

## The role of government in the manufacturing sector

### The role of governments in a global market

- 3.1 The level of government assistance to the manufacturing sector differs considerably amongst developed nations. However, most share a common feature – declining overt government assistance, particularly the removal of trade barriers, yet the maintenance of some form of industry support.
- 3.2 The Australian Government provided around \$6.9 billion<sup>1</sup> in total manufacturing assistance in 2004–05. This is equivalent to around 7.2 per cent of manufacturing’s total contribution to GDP<sup>2</sup>, but some manufacturing industries far exceed this rate.<sup>3</sup> States offer further assistance to manufacturing industries in their jurisdictions, last estimated by the Productivity Commission in 2001–02 at around \$93 million.<sup>4</sup> A list of budgeted Australian Government assistance is in Appendix D.
- 3.3 While the manufacturing sector is still around 12 per cent of the Australian economy, its share has been declining. Coupled with this sectoral

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1 Productivity Commission (PC), *Trade & Assistance Review 2005–06*, Canberra, April 2007, p. 2.11.

2 Manufacturing contributed \$96 366 million to GDP in 2004–05. Refer: ABS, *Australian System of National Accounts*, Cat. 5204.0, 200506, Industry Gross Value Added, p. 33.

3 For example the textile, clothing and footwear sector’s assistance is 19.2 per cent of their GDP contribution. Refer: ABS, *National Accounts* and PC, *Trade & Assistance Review 2005–06, Annual Report Series*, April 2007, Table 2.2b p. 2.5 & Table 2.4b, p. 2.11.

4 PC, *Trends in Australian Manufacturing*, 2003, p. 214.

adjustment most OECD countries have embraced more open and unimpeded trade policies, leading to greater manufacturing exports and less emphasis on import substitution (and their protection).

- 3.4 Australia's effective rate<sup>5</sup> of assistance to manufacturing has declined considerably over the last 40 years from around 35 per cent in 1967-68 to around five per cent in the new century (Figure 2.2, p. 13).<sup>6</sup> The reduction in Australian protection commenced in 1973 with an across the board reduction in tariffs of 25 per cent. A gradual decline has occurred since then with only two sectors remaining under transitional protection regimes; the automotive and the Textiles Clothing and Footwear (TCF) sectors.
- 3.5 Tariffs in the automotive industry are currently ten per cent, down from 57.5 per cent in 1988. On 1 January 2010 the tariff rate for passenger motor vehicles will reduce to five per cent.<sup>7</sup>
- 3.6 The TCF tariff rates are more complicated. Those for clothing and some finished textiles are currently 17.5 per cent; cotton sheeting, woven fabrics, carpet and footwear stand at 10 per cent, while sleeping bags and table linen are 7.5 per cent. The latter categories will reduce to five per cent in 2010. The clothing category will not reduce to five per cent until January 2015 but will transition to ten per cent in 2010.
- 3.7 Australia lagged behind most of its trading partners in the early stages of the trade liberalisation process, but now has average tariff levels comparable to those in the US, European Union and Japan. With APEC's goal of free trade access to developed countries by 2010, transitional programmes of tariff reduction should not be protracted.
- 3.8 Despite the natural progression in sectors as nations advance, a number of advanced economies have policies designed to ensure the manufacturing sector of their economy is viable and prosperous.<sup>8</sup> This is often predicated on a desire for a 'balanced economy' with representation from all sectors of the economy, despite comparative advantages in some sectors.

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5 The effective rate of assistance takes into account not only support directed at an industry but the amount of support indirectly received, or the tax paid, by the industry because the government has subsidised or taxed a supply industry.

6 PC, *Trends in Australian Manufacturing*, 2003, p. 148.

7 PC, *Trade & Assistance Review 2005-06*, Annual Report Series, Canberra, April 2007, p. 3.16.

8 Ireland; Germany; Sweden; Canada; Singapore and Korea focus on innovation and high-end manufacture. European Commission, Enterprise & Industry Directorate General, *The European TrendChart on Innovation*, 2006, as viewed 19 May 2007, <[http://europa.eu.int/comm/enterprise/index\\_en.htm](http://europa.eu.int/comm/enterprise/index_en.htm)> and <<http://www.trendchart.org>>.

## Australian Government industry policy

- 3.9 Australian Government industry policy is moving towards non-financial and more market-driven assistance. There are, however, a large number of discrete industry assistance programmes that provide direct support to the manufacturing sector.<sup>9</sup>
- 3.10 While the Australian Government's stated approach is sector-neutral, some programmes favour particular industries. In line with a world-wide trend, there is an increasing emphasis on supporting innovation, science and technology activities and recently, green technologies.<sup>10</sup> These activities are not manufacturing specific but probably have a greater applicability to manufacturing than other sectors. In addition, targeted support (and phased-out protection) to traditional manufacturing industries, like the automotive and textiles, clothing and footwear industries, continues.<sup>11</sup>
- 3.11 Sector specific support is mostly employed to overcome fast-paced sectoral change<sup>12</sup> or cushion the phase-out of protection measures.<sup>13</sup> However, there are other sector specific strategies which could be construed as backing particular industries within manufacturing.<sup>14</sup>
- 3.12 'Picking winners' is not desirable because, as the Treasury noted, governments are no better placed than firms to know what direction the market may take. The Treasury's submission also stated:
- The most effective initiatives are those that are broad-based, thereby limiting market distortions and allowing individual firms to select the most profitable investments.<sup>15</sup>
- 3.13 The Australian Chamber of Commerce and Industry (ACCI) stated:

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9 AusIndustry and Austrade together provide in excess of 20 programmes as listed in Appendix D.

10 As an example, the CSIRO Niche Manufacturing National Research Flagship is designed 'to help drive a new wave of niche industries based on nanotechnology'.

11 In 2005-06 motor vehicle & parts manufacturing had budgeted assistance of \$585.1 million; of that \$512.3 million was industry specific. Similarly, in 2005-06 TCFL received \$209.8 million budgeted assistance; of that \$179.9 was industry specific. PC, *Trade & Assistance Review 2005-06*, Canberra, April 2007, Table A.13-A.14 & pp. A.17-A.18.

12 Discussed further in this chapter under *Structural and Sectoral Change*.

13 PC, *Trade & Assistance Review 2005-2006*, Canberra, April 2007, Chapter 2, p. 10.

14 The Pharmaceutical Partnerships Programme (P3) and Food Innovation Grants are examples.

15 The Treasury, *Submission no. 21*, p. 11.

The future of manufacturing does not lie in increasing government intervention, building higher tariff walls, providing greater subsidies or picking winners'.<sup>16</sup>

3.14 BlueScope Steel argued that government support for certain sectors '...amounts not to picking winners, but to helping winners do even better'.<sup>17</sup> Whilst there is an argument that comparative advantages be seized with the assistance of government, there is only a tentative case for overt government support for already succeeding manufacturers.

3.15 Action Agendas<sup>18</sup> could be said to foster industry picking its own winners. However, this strategy may result in industry sectors lobbying government to 'pick them'. Such behaviour is to be avoided as noted in discussions between the committee and the Australian Manufacturing Workers Union (AMWU):

That is, the bureaucrats do not say, 'You got it and you didn't, because you are better lobbyists,' but because company A fitted the criteria well.<sup>19</sup>

3.16 The AMWU noted that Ireland, Singapore and to a lesser extent Germany have all nominated strategic industries.<sup>20</sup> The Australian Electrical and Electronic Manufacturers' Association's (AEEMA) supplementary submission also highlighted the successful industry targeting strategies in other countries, stating that :

There are winners in other countries, Taiwan, Sweden, Belgium for instance, from which lessons can be learnt, and armed with this information we should not follow the losers.<sup>21</sup>

3.17 Mr Angus Robinson, chief executive of AEEMA said that the mining sector was a 'targeted winner' and that, over and above comparative advantages, the actions of supporting that industry made a difference. He noted that most other countries have mineral deposits, but they had not focussed policy efforts in that area:

The industry asked the government to commit to railway lines, ports and infrastructure and work to develop supply chain

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16 Mr G Evans, ACCI, *Transcript*, 2 March 2007, p. 18.

17 BlueScope Steel, *Submission no. 39*, p. 17.

18 Strategic plans for industry, facilitated and endorsed by the Australian Government are discussed further at paragraph 3.54 in the Chapter.

19 Dr C Emerson MP, *Transcript*, 29 August 2006. p. 86.

20 Mr P Conroy, Australian Manufacturing Workers' Union (AMWU), *Transcript*, 28 August 2006, p. 85.

21 AEEMA, *Submission no. 44*, p. 6.

relationships ... and address the issues of getting mines to market.  
... They picked winners in the mining industry...<sup>22</sup>

3.18 In contrast, the Western Australian branch of the Chamber of Commerce and Industry, hailing from the biggest mining boom state, disagreed, stating: ‘...”picking winners” appeared in practice to amount to spending huge sums shoring up ailing companies’.<sup>23</sup>

3.19 The Global Integration Background Paper indicates that supporting business capabilities is the new policy focus: ‘In the industry policy arena, the focus has shifted from crude protectionism to encouraging capable businesses which can compete successfully in an open market.’<sup>24</sup> This policy may not actually be picking the winners, rather allowing the best to grow as enunciated by Mr Paul Laver, vice president of the Australian Academy of Technological Science and Engineering (AATSE):

We have to allow the winners to flower and bloom on their own – but we have to provide an environment where the flowers can grow.<sup>25</sup>

3.20 The government’s industry policy, as outlined in the Industry Statement 2007, concentrates on supporting industries to become more outward looking and integrated into world markets and global supply chains.

