



29 July 2011

Dr Matthew Butlin
Chair
Victorian Competition and Efficiency Commission
GPO Box 4379
MELBOURNE VIC 3001

**Victorian Employers'
Chamber of Commerce
and Industry**
ABN 37 650 959 904
486 Albert Street
East Melbourne
Victoria 3002 Australia
GPO Box 4352 Melbourne
Victoria 3001 Australia
Telephone: 03 8662 5333
Facsimile: 03 8662 5462
vecci@vecci.org.au
www.vecci.org.au

Dear Dr Butlin *Matthew*

**Re: VECCI Submission to the VCEC Inquiry into a More Competitive
Manufacturing Industry**

The Victorian Employers' Chamber of Commerce and Industry (VECCI) welcomes the opportunity to respond to the VCEC draft report on the Inquiry into a More Competitive Manufacturing Industry.

The inquiry and Commission's analysis is both timely and important in light of the significance of manufacturing to the Victorian economy, now, and into the future.

At the outset, we commend the Victorian Government for directing the Commission to undertake this inquiry. This action reflects a strategic and practical commitment to ensure policy and program settings are squarely focused on supporting the growth in manufacturing employment, investment and competitiveness. Victoria's economic future depends in no small part on getting these settings right.

In making our submission we have focused our comments on what we consider to be the most important areas that VCEC has made draft recommendations on, namely:

- The recommended policy framework and principles.
- A focus on high performing enterprises.
- Government programs for the manufacturing sector.
- Government procurement policies.
- The role of the Department of Business and Innovation.

Before turning to these issues in detail, we would like to provide some comments on the context of Victoria's manufacturing performance.

...2/..

Ballarat
305A Dana Street
Ballarat Victoria 3350
Telephone: 03 5327 7190
Facsimile: 03 5333 3074
ballarat@vecci.org.au

Bendigo
21 Short Street
Bendigo Victoria 3550
Telephone: 03 5434 1102
Facsimile: 03 5441 4865
bendigo@vecci.org.au

Geelong
20 Little Pyrie Street
Geelong Victoria 3220
Telephone: 03 5227 7990
Facsimile: 03 5223 3958
geelong@vecci.org.au

Traralgon
Unit 2 11 Kay Street
Traralgon Victoria 3844
Telephone: 03 5173 9200
Facsimile: 03 5174 7100
traralgon@vecci.org.au

Wodonga
95 Hume Street
Wodonga Victoria 3690
Telephone: 02 6056 9198
Facsimile: 02 6056 0190
wodonga@vecci.org.au

The Economic Context

VECCI concurs with VCEC's assessment of manufacturing trends over the past decade and the many influences that have had a bearing on - and continue to shape - Victoria's manufacturing performance and prospects.

It is not our intention to replicate this analysis but, in recognising that the share of manufacturing output has fallen over the past decade, we point out that this is not a trend unique to Australia but reflects the progressive structural change taking place in the sector over many years as a consequence of globalisation and an ever changing competitive environment. Manufacturing has been in relative decline in many advanced countries as the services sector at home has grown and as new lower cost manufacturing locations have emerged overseas.

As VCEC notes, the composition of our manufacturing sector is continually changing. Some 'traditional' industries have contracted, while others continue to evolve and even newer ones emerge. The point here is that we must avoid the risk of generalisation that ALL manufacturing is in decline when certain sectors and individual establishments have developed new competitive edges, new products and new markets.

Thus, while manufacturing today may be a smaller part of the state economy, it is also a more efficient one. This provides a solid base upon which to build new, enduring growth opportunities for the sector and its workforce.

We also affirm VCEC's finding that manufacturing is important to regional Victoria and that it faces many challenges similar to Melbourne. However, we also point out that our regions possess a number of unique characteristics – available low cost labour, affordable land, lifestyle attributes, access to markets, abundant resources, and links to the service sector and natural assets - that we need to actively leverage off to create new sustainable advantages.

The challenge for policy-makers is to recognise these attributes and compositional differences and provide the policy and program framework that helps industries under pressure make a successful transition to sustainable growth, and spur new activity among those industries and establishments that are already growing.

Recommended Policy Framework and Principles

VECCI agrees that an appropriate aim for government policy is to improve the wellbeing of Victorians by having more high performing enterprises operating in a dynamic and internationally competitive Victoria. To achieve this, governments need to support the operation of markets, intervene where there is an identified problem, and transparently evaluate the effectiveness of interventions both before and after the event.

In practice, it is important that governments move beyond principles, with policy and program responses that facilitate market success for manufacturers, and not just address wider market failures.

VECCI believes that governments can (and should actively) influence key drivers of growth, as noted in the draft report: skill formation; innovation; regulation and taxation; and economic infrastructure. These are important policy levers that have a significant influence on manufacturing businesses.

Reforms that lower costs and improve business efficiency must be pursued. Business wants fewer barriers and better information on how to grow their business and interact with customers, including when transacting business to business and business to government.

It is equally important that other areas of government policy are more integrated with industry policy, given their impact. A high-level, whole-of-government approach is needed. For example government policies in areas as diverse as planning, regional policy, trade and investment, transport, energy policy, migration and housing policy, can all impact on business development opportunities.

