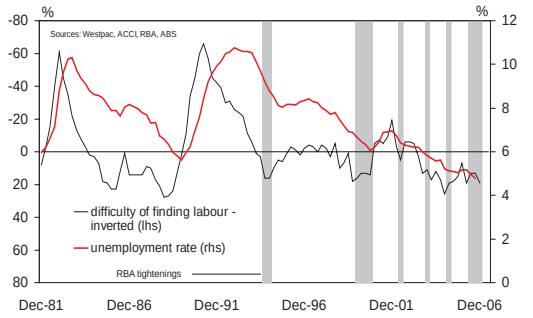
**Overtime worked**
Actual & expected




## Labour market tightness

- Despite the slight softening in labour demand indicators in the December quarter survey, respondents reported an increase in the difficulty of finding appropriately skilled labour. The net balance reporting labour as 'harder to get' rose to 19% from 13% previously, well above the decade average (6%) and within sight of the 2004Q4 peak of 26%.
- This historically high level of labour market tightness, combined with the resilience in the Labour Market Composite index, suggests the unemployment rate can remain around its 30 year low of 4.6%.

**Difficulty of finding labour**

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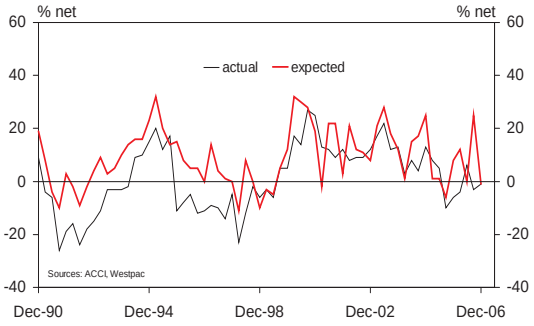
# Prices & inflation

### Average selling prices

| | Q3 2006 | Q4 2006 |
|---|---|---|
| Actual – net balance | –3 | –1 |
| Expected – net balance | 25 | –1 |

- Contrary to predictions, there was little change in average selling prices in the December quarter 2006. Instead of rising sharply, the net prices indicator remained soft and marginally negative. The proportion of respondents reporting price increases was higher (21% vs 13%) but those recording a decline also rose (22% vs 16%), resulting in net balance of –1% (vs –3%), with 57% (vs 71% previously) reporting no change. A similar net outcome is predicted for the March quarter 2007 (–1% vs 25%) with 59% (vs 61%) expecting no change.

**Average selling prices**
Actual & expected

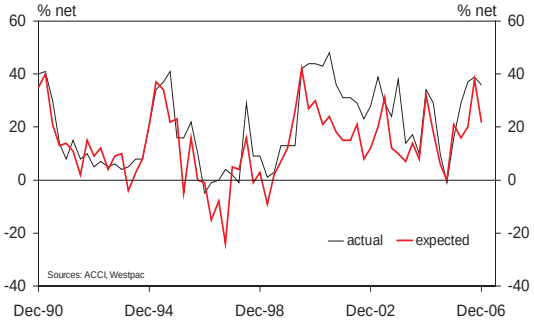



### Average unit costs

| | Q3 2006 | Q4 2006 |
|---|---|---|
| Actual – net balance | 39 | 36 |
| Expected – net balance | 38 | 22 |

- On balance, the actual net outcome for average unit costs remained historically high in the December quarter at 36% (vs 39%). The proportion of manufacturers surveyed reporting rising costs eased slightly (43% vs 46%). Those recording decreases remained unchanged (7%). On balance, the pace of cost increases is expected to slow down in the next three months (22% vs 38%), but remains above the decade average (13%) and well in excess of expected selling prices, implying ongoing margin pressures.

**Average unit costs**
Actual & expected

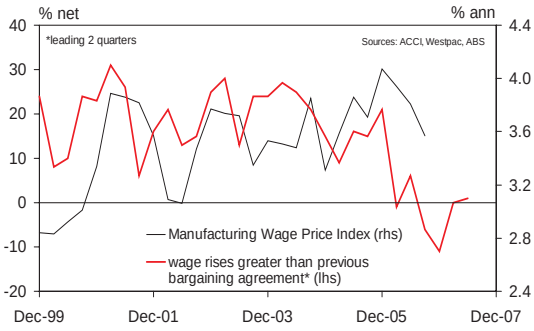



### Manufacturing wages

- Despite the increased difficulty of finding labour and resilient labour demand indicators, manufacturing wage expectations increased minimally in the quarter.