## Strategic policy platform

3.21 The Department of Industry, Tourism and Resources (DITR) oversees the Government’s industry policy. The department’s current focus is on nine strategic priorities embodied in their Strategic Plan 2006–2009:

- implementing new measures;
- securing Australia’s energy future;
- capitalising on Australia’s resources;
- measurable reduction in compliance burden;
- commercialisation; collaboration and investment in innovation;

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22 Mr A Robinson, AEEMA, *Transcript*, 7 December 2006, p. 6.

23 Western Australian Chamber of Commerce & Industry, *Submission no. 28*, p. 15.

24 DITR, *Global Integration Background Paper*, July 2006.

25 Mr P Laver, AATSE, *Transcript*, 28 August 2006, p. 41.

- Australia as a leader in platform technologies and industries of the future;
  - skills development to meet business needs;
  - global integration; and
  - microeconomic reform and the business environment.
- 3.22 A number of these priority areas are the primary policy domains of other portfolio departments.
- 3.23 The current policy framework derives from the Government's 1997 industry statement, 'Investing for Growth'. In May 2007, after the committee had finished its hearings, Minister Ian Macfarlane released a new Industry Statement<sup>26</sup> which updated the outlook and strategy and established the industry policy framework for the next decade.<sup>27</sup>

## Manufacturing policy

- 3.24 As previously discussed, Australia has a sector-neutral industry policy. Similarly, Canada has a broad industry policy platform, consisting of '...a fair, efficient and competitive marketplace; an innovative economy; and competitive industry and sustainable communities'.<sup>28</sup> In New Zealand, the Ministry of Economic Development's industry strategy is embodied in its 'Statement of Intent 2006–2009'.<sup>29</sup> This is a comprehensive document providing an analysis of their industry and identifying strategic trade partners – yet it does not contain a stand-alone manufacturing strategy.
- 3.25 In contrast, in 2002 the United Kingdom's Department of Trade and Industry introduced a specific manufacturing strategy,<sup>30</sup> as distinct from a broader industry strategy. This is a targeted policy which focuses on the unique issues facing their manufacturing sector. It is based on an appraisal of the country's manufacturing strengths and recognises its weaknesses. Notably, it is written in plain English with an absence of 'spin'.

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26 For the overview of the 2007 Industry Statement refer to Appendix G.

27 DITR Strategic Plan 2006–2009, as viewed 15 May 2007, <<http://www.industry.gov.au/content/itrinternet/cmscontent.cfm?objectID=84A3EE89-D757E9C1-4672E5245B463E67>>.

28 The Department of Industry, Canada, 2007, as viewed 19 April 2007, <<http://www.ic.gc.ca/cmb/welcomeic.nsf/ICPages/Department>>.

29 Ministry of Economic Development, New Zealand, 2006, as viewed 19 April 2007, <<http://www.med.govt.nz/upload/35379/soi-2006.pdf>>.

30 Department of Trade and Industry, *Manufacturing Strategy 2002*, as viewed 19 April 2007, <<http://www.dti.gov.uk/sectors/manufacturing/manufacturingpolicy/strategy/page25211.html>>.

- 3.26 The AEEMA supplementary submission highlighted that some Australian states have specific manufacturing strategies:

States such as Victoria, South Australia and Queensland have articulated clear manufacturing policy strategies about the critical place manufacturing occupies in overall economic development.<sup>31</sup>

- 3.27 Comparable countries to Australia have similar ministerial portfolio structures for industry<sup>32</sup> and also have no manufacturing portfolio per se. The State of Victoria is the only state or territory in Australia to have a specific Minister for Manufacturing.<sup>33</sup> One of the advantages of having a single minister for the sector is administrative simplicity – a single port of call for manufacturing issues may be created.

- 3.28 The committee considered the different roles of the Australian Government's industry promotional agencies and whether they should be merged. In response to this proposition the Australian Trade Commission (Austrade) asserted:

It is probably up to all of us as agencies to work more closely together, and we are all government, so where we happen to sit does not really matter. As long as we are working and exchanging information and pursuing opportunities, then it is nominal.<sup>34</sup>

- 3.29 The merging of agency operations have been considered in the past, with independent reviews finding that it is better to keep different activities for the same sector in discrete agencies than to merge all activities for the same sector under one roof. For example the 2001 'Blackburne Review'<sup>35</sup> of Invest Australia determined that the agency should conduct all investment attraction operations. The subsequent 2005 review by the Allen Consulting Group agreed 'that the agency should remain whole and should not be merged with Austrade or anything of the kind ...'<sup>36</sup>

- 3.30 However, AEEMA noted at a public hearing that there is no mechanism to unify all departments and agencies serving the sector:

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31 Australian Electrical and Electronic Manufacturers' Association, (AEEMA), *Submission no. 44 (supplementary)*, p. 2.

32 Canada has a Minister for Industry; United Kingdom a Secretary of State for Trade and Industry and New Zealand a Minister for Industry & Regional Development.

33 The Victorian Minister for Manufacturing Industry was appointed in 2000.

34 Mr L Strangis, Austrade, *Transcript*, 1 December 2006, p. 25.

35 I Blackburne (Chair), *Winning Investment: Strategy, People and partnerships – A review of the Commonwealth's investment promotion and attraction efforts*, report to the Prime Minister, 2001.

36 Mr Jones, Invest Australia, *Transcript (Services)*, 1 December 2006, p. 35.

DITR have these bureaucrats working through strategies in limited discussions with industry, and certainly you wonder about the extent to which there are discussions between them and Finance and Treasury, the central agencies. ...there needs to be some high-level mechanism for bringing together the best of industry thinking and the best of government thinking, setting some high level strategic goals for Australia in this area and working on some high-level national plans.<sup>37</sup>

- 3.31 A National Manufacturing Forum (NMF) was formed as a result of the National Manufacturing Summit held in Melbourne in December 2005. The summit was arranged because of a view that ‘...collective action is required for the development of a national manufacturing strategy – one that will secure the industry’s future as an innovative global supplier’.<sup>38</sup>
- 3.32 The NMF comprised representatives of all state and territory governments; the manufacturing industry; unions and peak industry associations from across Australia. Although the Commonwealth government did not participate directly, the forum is informed by the Industry Capability Network (ICN)<sup>39</sup>, an organisation supported by the federal government.
- 3.33 The NMF released its report *Strategic actions to boost Australian manufacturing* in October 2006. The report outlines a framework for government manufacturing policy centred on four key priorities: globalisation; investment; innovation and R&D; and skills.
- 3.34 In evidence to the committee, Mr Nigel Reeves, project manager, NMF, noted that regional manufacturing plans need to be developed using a national strategic plan approach:

We have recommended to each of the state and territory manufacturing councils – groups of people who are manufacturers who engage with state and territory governments – a framework for them to go ahead and, within their own jurisdiction, do an analysis of what their particular strengths are. ...and that obviously leads to going about maximising those advantages.<sup>40</sup>

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37 Mr A Robinson, AEEMA, *Transcript*, 7 December 2006, p. 10.

38 National Manufacturing Forum, *Strategic actions to boost Australian manufacturing—a report by the National Manufacturing Forum to State and Territory Ministers responsible for manufacturing*, Melbourne, 2006.

39 The ICN provides support in all states and territories to import-competing industries and more recently, to those entering global supply chains. Its focus is on identifying project or supply chain capabilities.

40 Mr N Reeves, NMF, *Transcript*, 22 November 2006, p. 7.



- 3.35 The Geelong Manufacturing Council echoed this view, embedding regional strategy plans into the national strategy:

Our national economy could be strengthened through the development of a 'National Manufacturing Strategy and Plan' to grow and encourage Australia as a manufacturing centre.<sup>41</sup>

- 3.36 An example of a national manufacturing-based plan embodying regional issues is the Swedish 'national strategy plan for regional innovation', which includes 'regional growth programs'.