Moreover, while state governments cannot control the national industry policy reform agenda, they need to be strident in trying to shape it on behalf of Victorian business interests. Business needs strong advocacy within the state government and state public sector, and also at the national level.

VECCI supports the principles outlined within this framework of potential policy levers. In particular, we support government interventions primarily where there are identified market failures in areas such as skills formation, business, investment and trade promotion/facilitation, innovation and infrastructure.

We also support a role for government where government can add clear value to private sector activities, for example in infrastructure provision or investment facilitation.

The very fact that state governments have a vital role to play in industry development means this feature should be a key component of the policy framework and principles.

Around the world governments actively compete for economic activity, directly through efforts to attract tourists, trade and investment, through the quality of the business environment established, through government-delivered services to industry, but also through the quality and quantity of its support for its business base.

Small countries without the lure of large domestic or nearby markets have successfully used a wide set of tools to promote and support both the growth of their established base and the development of new industries.

We do not necessarily expect such an approach for Victoria given that these are separate nations but we do want to see an understanding in government policy formation and implementation that governments need to compete just as much as companies do.

VECCI notes the focus on public sector benchmarking in VCEC's State-based reform agenda issues paper and strongly supports an approach to government service delivery that actively embraces the local and international benchmarking of government inputs to private sector activities.

Such benchmarking would signify the government explicitly recognises its influence on business competitiveness and also provide appropriate foundations for setting priorities for improvement.

A Focus on High Performing Enterprises

VECCI also endorses an approach that focuses on high performing enterprises. It will be no small challenge to develop an approach that enables government interventions to selectively support high performing enterprises, but this challenge must be taken up.

In doing so, it will be important to avoid an approach that assumes only enterprises worthy of government support can be found in a limited number of 'target' industries.

As noted above, we strongly support an approach built around high performing enterprises, irrespective of industry. This view is not just principled but pragmatic. It recognises that what is "manufacturing" and what is not is debatable and changes over time.

Therefore, while a new focus in policy *for manufacturing* is important:

- Industry policy and its associated programs should be equally supportive of service industries and the valuable contribution they will continue to make to output, jobs, exports and investment.
- Good industry policy is not a substitute for good economic management. Unless the economic fundamentals are right – spending, taxation and regulation, infrastructure, skills and training – the best-laid industry policy objectives will not be realised.
- Of itself, industry policy is not a panacea for industries under pressure from global competition. The private sector will ultimately take the lead in becoming more innovative, competitive and adaptable to these pressures. Industry and economic policy should complement these efforts by creating the right environment for growth.
- Industry policy – while providing confidence and certainty to stakeholders – also needs to be sufficiently flexible to be responsive to underlying changes in industry structure, economic conditions, social trends and technological developments.

Government Programs for the Manufacturing Sector

Though VCEC does not discuss the details of particular programs, we note the Commission's preliminary finding that '*Victoria's many manufacturing programs are costly to administer with little evidence as to their effectiveness*'.

We also note VCEC's assessment that manufacturing firms can access a large number of programs which do not appear to be framed within a publicly articulated, coherent, strategic framework.

Feedback from our members suggests there would be clear benefits associated with:

- Reducing the number of programs and setting them within a clear strategy.
- Improving program monitoring, evaluation and transparency.
- Strengthening direct engagement with business, to improve intelligence about what is needed and what works.

Program Design and Evaluation

VECCI's supports an approach to program design (and delivery) that is based on a thorough cost-benefit assessment of any prospective intervention. To enable the broad range of impacts from government interventions to be captured, VECCI supports the use of econometric models that attempt to capture the economy-wide effects, subject to a small number of qualifications.

These qualifications include whether small impacts from individual case by case interventions can be properly captured by large scale models built on high level data.

We consider the model(s) need to be sufficiently flexible to also capture *marginal impacts* arising from:

- Net additions to Victoria's resource base such as capital inflows, skilled management, new technologies and access to international markets.
- The employment of otherwise under-employed resources e.g. unemployed labour in regional areas.
- Competition for resources which are otherwise already employed.
- Intangibles such as the access to international supply chains that foreign investors may bring.
- The additional business which may come to the state from successful international branding campaigns.

Finally, VECCI notes that in the case of investment assistance, VCEC proposes a presumption that the gross economic activity associated with all such projects is not additional and that the assessment of gross benefit of such assistance be based on technological and knowledge spillovers.

This may be unnecessarily punitive as there will be cases where research by the state's investment team identifies a target, gets Victoria on their radar, and then successfully attracts them to Victoria.

In such cases, merely counting the knowledge and technological spillovers would significantly underestimate the gross benefits to the state. We therefore support tools that examine economy-wide impacts but believe these tools and the assumptions made to drive them should be carefully matched to the cases they are chosen to evaluate.

Program Delivery

In our view, consideration of alternative delivery mechanisms at the time of the design of programs is particularly important. In principle, we support private sector delivery of more government programs.

We believe that there are a number of arguments in support of this principle.