- 19% of respondents expect wage rises in their firm's next round of enterprise agreements to be higher than the previous agreement outcome, and 18% lower, giving a 1% net balance (vs 0% previously). This remains well below the decade average (12%) and implies a further easing in manufacturing wage growth into 2007, which has already eased (using manufacturing wage price index) from a 2005Q4 peak of 4.1%yr to 3.6%yr in 2006Q3.

**Manufacturing wages to decelerate further**

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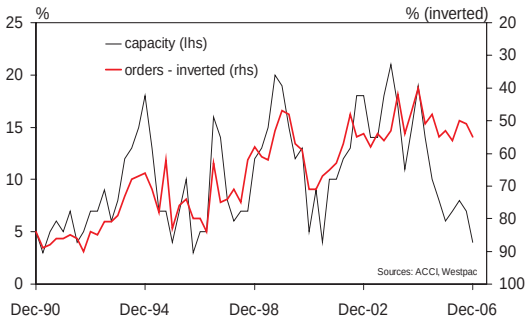
# Other results

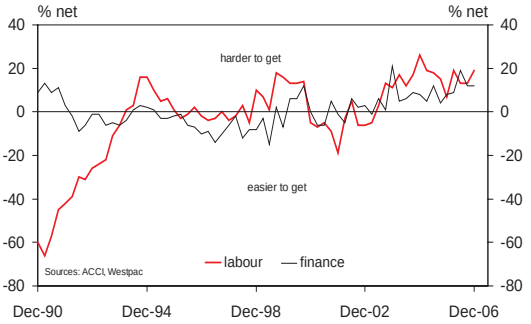
**Key factor limiting production**
% of respondents



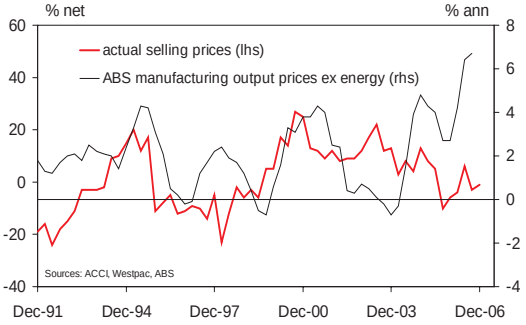

**Factors limiting production**

| | Q2 2006 | Q3 2006 | Q4 2006 |
|---|---|---|---|
| Orders (%) | 50 | 51 | 55 |
| Capacity (%) | 8 | 7 | 4 |
| Labour (%) | 4 | 5 | 8 |
| Finance (%) | 4 | 3 | 1 |
| Materials (%) | 4 | 5 | 4 |
| None (%) | 6 | 7 | 10 |
| Other (%) | 24 | 22 | 18 |

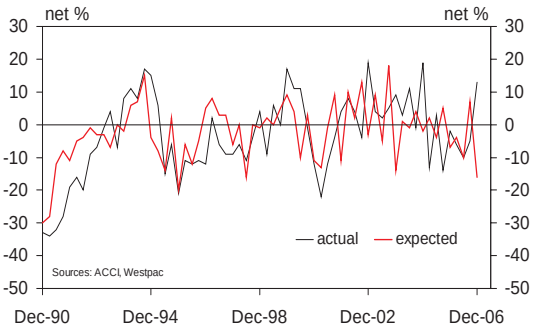
**Availability of labour & finance**



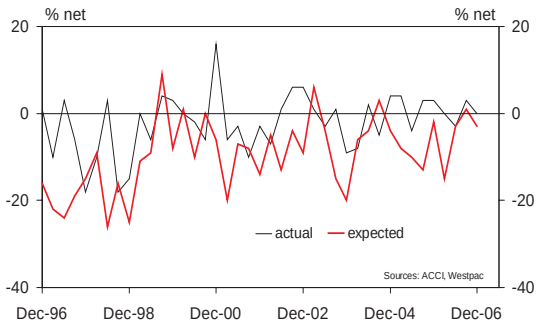

**Mfg upstream price pressures should ease**




**New orders accepted but not delivered**
Actual & expected




**Stocks of finished goods**
Actual & expected

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# Summary of results

**1.** Do you consider that the general business situation in Australia will improve?

| | **Net balance** | Improve | Same | Deteriorate |
|---|---|---|---|---|
| | **–13%** | 14% | 59% | 27% |

**2.** At what level of capacity utilisation are you working?

| | **Net balance** | Above normal | Normal | Below normal |
|---|---|---|---|---|
| | **+5%** | 24% | 57% | 19% |

**3.** What single factor is most limiting your ability to increase production?

| | | | |
|---|---|---|---|
| Orders | 55% | Finance | 1% |
| Capacity | 4% | Labour | 8% |
| Materials | 4% | None | 10% |
| Other | 18% | | |