- 3.37 The executive chairman of the NMF, Mr Robert Herbert, stressed the importance of a national framework for manufacturing policy, even if it incorporates regional plans:

We recognised that states will have different needs and the composition of manufacturing in them will vary. ... But some things can be better coordinated nationally...<sup>42</sup>

- 3.38 Mr Herbert noted the problems associated with state operated freight as an example of why a national approach is required:

In order for BlueScope to transport its product from Melbourne to Queensland there are some 15 stops along the way getting through the Sydney network. That is an Australian problem.<sup>43</sup>

- 3.39 In recognition of the work undertaken by the NMF, the South Australian Government's submission recommended:

Given the Commonwealth control of the economic levers that drive growth, it is therefore recommended that the Commonwealth Government join State Governments in working toward the establishment of a National Manufacturing Strategy.<sup>44</sup>

## Should the contraction in manufacturing be resisted?

- 3.40 While a global phenomenon, the long-term decline in the relative size of Australia's manufacturing sector has led to some concern. Some regard the tangible output of manufacturing as inherently more worthwhile than services, and employment in manufacturing as a 'real job'.<sup>45</sup>

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41 Geelong Manufacturing Council, *Submission no. 25*, p. 7.

42 Mr R Herbert, NMF, *Transcript*, 22 November 2006, p. 8.

43 Mr R Herbert, NMF, *Transcript*, 22 November 2006, p. 12.

44 South Australian Government, *Submission no. 26*, p. 21.

45 An extreme version of this view was that most services were excluded from 'net material product', the equivalent of GDP, by statisticians in the Soviet Union (and for a time China).

- 3.41 There are also views that it is desirable for an economy to have a mix of sectors, with a significant role for manufacturing. Mr Robinson from AEEMA argued:

Our real concern is that the balance of GDP assigned to manufacturing is too low ... our overall GDP mix is unbalanced and, from a risk management perspective, we need to review it.<sup>46</sup>

- 3.42 This argument could lead to a 'target size' for manufacturing. Mr Robinson continued:

Singapore has quite a clear understanding of keeping its GDP manufacturing in the range of 20 to 25 per cent. ... Australia appears to have no similar strategic parameters.<sup>47</sup>

- 3.43 However, there was little support for such a target. Dr Peter Brain, executive director of the National Institute of Economic and Industry Research (NIEIR) commented:

The size of the manufacturing sector you should aim at is a manufacturing sector that delivers your general macro outcomes of the supply of quality employment for your citizens, generates enough exports to ensure that we do not leave the next generation with massive piles of debt and so that we achieve some sort of balance of payments equilibrium; and a geographical distribution of economic activity that ensures that the resources in each jurisdiction and sub-jurisdiction are reasonably efficiently used.<sup>48</sup>

- 3.44 Some submissions referred to concerns that the manufacturing sector could drop below a minimum viable size and then contract markedly to negligible dimensions. The Geelong Manufacturing Council expressed concerns about the 'critical mass' needed for the manufacturing industry to be competitive being under threat as it is subject to 'hollowing out'.<sup>49</sup>

- 3.45 Blue Scope Steel's submission also discussed this issue:

Loss of critical mass in key manufacturing sectors is of particular concern .... Supplying steel to this [automotive] sector requires continual investment in upgrading processes and in new steel products in order to meet the ever-tightening standards of the globalised auto industry. It is very important that the local

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46 Mr A Robinson, AEEMA, *Transcript of Evidence*, 7 December 2006, p. 3.

47 Mr A Robinson, AEEMA, *Transcript*, 7 December 2006, p. 3.

48 Dr P Brain, National Institute of Economic and Industry Research (NIEIR), *Transcript*, 22 November 2006, p. 38.

49 Geelong Manufacturing Council, *Submission no.25*, p. 4.

industry maintains critical mass – without it, BlueScope Steel would find it difficult to continue to invest to meet the demanding requirements of the sector. And a local automotive industry would, in turn, be difficult to maintain without a local steel producer.<sup>50</sup>

- 3.46 Some scepticism was expressed about the strategy of just keeping the ‘smarter’ parts of manufacturing, such as production of sophisticated components, and related services such as innovation, design, marketing and management within Australia, while shifting the more routine, labour-intensive, parts offshore. The AMWU felt this strategy was:

Doomed to failure. Once a supply chain loses critical mass, firms along the chain are at a severe disadvantage.<sup>51</sup>

- 3.47 Mr Doug Cameron, national secretary of the AMWU, also remarked:

In our view, you cannot keep the cream of manufacturing, you cannot do the R&D and the prototyping here and hope that you can keep it here.<sup>52</sup>

- 3.48 One argument for this was that much innovation originates on the shop floor and becomes less likely if assembly lines are located in different countries to management and design.

- 3.49 Another argument advanced for keeping a large manufacturing sector was that it was seen as having a stronger ‘multiplier’ impact on the rest of the economy as it requires many raw materials and services as inputs. This argument has less impact as the economy approaches full employment.

- 3.50 There is a view that manufacturing is being concentrated in a smaller number of large companies who operate on a global basis, but with key decisions being taken in their home country. This might give rise to concerns that Australia has fewer large manufacturers than do a number of much smaller economies such as Switzerland (home to Novartis, Roche, Nestlé), Finland (Nokia, Metso) and Sweden (Ericsson, Volvo, Electrolux).<sup>53</sup>

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50 Blue Scope Steel, *Submission no. 39*, p.9. Similar views are expressed by the Australian Steel Institute, *Submission no. 9*, p. 4.

51 AMWU, *Submission no. 34*, p. 25.

52 Mr D Cameron, AMWU, *Transcript*, 29 August 2006, p. 72.

53 All the companies named are larger than Australia’s largest manufacturer and all the economies named have more manufacturers among the world’s largest 2 000 companies than Australia, according to *Forbes* magazine’s latest ranking.

- 3.51 However, the majority of economic policy advisers do not share these concerns about manufacturing becoming a declining share of the economy. A review by the Productivity Commission concludes that:

It is also apparent from the empirical evidence that a high share of manufacturing in GDP is not essential to sustain high living standards or strong economic growth.<sup>54</sup>

- 3.52 The Treasury commented that if the government is:

‘Going to prop this part of the economy up,’ you are taking labour away from another part of the economy that wants to grow. You have to think pretty carefully about that and think about why you have, in some sense, some special knowledge about why that labour should not move compared to where business thinks it should go.<sup>55</sup>

There was a group of economists called the physiocrats who argued that agriculture was the only true source of value in the economy and were greatly concerned when agriculture’s share of the economy was falling. Similarly, there are people who see manufacturing as the backbone of the economy and are concerned when its share declines.<sup>56</sup>

- 3.53 But while most economists seem accepting of a relative decline in manufacturing, there remain community concerns, evident in public opinion polling.<sup>57</sup> These concerns may be exacerbated by media reporting which may underplay ‘good news’ about emerging innovative manufacturers. AEEMA commented:

Many of these success stories take a while to get noticed publicly and they typically fly ‘under the radar’ so far as the media and community are concerned. ‘Bad news’ stories like plant-closures and re-locations of ‘low value’ product manufacturing operations to China naturally get attention from commentators...<sup>58</sup>

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54 PC, *Trends in Australian Manufacturing*, Canberra, August 2003, p. 40.

55 Dr S Kennedy, the Treasury, *Transcript*, 1 December 2006, pp. 6-7.

56 Mr J Hawkins, the Treasury, *Transcript*, 1 December 2006, p. 8.

57 An opinion poll in 2006 found 93 per cent of respondents in marginal seats agreed that ‘it is essential to maintain our manufacturing industries in Australia, even if they need some government support’. AMWU, *Submission no. 34*, p. 25.

58 AEEMA, *Submission no. 19*, p. 6.

## Action Agendas

- 3.54 Action Agendas became a primary driver of industry policy in 1997, hailing from the Mortimer report.<sup>59</sup> They contain strategic directions for sectors of industry, set by government with industry input. Thirty-eight Action Agendas have been approved for development over the past decade, of which 22 cover a variety of manufacturing industries (listed in Appendix E). There are currently eight manufacturing agendas under implementation and a further fourteen have been completed.
- 3.55 Industries apply to participate in an agenda. DITR states that 'a key determinant [of participation] is the industry's willingness to commit the resources and energy to see the process through'.<sup>60</sup> While DITR provides secretariat support and a ministerial champion, there is no direct financial support for industry participation in the process. As such, only the most coordinated sectors of the industry (generally those with peak or professional associations) and those of sufficient size, participate.
- 3.56 After an industry receives ministerial approval to develop an action agenda, a group comprising industry leaders will meet regularly, over a two year period, to determine key issues for their industry. Working groups are formed to pinpoint strategies to deal with individual issues.
- 3.57 The end result is an Action Agenda Report, the recommendations of which, once signed off by Cabinet, become an Action Agenda. Industry, with limited secretariat support, then works on the implementation of the agenda over a three year period. At the end of this period, secretariat support ceases and the agenda is considered 'completed', however, in practice it may not be fully implemented.
- 3.58 The committee heard mixed views about the agenda approach. Some were complimentary, including Science Industry Australia (SIA), while others felt the arrangements, although having merit, were deficient. Mr Robinson from AEEMA proposed a more strategic manufacturing policy linking to the agendas:

I seriously believe that we need to set up mechanisms where the government is actively engaging with the industry leaders beyond just the action agendas. This could be through consultative

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59 D Mortimer, *Review of Business Programs: Going for Growth – Business Programs for Investment, Innovation and Export*, 30 June 1997.