Firstly, it enables a stronger government focus on what is its primary role, namely policy formation. It should also provide stronger foundations for advocacy of the business case within government.

Secondly, it enables advantages to be taken of the sorts of efficiencies that the private sector can provide, for example, a better understanding of business needs in business-to-business dealings. Moreover, by coupling private sector delivery with sunset clauses for all programs, and a private sector understanding of bottom line accountability, we believe that the government could achieve substantial efficiency and gains.

A further advantage of this approach is that it would encourage a much greater focus by the Department on the deliverables associated with any program in the process of contract development and management.

The final advantage for government is that it diminishes the political risk associated with program delivery by placing the latter at arm's length.

Government Procurement Policies

VECCI acknowledges the arguments behind VCEC's recommendation that Government procurement policies should be based on the objective of realising whole-of-life value for money. However, given the size of government spending and its potential importance to many businesses, it is vital that all firms have equality of opportunity in accessing government tenders.

Value for money should be a key driver but some weighting should be attached to those bids that can demonstrate wider capabilities and contributions in areas such as the transfer of technology, productivity gains, skills development and/or transfer, sustainable employment, exports, linked investments in allied industries, carbon reducing actions, improved amenity and social wellbeing.

Furthermore, the opportunity for government to make an important contribution directly should not be missed given the importance of government as a major customer in key parts of the economy.

In domestic markets where the government is a significant customer, prospective foreign customers for the same Australian-produced goods and services will expect local companies to have government supply contracts.

They will see this as endorsement of the Australian products, especially if their own governments have local purchasing preference schemes. This role – of governments playing in the marketplace – needs to be considered and counted in any evaluation of the government's procurement policies.

While there are many dimensions to government procurement in Victoria, we consider the Victorian Industry Participation Policy (VIPP) has an important role to play in helping ensure bidders and procurement agencies consider local supply opportunities, and with that, local employment. VIPP's focus on promoting greater access for SMEs to supply work on major projects is valuable and must be retained.

Of course, the capacity of VIPP to spur local firm involvement in government purchasing will remain constrained while barriers to SMEs exist. It is therefore important that greater effort be directed towards reducing these barriers, particularly those relating to:

- SME knowledge about procurement opportunities.
- Unnecessary scale impediments.
- Overly prescriptive tender specifications.
- Overly burdensome prequalification rules.
- Inconsistent or excessive contractual conditions.
- Failure to adequately consider whole-of-life costs in tender assessment.

Also vitally important is that government departments and agencies understand and correctly implemented any changes in procurement policy.

The Role of the Department of Business and Innovation (DBI)

In its draft report, VCEC recommends that the Department of Business and Innovation should strengthen its focus on what it calls "strategic business intelligence". VECCI endorses this recommendation and the supporting recommendation that this improved intelligence should be used to inform policy formation within the department.

This approach – of a policy driven department – would create a strengthened policy function and would, on the evidence so far in front of the VCEC, fill an existing vacuum and create a much stronger departmental advocate for business.

This latter outcome would be highly valued by VECCI. This, in turn, would be enhanced by a clear recognition of the respective strengths and weaknesses of private and public sector program delivery, and appropriate consideration of the private sector service delivery alternative.

This package – of an industry department which is policy driven and focussed on securing value for money in a full cost-benefit sense - would have benefits for our members, government and taxpayers alike.

It would encourage the full costs of public sector service delivery to be taken into account in all cases. It would enable the state government to become more nimble in its selection and implementation of business development policies. It would also enable the government to reduce the political risk associated with financial support for the private sector. Finally, it could establish a strong advocate for business within the state government.

Conclusion

Our overall position is one of support for the Commission's draft report findings. Where necessary we have offered qualifications. *Nonetheless, in the final report VCEC must spell out the implications of its findings for the government and the next steps that it could take.*

We have attempted to distil some of these implications ourselves as they relate to policy framework and focus, program design and evaluation, the role of government procurement, and possible new directions for DBI.

Our analysis of the report, and our understanding of the needs of members, reinforces the need for some flexibility in the implementation of government policies for manufacturing firms.

At the highest level, we see little merit in having a manufacturing industry policy that is separate and different from government policy towards businesses right across the economy. Having said that, we also wish to see a policy and service delivery capability in government that recognises that individual firms, indeed different groups of manufacturing firms, may benefit from different sorts of interventions.

The recommended policy focus in this report on enterprises demands a flexible focus on the needs of businesses in service delivery. Clearly, this requires a different set of delivery skills from the existing program/budget focus.

Finally, we recognise that VCEC makes *recommendations* to government and does not determine policy or indeed how it is to be implemented. Nonetheless, providing some indicative detail at the program level of the sorts of actions which the government might take to improve the competitiveness of manufacturing industry would maximise the likelihood of government acceptance of many of VCEC's recommendations.

VECCI stands ready to continue to work closely with VCEC, the government and its other agencies to secure renewed growth and improved competitiveness across this important sector of the Victorian economy.

We would welcome the opportunity to discuss these issues with you in further detail if required.

Yours sincerely



Mark Stone
Chief Executive