**4.** Do you find it is now harder, easier, or the same as it was three months ago to get:

| | **Net balance** | Harder | Same | Easier |
|---|---|---|---|---|
| (a) labour? | **+19%** | 23% | 73% | 4% |
| (b) finance? | **+12%** | 20% | 72% | 8% |

**5.** Do you expect your company's capital expenditure during the next twelve months to be greater, the same, or less than the past year:

| | **Net balance** | Greater | Same | Less |
|---|---|---|---|---|
| (a) on buildings? | **–4%** | 13% | 70% | 17% |
| (b) on plant & machinery? | **+7%** | 23% | 61% | 16% |

Excluding normal seasonal changes, what has been your company's experience over the past three months & what changes do you expect during the next three months in respect of:

| | | *Change in position in the last 3 months* | | | | *Expected change during the next 3 months* | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | **Net balance** | Up | Same | Down | **Net balance** | Up | Same | Down |
| **6.** | Numbers employed | **+4%** | 19% | 66% | 15% | **+3%** | 14% | 75% | 11% |
| **7.** | Overtime worked | **+14%** | 32% | 50% | 18% | **–12%** | 15% | 58% | 27% |
| **8.** | All new orders received | **+26%** | 41% | 44% | 15% | **+5%** | 26% | 53% | 21% |
| **9.** | Orders accepted but not yet delivered | **+13%** | 28% | 57% | 15% | **–16%** | 13% | 58% | 29% |
| **10.** | Output | **+24%** | 40% | 44% | 16% | **+7%** | 26% | 55% | 19% |
| **11.** | Average costs per unit of output | **+36%** | 43% | 50% | 7% | **+22%** | 29% | 64% | 7% |
| **12.** | Average selling prices | **–1%** | 21% | 57% | 22% | **–1%** | 20% | 59% | 21% |
| **13.** | Export deliveries | **+18%** | 21% | 76% | 3% | **+8%** | 12% | 84% | 4% |
| **14.** | Stock of raw materials | **–6**% | 6% | 82% | 12% | **–4%** | 8% | 80% | 12% |
| **15.** | Stocks of finished goods | **0%** | 10% | 80% | 10% | **–3%** | 9% | 79% | 12% |

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# Summary of results

**16.** Over the next twelve months do you expect your firm's profitability to:

| | |
|---|---|
| (a) Improve? | 27% |
| (b) Remain unchanged? | 55% |
| (c) Decline? | 18% |
| **Net balance** | **+9%** |

**17.** Do you expect your firm's next wage enterprise deal will produce annual rises which vis-a-vis the previous deal are:

| | |
|---|---|
| (a) Greater? | 19% |
| (b) Same? | 63% |
| (c) Less? | 18% |
| **Net balance** | **+1%** |

**A.** Industry profile of survey**:**

| | (% of respondents) |
|---|---|
| Food, beverages, tobacco | 11 |
| Textiles, fabrics, floor coverings, felt, canvas, rope | 1 |
| Clothing, footwear | 4 |
| Wood, wood products, furniture | 5 |
| Paper, paper products, printing | 12 |
| Chemicals, paints, pharmaceuticals, soaps, cosmetics petroleum & coal products | 6 |
| Non-metallic mineral products: glass, pottery, cement bricks | 10 |
| Basic metal products: processing, smelting, refining, pipes & tubes | 2 |
| Fabricated metal products: structural & sheet metal, coating & finishing, wire, springs, hand tools | 14 |
| Transport equipment: motor vehicles & parts, excluding repairs, rail, ships, aircraft, including repairs | 4 |
| Other machinery & equipment: electrical, industrial scientific, photographic | 17 |
| Miscellaneous: including manufacturers of leather, plastic & rubber, sporting equipment, jewellery | 14 |

**B.** How many employees are covered by this return?

| 1–100 | 101–200 | 201–1000 | Over 1000 |
|---|---|---|---|
| 46% | 17% | 17% | 20% |

**C.** In which state is the main production to which this return relates?

| WA | SA | VIC | NSW | QLD | TAS |
|---|---|---|---|---|---|
| 6% | 11% | 24% | 38% | 16% | 5% |

### The Westpac-ACCI Composite Indices

The Westpac-ACCI actual and expected composite indices are weighted averages of the various activity measures in the survey. The weights are as follows: employment 20%; new orders 30%; output 25%; orders accepted but not delivered 15%; overtime 10%.

The labour demand indicator is a weighted average of current and expected labour indicators from the Westpac-ACCI survey. The indicator is expressed as a detrended net balance. Approximate weights are as follows: employment 40%; expected employment 20%; overtime 30%; and expected overtime 10%.



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