60 DITR website, *About Action Agendas*, as viewed 27 April 2007, <<http://www.industry.gov.au/content/itrinternet/cmscontent.cfm?objectid=CC8A8D86-0597-412D-B105C70F98CC428B&indexPages=/content/sitemap.cfm?objectid=48A5B076-20E0-68D8-EDDA6165C0953D2F>>.

measures, some strategic planning ... so there is a shared understanding, a game plan ... in our key industry sectors of what we are trying to achieve.<sup>61</sup>

- 3.59 Mr Herbert of the NMF noted that when the secretariat involvement ceased '...the programme seemed to come to an end'.<sup>62</sup> He suggested the state-based manufacturing advisory councils could help maintain momentum:

Can you extend the work that has flown from the action agendas through those advisory bodies to capture those who might be relevant to those action agendas, taking actions forward?<sup>63</sup>

- 3.60 The Government's Action Agenda Evaluation 2003 report, conducted by DITR, echoed these views. A weakness of the action agendas was reported:

The follow up on commitments needs to be strengthened and there needs to be a more "whole-of-government" commitment to delivering outcomes. It is not just the responsibility of DITR.

These sentiments were also echoed by the secretariats, who also noted some examples where they considered industry had not followed through sufficiently on implementation of recommendations.<sup>64</sup>

- 3.61 There were others who thought action agendas provided a good platform for industry to be pro-active, including the Department of Education Science and Training<sup>65</sup> and the Australasian Institute of Mining and Metallurgy.<sup>66</sup> SIA saw the development of their action agenda as an important contributor to sectoral cooperation, stating that their industry 'has been fragmented in the past and has, through the Science Industry Action Agenda, now started to come together'.<sup>67</sup>

- 3.62 The work undertaken in formulating an agenda was reported to shed light on industry weaknesses which enabled better sectoral strategies to be developed. AEEMA wrote:

61 Mr A Robinson, AEEMA, *Transcript*, 7 December 2006, p. 10.

62 Mr R Herbert, *Transcript*, 22 November 2006, p. 4.

63 Mr R Herbert, *Transcript*, 22 November 2006, pp. 4-5.

64 DITR, *Action Agendas Evaluation: A review of action agendas and the action agenda process*, February 2004, p. 4.

65 DEST, *Submission no. 49*, p. 15

66 Mr D Larkin, Australasian Institute of Mining and Metallurgy (the Aus IMM), *Transcript*, 28 August 2006, p. 31.

67 Professor M Baker, Science Industry Australia (SIA), *Transcript*, 2 March 2007, p. 2.

A major conclusion of the Electronics Industry Action Agenda Industry Working Group, led by AEEMA, has been that Australia's greatest weakness in innovation continues to be product realisation.<sup>68</sup>

- 3.63 The CSIRO<sup>69</sup> and SIA<sup>70</sup> believe the action agendas are facilitating better government-industry interaction on applied research.
- 3.64 Action agendas are designed to provide 'a whole of government approach to address issues across a broad range of portfolios, including innovation, investment, workplace relations, education, market access and development, regional development, regulatory reform and the environment'.<sup>71</sup> A case study was cited by the SIA showing how the action agenda, via a whole-of-government approach, had been the impetus for regulatory reform for the chemicals and plastics industry.<sup>72</sup> This was the only case of regulatory reform through Action Agendas cited in evidence.

### A dedicated manufacturing advisory agency?

- 3.65 One of NMF's key report recommendations was the creation of a manufacturing advisory agency, modelled on the UK one-stop-shop, the Manufacturing Advisory Service (MAS), created in 2002.<sup>73</sup> An agency of this nature would provide comprehensive advice on all activities associated with manufacturing, including export and import competing issues.
- 3.66 This proposal differs from the current role of the DITR's main industry contact agency, AusIndustry, in two broad ways:
- it is manufacturing specific, having manufacturing oriented representatives in regional offices and contracting experts to assist with programmes in-the-field; and

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68 AEEMA, *Submission*, p. 8.

69 Mr G Redden, CSIRO, *Transcript*, 22 March 2007, p. 10.

70 Professor M Baker, SIA, *Transcript*, 2 March 2007, p. 2.

71 DITR, *A Guide to Developing and Implementing Action Agendas*, July 2006, p. 2.

72 SIA, *Submission no. 7*, p. 20.

73 The UK MAS is not a unique approach. The US Department of Commerce liaises with its manufacturing sector in a similar way through its 'Manufacturing Initiative'; US Department of Commerce, *Manufacturing in America: A Comprehensive Strategy to Address the Challenges to US Manufacturers*, Washington, D.C, January 2004. The Manufacturing Extension Partnership (MEP) a not-for-profit organisation funded by US state, federal and local governments and operates in almost 350 US locations and its sole purpose is to provide small manufacturers with necessary services. The MEP network provides services to evaluate manufacturers' processes, skills-base, technologies and management capabilities and tailors programmes to address identified weaknesses.

- it provides a greater level of advice and information dissemination to the sector, far beyond assistance programme intricacies.

3.67 The Chair of the NMF also stressed that the proposed advisory agency should be a combined federal, state and territory initiative:

The model we propose does not mirror that proposal [UK MAS] exactly. It can be shaped to the needs of Australian industry, and the interplay between the states and the Commonwealth would have a bearing on that. The Commonwealth and the states should come together to operate a body of this nature.<sup>74</sup>

3.68 Each state and territory government has a manufacturing advisory body. The NMF suggested linking them to a national advisory body to ensure Australia has a cohesive approach to national manufacturing issues yet may also capitalise on regional advantages.<sup>75</sup>

3.69 A manufacturing advisory agency would allow manufacturers to share knowledge and for the agency to provide information and education on manufacturing innovation, business strategies and emerging issues. The Australian Council of Trade Unions (ACTU) outlined the advantages of such an approach:

By setting up the advisory service described above thousands of manufacturing firms (mainly SME's) will be afforded the opportunity to enhance their capabilities so that they have the capacity to reposition their activities in those niches with the most sustainable competitive advantages.<sup>76</sup>

3.70 The UK MAS contracts manufacturing specialists to work on-site with manufacturers to diagnose firm strengths and weaknesses, and to improve practices such as logistics, production operations and product marketing. There are shared cost elements to this support. The ACTU suggested a similar arrangement for an Australian equivalent programme for firms to work with consultants to diagnose the status of, and undertake work to improve, their management systems and organisational capability. Mr Nixon Apple, industry and investment policy advisor for the ACTU cited the Australian QMI Solutions organisation, which undertakes manufacturing capability assessments, as a model:

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74 Mr R Herbert, Manufacturing Advisory Forum, *Transcript*, 22 November 2006, p. 3.

75 NMF, 'Strategic Actions', *Exhibit no. 22*, p. 19.

76 ACTU, *Submission no. 27*, p. 22.



The first visit is free; after that it is a shared cost arrangement. It is very low cost. It is very high bang-for-buck because you are improving firms' capabilities.<sup>77</sup>

- 3.71 In addition to building in-house business capabilities the MAS gives attention to building market strategies, mostly global. The National Manufacturing Forum's report stated that the three main components of the UK MAS were 'MAS regional centres, specialist support organisations and the MAS website'.<sup>78</sup>
- 3.72 The Australian government announced on 1 May 2007 an initiative called Australian Industry Productivity Centres (AIPC). The fact sheet available about the centres states: 'The programme is modelled on the well-regarded Manufacturing Advisory Service in the United Kingdom'.<sup>79</sup> The AIPC is not exclusively manufacturing focussed. It will 'target the nearly 50 000 trade-exposed manufacturing and service firms wanting to upgrade their capabilities or needing solutions to technical or process issues'.<sup>80</sup> The AIPC will not assume the independent roles of existing support agencies, but would disseminate information about them to the sector.
- 3.73 From the limited information available about the AIPC at the time of writing, it appears the programme mirrors the approach of the UK MAS, providing a free business diagnostic service at manufacturers' places of business, benchmarking firms against world's best practice, and providing fund matching of up to \$20 000 for expenditure incurred on 'tailored advisory services' to confront issues raised in the business diagnostic. In addition, firms may receive matched funding of up to \$20 000 to help solve technology problems and make process improvements.
- 3.74 Sharing other characteristics of the MAS, the AIPC will work cooperatively with industry, industry associations, publicly funded research institutions and centres of expertise in skills and training. These were all recommendations of the NMF's report. There is, however, no mention in the released material<sup>81</sup> about the initiative linking to state based manufacturing advisory bodies which was central to the NMF's recommendation and is key to the UK MAS.

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77 Mr N Apple, ACTU, *Transcript*, 22 November 2006, p. 16.

78 NMF, *Strategic Actions*, p. 35.

79 Australian Industry Productivity Centres fact sheet, DITR, as viewed 13 May 2007, <[http://www.industry.gov.au/assets/documents/itinternet/Industry\\_Productivity\\_Centres20070504170851.pdf](http://www.industry.gov.au/assets/documents/itinternet/Industry_Productivity_Centres20070504170851.pdf)>.

