

7 September 2006

Committee Secretary
Standing Committee on Economics, Finance and Public Administration
House of Representatives
PO Box 6021
Parliament House
CANBERRA ACT 2600
AUSTRALIA

Inquiry into the state of Australia's manufactured export and import competing base now and beyond the resources boom

Dear Sir,

The terms of reference for this inquiry and your Committee's parallel inquiry into the services industry raise very important issues about the development of our economy and about the direction of economic and industry policy in Australia. We believe this committee has the potential to inform the debate and to play an important role in making sure that policymakers are directed into sensible and constructive channels.

The majority of Ai Group's members are manufacturers. We also have members in many other sectors including construction, ICT, logistics, labour hire and service industries. Our close contact with our members together with our ongoing research into Australia's industries including manufacturing gives us unique insights into the conditions facing the sector.

The current state of the manufacturing industry, particularly in the context of the current minerals boom is something that Ai Group has researched and written about over several years.

Our more recent research in this area includes last December's *Balancing the Risks: Building Australia's Economic Resilience* and *Manufacturing Futures: Achieving Global Fitness* which we released in April this year. We also published the path breaking *World Class Skills for World Class Industries* in May this year. These documents are attached. I also attach an address I gave to the National Press Club on of 19 April this year *Balancing the Risks: Ensuring Australia's Prosperity Survives the Boom*.

The attached material is very comprehensive and in the remainder of this submission we provide a brief overview of Ai Group's approach with particular reference to the research and principles that lie behind our diagnosis of the state of Australian manufacturing, its prospects and the appropriate policy responses. We also include a list of policy areas for your consideration.

Australian Manufacturing

Australia's manufacturing sector is under considerable pressure as evidenced by frequent news stories of closures, cuts backs and cost-downs. It is a very tough period and for some businesses and their employees the prospects are far from bright.

These developments need to be seen against the general backdrop of an economy that is subject to constant change and in which, even at the best of times, businesses scale back and are shut down. These sorts of movements are part and parcel of the general tide of "creative destruction" that characterises a modern dynamic economy. Fortunately in this general process new businesses open up and others expand their operations. At a time when employment is growing strongly and the official unemployment rate is now well below 5%, some comfort can be taken from the aggregate success of the Australian economy.

Nevertheless the conditions currently facing Australian manufacturers are particularly challenging. Part of this is due to the strength of the minerals boom. The surge in commodity prices has strengthened the exchange rate, has helped absorb spare capacity and has drawn resources, particularly skilled labour, away from non-booming sectors such as manufacturing. Australian manufacturing is undergoing a bout of Dutch disease.

Even more than this, Australian manufacturers are facing the challenges of the manufacturing-led "emergence" of China together with the rapid development of other nations such as India, Brazil and a number of Eastern European countries. The competitive pressures stem not only from cheaper labour - although this is a big part of the story: they also come from the strong investments that these countries are making in training and education, in technology and in sophisticated products and processes.

Unfortunately the competitive pressures in some cases also stem from what is seen to be "dumping" of below-cost product in local and export markets and a lack of success in securing intellectual property rights – both in other countries and in the domestic market.

These global developments are, of course, affecting manufacturers and their workforces around the globe. In most countries, however, manufacturers are not also fighting off Dutch disease.

Our research into the manufacturing sector reveals a very vigorous response by Australian businesses to these challenges. In *Manufacturing Futures* we document the extent to which manufactures were themselves investing in new products and processes; increasing the attention they pay to recruitment and training; developing export markets;

innovating; building and linking into global supply chains; and investing directly abroad. We also found that manufacturers were renovating their businesses by cutting costs.

Perhaps our most disturbing finding was that up to 30% of manufacturers were not actively renovating their businesses in the face of these competitive challenges.

At the other end of the scale, we also find that manufacturers are intent on turning challenges into opportunities. Many are undertaking or assessing investment opportunities abroad – particularly to take advantage of new sources of demand and new capabilities in emerging economies. These businesses are challenging many of our preconceptions of what it means to be “an Australian manufacturer.” Many also are leveraging the efficiency gains they have generated to build their businesses.

Policy

Ai Group’s approach to policy is based on strong and rigorous research and by our close contact with our members. We are guided by several principles.

- Firstly, we are very wary of policies that would damage the aggregate economy, even if they are *intended* to help manufacturers. Manufacturing, at about 13% of Australian Gross Value Added, is inextricably tied into the success of the aggregate economy and policies that slow the aggregate rate of growth are likely to also see fewer opportunities emerge for manufacturers.
- Second, we are wary of the ability of Governments to pick particular winners.
- Thirdly, we are supportive of policies that create the conditions for the continuous emergence of new winners. We therefore see particularly strong scope for policy that will facilitate the development of business capabilities and workforce skills. We also support policies that remove impediments to growth.

With these principles in mind, in *Manufacturing Futures* we put forward for consideration policies in six main areas.

- Improving incentives to invest;
- Developing workforce skills;
- Building Australia’s business capabilities;
- Making further improvements to Australia’s innovation system;
- Reducing the red tape burden imposed on business; and
- Encouraging and removing barriers to global engagement.

More detail of our policy suggestions are set out in *Manufacturing Futures*.

I would like to conclude with the observation that, despite the considerable challenges facing Australia’s manufacturers, overwhelmingly they are responding actively and creatively.

With appropriate policy, the considerable efforts and energy of Australian manufacturers and their workforces can ensure that they are successful and well equipped to assume a leading role in the economy when, and if, the minerals boom subsides. Of course, even then, global competitive pressures will continue to intensify.

Yours Sincerely

A handwritten signature in black ink, appearing to read "Heather Ridout". The signature is fluid and cursive, with a long horizontal stroke at the end.

Heather Ridout
Chief Executive