80 Australian Industry Productivity Centres fact sheet, DITR, as viewed 13 May 2007, <[http://www.industry.gov.au/assets/documents/itinternet/Industry\\_Productivity\\_Centres20070504170851.pdf](http://www.industry.gov.au/assets/documents/itinternet/Industry_Productivity_Centres20070504170851.pdf)>.

81 The Industry Statement 2007 and the AIPC fact sheet.

- 3.75 The ACTU noted that the level of funding required to support the UK's manufacturing advisory service amounts to roughly A\$30 million per annum.<sup>82</sup> The AIPC initiative has a \$352 million commitment over ten years, giving an annual commitment of around \$35 million per annum. Given the UK agency serves a population of 60.2 million, almost three times the Australian population, the funding commitment indicates that the programme will be well resourced. However, while the Australian programme covers a much bigger geographic area, it has only five regional centres, compared with the UK's eleven.
- 3.76 Another fundamental difference between the AIPC and the UK MAS is that the UK agency does not cater for the services sector. The MAS considers associated issues, for example, value-adding through service provision, but its primary focus is the manufacturing sector.

## Conclusions

- 3.77 Australian Government industry policy is predicated on three identified drivers of economic growth—innovation, investment and international competitiveness. The committee is supportive of this approach and believes an explicit manufacturing policy would strengthen this framework. In the UK, government manufacturing policy is clearly defined in their manufacturing strategy.
- 3.78 A manufacturing strategy provides a sector-specific direction for manufacturing. It clearly defines the government's objectives and justifies why support programmes exist. The committee concludes that a national manufacturing policy, which considers regional issues, would supplement the current broad industry approach.
- 3.79 Action agendas are the foundation of current industry policy—supplemented by general industry assistance and more targeted assistance programmes. The process appears to build cooperation and trust within industries that participate. However, only those sectors with sufficient resources or viable size can be involved and will therefore have a voice to lobby government. This could result in the exclusion of infant or micro-industries with much potential. Industry collaboration through the agenda process appears to be short-lived given that unresolved issues are not always actioned after government facilitation ends.
- 3.80 The Action Agenda strategy has now been in place for a decade with the majority of manufacturing sectors having completed agendas. The

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82 Mr N Apple, ACTU, *Transcript*, 22 November 2006, p. 16.

committee therefore believes it is time to conduct a review of this 'industry-up' approach to manufacturing policy.

- 3.81 Governments and policy-makers are not better placed to determine the market winners or failures of tomorrow than industry itself. However, the committee recognised that governments may be mindful of international trends and industries which deliver public externalities, like medical and environmental breakthroughs.
- 3.82 The committee recognises that there are commonalities between different industry sectors, for example, global integration. However, unique needs and information requirements exist in each sector. This was recognised in the UK through the establishment of a dedicated MAS to support the opportunities and challenges confronting the manufacturing sector in the 21<sup>st</sup> century. The committee also notes the US government has a similar manufacturing support organisation.
- 3.83 The committee acknowledges that the new AIPC initiative, modelled on the UK MAS, will provide manufacturers with the necessary tools to build better business capability and global strategy. However, the committee is concerned that the multi-sector focus of the nascent AIPC may lead to resource dissipation and ultimately make it less relevant to the manufacturing sector. The UK MAS was customised for the needs of an evolving manufacturing sector – and this fit-for-purpose approach seems to be the key to its success.
- 3.84 The AIPC should also forge links with the existing state-based manufacturing advisory agencies. This will ensure the national strategy takes account of regional issues.

### **Recommendation 1**

- 3.85 **The committee recommends that the Government develops a strategic Australian manufacturing policy, including regional strategies, to supplement existing industry policy.**

### **Recommendation 2**

- 3.86 **The committee recommends that the Government reviews the on-going need for an Industry Action Agenda approach.**

**Recommendation 3**

3.87 **The committee recommends that the Australian Industry Productivity Centres initiative be finetuned to ensure that:**

- **akin to the UK Manufacturing Advisory Service it maintains a manufacturing focus so as not to dissipate resources;**
- **it is well promoted and easily accessible;**
- **Australian regions are sufficiently resourced and that there is one centre in every large manufacturing region;**
- **there is appropriate liaison with state-based manufacturing advisory agencies.**

**Industry environment; transitions; externalities and impediments**

3.88 Governments' involvement in the manufacturing sector is partly historical and partly political. Historically it is a legacy of the post-war strategy of 'populate or perish' – building up labour intensive industries for migrant workers and a desire for greater self-sufficiency in case of blockades in future conflicts. Politically there has always been the concern about 'protecting' jobs, always dubious, but the case for this is even weaker in a full employment economy.

3.89 History and politics aside, the Australian Government's essential role is to provide a framework for business activity, smooth market change, foster activities that are in the public interest<sup>83</sup> or assist where a market impediment has been identified. In setting this framework robust macroeconomic and microeconomic policy is essential.

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83 Refer Chapter 8 for discussion on R&D spill-over effects. Productivity Commission, *Public Support for Science and Innovation*, Canberra, March 2007, covers externalities from science and innovation activities carried out by individual businesses.

## Economic Framework

### Macroeconomic policy

- 3.90 Australia's monetary and fiscal policies are transparent and accountable and broadly speaking, both enjoy bipartisan support; it has a history of stable governments; no civil unrest and the nation is currently enjoying its sixteenth year of economic growth. Australia also has a sound legal and parliamentary structure with rigorous regulation making processes. All these are necessary foundations for business activity and growth in trade.
- 3.91 Australia retains the confidence of international investors, with considerable inflows of foreign direct investment (FDI). The stock of FDI is equivalent to around 30 per cent of GDP, which places Australia around the median of OECD economies.<sup>84</sup> A smaller proportion of this FDI goes into manufacturing than in the average OECD economy, but this is unsurprising as Australia has a lot more mineral resources and farmland than the average OECD economy.<sup>85</sup>
- 3.92 One of the key macroeconomic issues for business is the corporate tax rate. Australia's statutory or 'headline'<sup>86</sup> corporate tax rate is 30 per cent, only slightly above the headline OECD unweighted average of 28.4 per cent.<sup>87</sup>
- 3.93 There was a notable lack of discussion on the Australian corporate taxation rate and its effect on the manufacturing sector across the submissions and at public hearings.
- 3.94 The committee heard from some that a lower corporate tax rate would assist the Australian manufacturing sector. In their *Manufacturing Futures* report the Australian Industry Group called for a reduction in the company tax rate from 30 per cent to 25 per cent over a five year period to 2011–12. They note the proposed cut:

Would, on the surface, result in a reduction in company tax collections in the order of \$8 billion, [but] ... a considerable portion

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84 OECD, *OECD Economic Globalisation Indicators 2005*, p. 39.

85 Neither a high nor low level of FDI is necessarily desirable. A large stock of (net) international liabilities will result from a succession of current account deficits. Some of these liabilities will take the form of debt, some will be portfolio equity investment and some will be FDI. If returns on domestic assets are low, then FDI has the advantage that it does not involve a fixed payment burden. If returns are high, then debt is better as the excess returns are retained by the domestic economy.

86 Not including any offsets, deductions or concessions that may reduce the 'effective' rate of corporate tax.

87 Business Council of Australia, *Corporate Taxation: An international comparison (2006 update)*, December 2006, p. 5.

of this cost would be clawed back through the lower value of imputation credits in the hands of shareholders.<sup>88</sup>

- 3.95 ACCI's submission agreed, but also pointed out that the recent strong corporate tax collection '... is likely related to strong profits growth in the mining and minerals industries'<sup>89</sup>, rather than over-taxing. They concluded that corporate tax reform was not a priority:

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, particularly as the difference between the company and personal tax rates (18.5 percent) is above the unweighted OECD average of 17.8 percent.<sup>90</sup>

- 3.96 A Council of Textiles and Fashion Industries of Australia Ltd (TFIA) member raised the corporate tax rate as an impediment to re-investment of after-tax income:

The corporate tax rate and the entire regulation and structure of the corporate tax system are an issue. I have run large design businesses and micro-businesses. For a small business, both the administration and the collection of tax are a real burden. There are absolutely no incentives to reinvest in small business.<sup>91</sup>

- 3.97 In reference to attracting investment for manufacturing to Australia AEEMA remarked '...Certainly lowering the corporate tax rate would be prima facie a great incentive for growth in this country.'<sup>92</sup>
- 3.98 The Irish boom which occurred following a manufacturing strategy implemented by the Irish Government, which included a reduction in their company tax rate to 12.5 per cent, has been touted as the impetus for multi-national manufacturers to set-up in Ireland.
- 3.99 The committee heard that adopting this 'Celtic Tiger's' corporate tax approach could similarly attract multi-national subsidiaries and assist local manufacturers be more competitive. However, Ireland offered many advantages for foreign investors to manufacture there, over and above the

88 Australian Industry Group, *Manufacturing Futures Achieving: Global Fitness*, Sydney, April 2006. Similar views were put by Council of Textiles and Fashion Industries, *Submission no. 17*, p.13 and BlueScope Steel, *Submission no. 33*, p. 37.

89 ACCI, *Submission no. 33*, p. 37.

90 ACCI, *Submission no. 33*, p. 38. (The top personal tax rate is now 45 per cent i.e. only 15 per cent above the company tax rate and from 1 July 2008 it will cut in at \$180 000; likely to affect only a small proportion of taxpayers.)

91 Ms C Hawkins, Cinnabar Designs Pty Ltd, *Transcript*, 8 February 2007, p. 12.

92 Ms L Johnson, AEEMA, *Transcript*, 7 December 2006, p. 17

corporate tax incentive. Some of these included existing resources, like skills<sup>93</sup> while others came from strategic government policy.

3.100 Professor Roy Green, an innovation policy expert, with extensive first-hand knowledge of the Irish economy, highlighted that it was necessary for Ireland's manufacturing strategy to go beyond a corporate tax pull when other countries in the EU lowered their corporate tax rates also. He mused 'So if they are emulating the Irish model, what are the Irish going to do now?'<sup>94</sup>

3.101 The average corporate tax rate in Western Europe fell from around 50 per cent in 1985 to 30 per cent in 2006. A number of Eastern European countries now have corporate tax rates in the 15 to 19 per cent range.<sup>95</sup> A European Commission paper concluded that the lowering of corporate tax rates in the EU resulted in a broadening of the corporate tax base and a narrowing of the personal income tax base. The attractiveness of a lowered corporate tax rate compared to the existing marginal tax rates induced more individuals to incorporate their business activities. This result implies that when corporate tax rates are reduced total company tax collection may not fall as much as anticipated, but that overall tax collection will fall.<sup>96</sup>

3.102 Dr Brain of the NIEIR stated that the corporate tax rate is more of a springboard for other industry policy than an end in itself:

They [Ireland] have a very active manufacturing industry development policy. They also have a very low general corporate tax regime, which helps—but I would argue that what they do strategically helps leverage up from their low company tax regime to get a much bigger outcome...<sup>97</sup>

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93 Professor R Green, private capacity, *Transcript*, 14 November 2006, p. 15.

94 Professor R Green, private capacity, *Transcript*, 14 November 2006, p. 15.

95 EU countries with relatively low corporate tax rates including Latvia and Lithuania at 15 per cent and Poland and Slovakia at 19 per cent. Refer: the Treasury, *Economic Round-up Spring 2004*, International trends in company tax rates – implications for Australia's company income tax, James Kelly and Robert Graziani, Canberra, 2004.

96 European Commission, *Corporate Tax Policy: Entrepreneurship and incorporation in the EU*, European Economy Economic Papers, Ruud A de Mooij and Gaetan Nicodeme, 2006.

97 Dr P Brain, NIEIR, *Transcript*, 22 November 2006, p. 38.

## Microeconomic policy

- 3.103 Australia's microeconomic environment is in good shape when benchmarked internationally.<sup>98</sup> Reforms to National Competition Policy, regulatory review procedures, and infrastructure (particularly ICT) and transport improvements by governments at both the federal and state level, have improved Australia's productivity but more remains to be done. As the OECD's Chief Economist recently warned, there is always a danger for international economies in 'cyclical buoyancy' of being complacent about microeconomic reform.<sup>99</sup>
- 3.104 The committee heard examples of on-going microeconomic issues affecting the manufacturing sector, largely to do with poor harmonisation between the federal and state/territory systems, for example, non-uniform rail networks and compliance burdens arising from overlapping and inconsistent jurisdictional regulations.
- 3.105 Evidence was also received on the way states vie for investment attraction and conduct state-based export promotion activities which impedes a national approach.<sup>100</sup> The fact that it is necessary for Australian states and territories to sign an *Interstate Investment Cooperation Agreement*<sup>101</sup> highlights these cross-state rivalries. Deficiencies in the sharing of information between state and territory agencies also exist.<sup>102</sup>
- 3.106 The committee heard that regulatory requirements for small and medium enterprises are still onerous despite concerted government efforts to reduce compliance burdens and unnecessary regulation. This response accords with a 2006 report which details Australian business experience with compliance costs; paperwork burden; lost opportunities; and the cumulative burden of regulation.<sup>103</sup>

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98 From 2000 to 2005 Australia's real GDP grew faster than that of all the G7 (Group of Seven) economies. OECD, *Productivity Database*, September 2006.

99 Mr Jean-Philippe Cotis, press release for OECD, *Going for Growth 2007: Economic Policy Reforms*, February 2007, as viewed May 19 2007, <[http://www.oecd.org/document/45/0,2340,en\\_2649\\_34325\\_38086509\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/45/0,2340,en_2649_34325_38086509_1_1_1_1,00.html)>.

100 Mr R Herbert, *Transcript*, 22 November 2006, p. 4.

101 Intergovernmental Agreement, *Interstate Investment Cooperation Agreement*, 30 March 2006. Queensland was not a party.

102 The Allen Consulting Group, *Evaluation of Invest Australia and its operations*, Final report to Invest Australia, July 2005.

103 Regulation Taskforce, *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business*, Report to the Prime Minister and the Treasurer, Canberra, January 2006, pp. 9-12.



- 3.107 Each of the three tiers of government has different regulatory regimes for the same or similar business activities and they also have overlapping requirements.
- 3.108 SIA reported the situation one of its member manufacturers faced complying with Commonwealth and various state government standards; as well as client specifications:

These additional specifications impose a burden on suppliers such as Eppendorf who consider it to be more appropriate if there was consistency of all electrical equipment regulations across the Commonwealth, and all states and territories. By having consistency, suppliers would be able to distribute their products more readily without incurring the cost of making alterations for each client.<sup>104</sup>

- 3.109 Similar views were put by the Australasian Institute of Mining and Metallurgy<sup>105</sup> (the AusIMM), the Australian Plantation Products and Paper Industry Council (A3P)<sup>106</sup>, and the TFIA<sup>107</sup>. The AusIMM submission encapsulated these views:

It is critical to both [mining and manufacturing] industries that all three levels of government work to reduce the regulatory burden, maximise the efficiency of new regulation, identify priority areas of regulatory reform, reduce regulation and overlap, and increase national consistency.<sup>108</sup>

- 3.110 A3P also mentioned the duplication of compliance requirements *within* jurisdictions and the need for further compliance streamlining.<sup>109</sup>
- 3.111 The committee heard particular grievances about the disharmony of occupational health and safety standards (OH&S) across the states and at the federal level. This problem was raised in the report of the Regulation Taskforce 2006.<sup>110</sup> The situation is causing considerable confusion and red tape burden, particularly for manufacturers based in different states. AEEMA stressed this issue:

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104 SIA, *Submission No. 7*, p. 9.

105 The AusIMM, *Submission no. 16*, p. 7.

106 The Australian Plantation Products and Paper Industry Council (A3P), *Submission No. 14*, p. 4.

107 The Council of Textile and Fashion Industries of Australia Ltd, *Submission No. 17*, p. 12.

108 The AusIMM, *Submission no. 16*, p. 7.

109 A3P, *Submission No. 14*, p. 4.

110 Regulation Taskforce, *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business*, Report to the Prime Minister and the Treasurer, Canberra January 2006, pp. 36–37.

Certainly at the state level we are, as I said earlier, working on those occupational health and safety regulations that differ from state to state. ... [OH&S regulations] are huge impediments to small industries and small businesses in particular.<sup>111</sup>

- 3.112 SIA gave an example of one member who has to deal with duplicative and conflicting OH&S standards in all Australian jurisdictions and an overlaid federal regulation on dangerous goods transport, storage and handling:

Their regulation compliance staff must remain conversant with the regulations covering each of these areas not only in Victoria, but also in Australia's other states and territories and the countries in Oceania.<sup>112</sup>

- 3.113 Despite this, ACCI agreed that there are advantages in having the separate tiers of government, but that better coordination between them is required to harmonise and streamline regulation.<sup>113</sup>

- 3.114 Inconsistent greenhouse regulations were also raised. The A3P noted the compliance burdens of dealing with conflicting departmental requirements for greenhouse and energy reporting:

'Let's just have one single program for greenhouse and energy reporting.' Once you have worked out what that program is, you could drop away all the others and remove all the other state and Commonwealth obligations that are currently overlapping and duplicating.<sup>114</sup>

## Conclusions

- 3.115 Australia's statutory corporate tax rate is broadly comparable to that of other OECD countries. There are mixed views about whether a reduction in the corporate tax rate is a priority for the manufacturing sector. While there has been a call for a reduction in the corporate tax rate from 30 to 25 per cent, this issue did not resonate throughout evidence (nor was much said about how it would be funded).

- 3.116 The committee concluded that although the reduced corporate tax rate in Ireland was a substantial boon for their manufacturing sector in initially attracting foreign investment, it was impossible to attribute long-term growth to this factor alone. Despite Ireland no longer being the only low

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111 Ms L Johnson, AEEMA, *Transcript*, 7 December 2006, p. 18.

112 SIA, *Submission no. 7*, p. 19.

113 Mr P Johnson, ACCI, *Transcript*, 2 March 2007, p. 24.

114 Mr M Prosser, A3P, *Transcript*, 12 October 2006, p. 15.

corporate tax regime in the EU, the Irish manufacturing sector still has strong growth.

- 3.117 The unintended consequence of narrowing the personal tax base when corporate tax rates were lowered in the EU was noted by the committee. Such income-shifting behaviour has fiscal policy implications.
- 3.118 There is no prima facie justification for reducing the corporate tax rate to improve competitiveness in Australian manufacturing without considering other taxation reform aspects. An in-depth analysis of taxation issues was beyond the scope of the inquiry.
- 3.119 A co-ordinated approach is required between federal and state government agencies on regulatory concerns common to both governments. A national approach to regulation is performed on COAG formulated policy and overseen by the Office of Best Practice Regulation. The Office's role has recently been strengthened and should ensure better regulatory oversight for impacts on business at the federal level.
- 3.120 Overlapping regulations at the local, state and federal government levels continue to create unnecessary compliance burdens for manufacturing businesses. Where possible, compliance reporting requirements and timing of information returns for jurisdictions should be identical. The committee heard the most evidence about lack of coordination between federal and state/territory occupational and health and safety standards and how this created an unnecessary impost on manufacturing businesses.

#### **Recommendation 4**

- 3.121 **The committee recommends that through the Council of Australian Governments (COAG), the States, Territories and the Commonwealth harmonise standards particularly in regard to occupational health and safety issues such that compliance and regulatory burdens for manufacturers are reduced, without compromising safety standards.**

### **Structural and sectoral change**

- 3.122 Australia's economy is currently experiencing dual structural change—the on-going dominance of the services sector and the resources led boom.

- 3.123 The Treasury stated that government support has its place for a number of reasons, including smoothing structural change as market equilibria are not immediately reached. The Treasury stated:

It may be appropriate to implement: measures to address market rigidities and transitional costs as resources move to alternative uses; and measures to improve information available to market participants.<sup>115</sup>

- 3.124 The ACTU believes impacts of structural change may be ameliorated if government programmes are designed to smooth the path:

Alan Blinder, a famous economist, said recently that if you look at the rate of structural change in manufacturing and what is going to happen to service activities in terms of off-shoring, you should give some serious consideration to your structural adjustment programs for those workers made redundant through global competition.<sup>116</sup>

- 3.125 The Victorian Government's submission also raises the issue of re-employment prospects for those once employed in traditional manufacturing:

The causes of structural change include technological change, rising incomes and changing tastes. People losing their jobs in manufacturing have had lower re-employment prospects than in other industries - particularly in the TCFL [Textiles, Clothing, Footwear and Leather] sector due to factors of age, location and education levels.<sup>117</sup>

- 3.126 The manufacturing sector is also experiencing dramatic technological and scientific advances. When sectoral change of this type occurs at a rapid pace the knowledge that market operators have about new methods and applications varies enormously. Where manufacturers possess the knowledge, there may be vast differences in their ability to apply it to their production. A market failure may therefore arise when a sector is in dramatic flux.

- 3.127 Two sectors significantly affected by sectoral change are the TCF and automotive sectors. These manufacturers have been subject to ever increasing cost pressures from similar imported goods from low-labour cost economies whilst direct trade protection has fallen. They are still

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115 The Treasury, *Submission no. 21*, p. 11.

116 Mr N Apple, ACTU, *Transcript*, 22 November 2006, p. 16.

117 Victorian Government, *Submission no. 40*, p. 11

under a transitional protection regime which accounts for the majority of assistance to the sectors. Net tariff assistance in 2005–06 was \$542.5 million to the automotive industry and \$319.1 million to the TCF industry.<sup>118</sup> However, these industries have also received substantial assistance to overcome sectoral change issues—measures to move them into niche or high value-add areas.

- 3.128 The Automotive Competitiveness and Investment Scheme (ACIS) was introduced in 2001 and is scheduled to end in 2015. The scheme credits import duties to registered ACIS participants based on their domestic production, investment and research and development activities. ACIS ‘encourages strategic investment and research and development in the Australian automotive industry and the establishment of links between Australian producers and the global industry’.<sup>119</sup>
- 3.129 Australian automotive manufacturers have received approximately \$3.4 billion<sup>120</sup> from the ACIS scheme to date. The final stages of ACIS, which commenced 1 January 2006, are worth \$4.2 billion, including a \$150 million Motor Vehicle Producer Research and Development grant scheme.<sup>121</sup> This is a sector-specific measure for the Australian auto industry to move it into specialty market niches.
- 3.130 A package of assistance measures valued at \$747 million<sup>122</sup> is targeted at TCF manufacturing, the main component being the Strategic Investment Program (SIP). Grants from the SIP are designed to support capital investment and product innovation by TCF firms.

## Market failure

### Spill-over effects

- 3.131 The government may intervene in a market when, but for the public sector, certain socially desirable activities may not take place. Particular business activities may be considered worthy of government support because they generate public benefits (‘positive externalities’) in excess of those accruing to the firm and so will be under-provided in a free market.

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118 PC, *Trade & Assistance Review 2005–06*, Canberra, April 2007, Table 2.25, p.25.

119 The Treasury, *Submission no. 21*, p. 11.

120 Productivity Commission, *Trade & Assistance Review 2005–06*, Canberra, April 2007, Table A.3, p. A.17 and *Trade & Assistance Review 2000–01*, Table 4.5, p. 86. DITR, Senate Standing Committee on Economics, *Budget Estimates 2007–08*, Tabled Document No. 3, 28 May 2007.

121 AusIndustry, *Automotive Competitiveness and Investment Scheme, ACIS Post-2005 Arrangements (1 January 2006–31 December 2015)*.

122 TCF Post-2005 Assistance Package announced 27 November 2003.

3.132 Some manufacturing activities may lead to improvements in quality of life, for example health and medical advances; as such, the government may see societal benefits in supporting manufactures in this arena.

3.133 The manufacturing sector as a whole may create positive externalities that are not as easily identifiable, but which spill-over into the broader economy. Most of these accrue from new technologies. NIEIR noted that advanced manufacturing activities have positive impacts on the economy:

If you have firms that are adopting new technology and skills, they are conduits for those through to the general economy and unleash a whole lot of positives to not only manufacturing but also the economy generally – business services and those sorts of exports that are important for fairly balanced overall growth.<sup>123</sup>

3.134 Nanotechnology Victoria spoke of the widespread support of nanotechnology activities by governments across the globe because of their broad applications beyond industry:

The government was particularly concerned because there were major initiatives emerging elsewhere: the US, Germany and Japan. A whole host of other nations now have very coherent nanotechnology activities and are using that as one of the future stimuluses for their industry.<sup>124</sup>

3.135 The A3P suggested in their submission that some government provision of infrastructure to support manufacturing is in the public interest.<sup>125</sup> This rationale has been reflected in the 2007–08 budgeted supplementary funding for the Open Pool Australian Light water reactor, scientific infrastructure which ultimately benefits manufacturing, but which would have been unlikely to have been built by industry itself.

### Other market impediments

3.136 Government intervention may be justified when the market is not operating as it should and a market failure exists. However, it is often difficult for governments to know whether a market failure actually exists or whether the market is just readjusting.

3.137 Markets may be poor information disseminators, within and between sectors. This is an issue when the global economy is changing rapidly and businesses rely on ever-increasing levels of knowledge and capital

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123 Dr P Brain, NIEIR, *Transcript*, 22 November 2006, p. 36.

124 Dr P Binks, Nanotechnology Victoria, *Transcript*, 15 March 2007, p. 1.

125 A3P, *Submission no. 14*, p. 6.

sophistication. Difficulties accessing information about the market was a reason cited by the Industry Capability Network (ICN) for their inception:

There was a market failure in that smaller organisations had no idea what was available, particularly in government procurement. And this organisation started to look at those opportunities.<sup>126</sup>

- 3.138 The Australian Manufacturing Workers' Union inferred that market failure may exist because individual manufacturers make operating decisions to boost their immediate bottom line; but this action does not necessarily assist the industry in the long-term:

It is of course understandable that at the individual firm level reductions in output can lead to productivity advances via rationalisation. ... However, industry development policy framework in Australia has committed the most elementary errors in economics, namely the fallacy of composition. This occurs when one attempts to generalise from a relationship that is true for an individual or firm, but is not necessarily true for a group, or in this case an industry.<sup>127</sup>

- 3.139 Similarly, Mr Robinson of AEEMA remarked that individual manufacturers do not build industries and that not all manufacturing sectors have the resources to have representative bodies. He asserted:

Individual firms will not do that because they cannot build industries. Individual firms have no capacity to build industries. Industry associations are limited because we only have limited resources. It is only governments that can make strategic decisions about what industries are going to create wealth for the country.<sup>128</sup>

- 3.140 In contrast, Professor Mark Dodgson, director of Queensland University's Technology and Innovation Management Centre – appearing in a private capacity – noted that government intervention in the manufacturing sector occurs in many countries but that worthwhile intervention does not necessarily mean greater intervention. In answer to the question of whether government should do more to encourage innovation he said:

'It should do things more smartly'.<sup>129</sup>

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126 Mr Lachlan, ICN, *Transcript*, 2 November 2006, p. 2. The ICN is a government funded organisation bringing together manufacturing capabilities with major projects.

127 AMWU, *Submission No. 34*, p. 24.

128 Mr A Robinson, AEEMA, *Transcript*, 7 December 2006, p. 13.

129 Professor M Dodgson, private capacity, *Transcript*, 19 October 2006, p. 14.

## Conclusions

- 3.141 The Australian Government takes an active role in supporting Australia's manufacturing sector over and above macro and microeconomic policies.
- 3.142 It provides substantial structural adjustment packages to sectors experiencing significant change, like the automotive and TCF industries. These industries have been most affected by the historic legacy of trade barriers and as tariffs fall structural assistance measures help sectors make changes to improve their competitiveness. The committee notes from the evidence received that structural adjustment programmes have played an important role in the economy, particularly with regard to retraining of employees as an industry automates and evolves globally. However, such industries should be aware that support of this kind is transitional only.
- 3.143 In addition, niche manufacturing activities have been supported for various reasons, one being that through their activities a positive public benefit may be conferred.
- 3.144 The committee acknowledges that it may be difficult to justify government assistance in areas of technological breakthrough where market success seems highly likely. If a 'truly original idea' has applications for many industries and all these returns can be captured through intellectual property protection, investment in this idea should be very attractive. However, if an idea is so revolutionary that it may be difficult for any one enterprise to reap the returns, then the activity will be underprovided by the market as investment in the project may not be as attractive. These latter business projects may have difficulty attracting start-up finance. Additionally, the costs of high-tech infrastructure for research and testing may be prohibitive for any one enterprise. The provision of key high-tech public infrastructure may enable industry-wide access to technology and innovation and foster collaboration – these are important determinants for global trade success.
- 3.145 One of the most important aspects of Australian government assistance is indirect, taking the form of information provision; advice; research and trade facilitation. This sort of support overcomes information asymmetry issues, an important aspect of the government's role at a time of rapid global change in the manufacturing sector.



## Trade liberalisation

- 3.146 The committee recognises the Australian Government priority of negotiating multilateral trade agreements over preferential agreements.<sup>130</sup> In the absence of global or regional agreements, bilateral agreements may be negotiated.
- 3.147 While an in-depth investigation into Australia's trade policies was beyond the scope of this inquiry<sup>131</sup>, free trade agreements (FTAs) were often mentioned in the evidence presented to the committee.

## Existing FTAs

- 3.148 Bilateral FTAs have been signed with four of Australia's major trading partners – the United States, Thailand, Singapore and New Zealand.
- 3.149 These agreements have opened up new platforms for Australian manufacturers overseas as indicated by the 6.5 per cent increase in overall Australian exports of manufactures to the US in 2005-06.<sup>132</sup> However, issues with the implementation and short-term outcomes also provide salient lessons for current negotiations.
- 3.150 Rules of origin restrictions included in the Australia-US FTA (AUSFTA) have inhibited growth for the Australian textiles and clothing industry, particularly at the more innovative end of the market. Ms Christine Hawkins, director of Cinnabar Designs gave an ironic example of merino knitwear:

It is all beautiful Australian wool, but there is no yarn processing in Australia – certainly not of the quality that goes into our knitwear. The Italians have the monopoly on that. So wool goes offshore; it is processed – it is spun – offshore. We bring the yarn in and turn it into fabric and finished product. That is excluded from the benefits of the free trade agreement also because of the yarn.<sup>133</sup>

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130 Department of Foreign Affairs and Trade (DFAT), *Trade Statement 2007: A Statement by Warren Truss, Minister for Trade*, June 2006, p. v. DFAT website, <<http://www.dfat.gov.au/trade/trade2007/trade2007.pdf>>, as viewed 26 June 2007.

131 A comprehensive examination of these issues may be found in: Joint Standing Committee on Foreign Affairs, Defence and Trade, *Report no. 128, Inquiry into Australia's Free Trade Agreements with Singapore, Thailand and the United States: Progress to Date and Lessons for the Future*, 7 November 2005.

132 DFAT, *Submission no. 38*, p. 13.

133 Ms C Hawkins, Cinnabar Designs, *Transcript*, 8 February 2007, p. 3. Rules of origin restrictions in the US preclude Australian importers from preferential trading treatment, despite the AUSFTA.

3.151 Some manufacturers, including the motoring and textiles industries have reported they are yet to reap the promised benefits of existing FTAs as partner countries have increased restrictions, or have continued to favour local industries, highlighting the need for adequate enforcement and clear articulation of the FTA's goals. Regarding the AUSFTA experience, Mr Ashley Van Krieken, executive director of the Council of Textiles and Fashion Industries of Australia (TFIA) said:

Certainly in the most recent agreements, we are not seeing a huge amount of benefit coming from them ... According to our data there has been no growth in TCF [textiles, clothing and footwear] exports from Australia to the United States under the agreement.<sup>134</sup>

3.152 The Government has made efforts to maximise the impact and opportunity of FTAs. After the agreement of the AUSFTA in 2005, around 30 additional Austrade export facilitators were appointed to support the increased number of exporters interested in the US market, with modest success so far.<sup>135</sup>

3.153 FTAs have not had an homogenous effect on manufacturers—the textiles and motoring industries report they have been adversely affected by existing FTAs, while pharmaceutical products have had gains under the Australia-Thailand FTA and medical instruments, toys, games and sporting goods have increased under the AUSFTA.<sup>136</sup>

## China and negotiating new FTAs

3.154 Australia is currently negotiating FTAs with other countries including China, Japan, Malaysia and Chile.<sup>137</sup>

3.155 The rapidly expanding Chinese economy accounts for only nine per cent of the market for Australian manufactures.<sup>138</sup> The potential FTA with China is perceived as both a challenge and opportunity by Australian manufacturers—largely due to China's different standards regarding intellectual property, non-tariff barriers and regulation—as BlueScope Steel noted:

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134 Mr A Van Krieken, Council of Textile and Fashion Industries of Australia Ltd (TFIA), *Transcript*, 8 February 2007, p. 2.

135 DITR, *Continuation of Export Facilitators Programme to Support the AUSFTA*, <[http://www.industry.gov.au/assets/documents/itriinternet/Continuation\\_of\\_Export\\_Facilitators20070504170717.pdf](http://www.industry.gov.au/assets/documents/itriinternet/Continuation_of_Export_Facilitators20070504170717.pdf)>, as viewed 9 May 2007

136 Austrade, *Submission no. 18*, p. 8.

137 Australia and China commenced negotiations on a FTA on 18 April 2005.

138 The Treasury, *Submission no. 21*, p. 2.

BlueScope Steel has significant concerns about the disparity between the very open Australian market ... and the distorted Chinese market, characterised by higher tariffs and trade barriers, extensive government intervention and ownership, and a range of overt and covert subsidies to steel manufacturers...<sup>139</sup>

- 3.156 Australian companies raised their concerns regarding China's transparency, regulatory uncertainty and poor intellectual property enforcement.<sup>140</sup> The Department of Foreign Affairs and Trade (DFAT) has not imposed a deadline on negotiations, stating it will spend as much time 'as is required' to negotiate a successful outcome.<sup>141</sup>
- 3.157 In countries such as China and Malaysia, there are a variety of non-tariff barriers, including import quotas, customs valuation methodologies and local content requirements (as well as in countries where FTAs have already been signed). Effective FTAs therefore need to identify any such barriers in the negotiation process along with clear processes for eliminating them.
- 3.158 Australia's strict intellectual property and regulatory standards are not matched by those of China. Effective FTAs therefore require a two-fold enforcement process—with Australian enforcement agencies fully operational by the time the agreement is ratified; and the encouragement of more stringent regulatory standards in China, as DFAT noted:

There will be some areas where the Chinese will evade implementation, where they will implement according to the letter of the law but frustrate the objective. And there will be areas where the Chinese will just have to be pushed very hard to do what they have promised.<sup>142</sup>

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139 BlueScope Steel, *Submission no. 39*, p. 17.

140 For example; Dr P Burn, Australian Industry Group, *Transcript*, 29 August 2006, p. 10; Australian Chamber of Commerce and Industry, *Submission no. 33*, p. 5; Mr D Cameron, AMWU, *Transcript*, 29 August 2006, p. 70; and TFIA, *Submission no. 17*, p. 10.

141 DFAT, *Launch of Negotiations*, <[http://www.dfat.gov.au/geo/china/fta/facts/launch\\_negotiations.html](http://www.dfat.gov.au/geo/china/fta/facts/launch_negotiations.html)>, as viewed May 9 2007.

142 Mr R. Wells, DFAT, *Transcript of Evidence*, 1 December 2006, p. 5.

