



**HOUSE OF REPRESENTATIVES  
STANDING COMMITTEE ON  
ECONOMICS**

**Inquiry into Raising the  
Level of Productivity Growth in the  
Australian Economy**

**ACCI Submission**

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## 1. EXECUTIVE SUMMARY

1. Productivity growth is essential to help sustain and improve Australia’s standard of living. Through income growth, it contributes to Australian well-being. An economy can grow by either capital accumulation and labour force participation, or by improvement in productivity, which can contribute to economic growth without necessarily requiring additional physical input.
2. Therefore, productivity growth is an important way to increase Australia’s living standards and to drive sustainable economic growth in employment and output.
3. In the labour market, growth in labour productivity enables employers to raise real wages and allows employees to receive the consequent benefit without increasing labour costs per unit of output. Productivity growth also allows business to increase the supply of goods and services to meet demand, without raising their production costs. Thus, increase in aggregate demand can be met without incurring a higher cost pass through from producers to consumers generating non-inflationary sustainable economic growth, especially during the economic boom cycles.
4. After a lacklustre performance during the 1970s and 1980s, Australia’s productivity growth surged in the 1990s. Growth in both labour productivity (output per hour worked) and multifactor productivity (output per combined unit of labour and capital) increased to record high levels between 1993-94 and 1998-99.
5. Despite the slowdown in Australia’s productivity since 2000s, strong improvements in the terms of trade, reflecting higher prices for commodity exports and lower prices for manufactured imports, have boosted prosperity by increasing the purchasing power of Australian income. Australia’s terms of trade have increased 6.2 per cent per year on average over the past seven years, reflecting over 30.7 per cent growth in export prices and a fall in import prices of 13.9 per cent.
6. Nevertheless, productivity growth is likely to remain the key to Australia’s long run prosperity. Strong productivity growth is crucial in the future in order to counteract the projected detrimental effects of an ageing population will have on the growth in living standards following lower average workforce participation (PC, 2005b).
7. Recent strong expansion in the Australian economy since the 1990 recession brought the rate of unemployment down to its historic low of 3.9 per cent in

early 2008. With the historic low rate of unemployment, it can be observed that relatively lower skilled workers are employed to resolve the skill shortage issues temporarily which might contribute negatively to Australia’s labour productivity before the global financial crisis.

8. At the meantime, the lower rate of unemployment also contributed to rising inflation which prompted the Reserve Bank to increase the cash rate to 7.25 per cent in March 2008. This experience points toward the need to embark on microeconomic reforms necessary to further reduce Australia’s non-accelerating inflation rate of unemployment (NAIRU), which is estimated to be around 6 to 7 per cent. (Dawkins, 2000). One way of achieving this is to improve labour productivity in order to bring unemployment down much further without causing rising inflation.
9. Moreover, recent global financial crisis highlights the importance of productivity growth as the key for pick-up in future household consumption following the impairment of household balance sheet worldwide (Stevens, 2009).

## 1.1 Key measures to improve productivity

10. **Better regulation:** In order to foster an environment that is conducive to productivity growth it is essential that Australia’s policy and institutional framework encourages a regulatory environment that minimises regulation compliance costs, fosters market flexibility, and adopts a regulatory design process, which is transparent, accountable and allows active public participation.
11. **Competitive tax system and expenditure reform:** Given the far-reaching impact of taxation on economic agents decision-making, it is important that Australia’s taxation system remains competitive and does not distort work, saving and investment decisions. While it is important to introduce reform in taxation system which provides the main revenue to governments, it is also imperative to examine governments’ expenditure outlay to promote efficiency and accountability in public sector.
12. **Promote competition and free trade:** It is also important to establish an environment that is conducive to competition and international trade. Through competition and openness to trade, business will innovate, rationalise and adopt the world best practice in order to increase its market presence and market share or to remain viable.
13. **Promote R&D and innovation:** Given the importance of R&D and innovation, it is essential that more incentives and assistances be channelled

into R&D and commercialisation such that new R&D ideas and products can be diffused and new inventions add value to the economy.

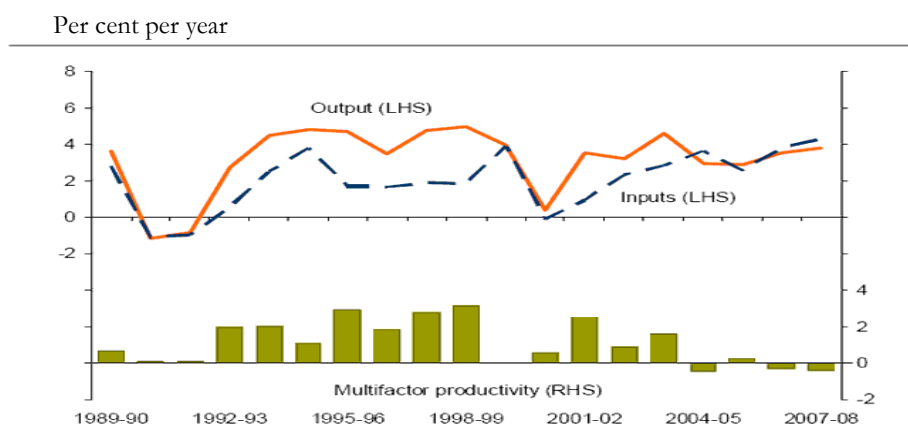
14. **Affordable, clean, efficient and sustainable energy supplies:** Historically, Australia has gained significant competitive advantage from relatively ‘cheap’ energy supply from fossil fuels. Thus, it is important to ensure that any policies to address climate change, for example the Carbon Pollution Reduction Scheme (CPRS) and the Mandatory Renewable Energy Target (MRET), do not negatively affect Australia’s energy costs. Thus, it is essential that the design, coverage and implementation of the proposed CPRS is aligned with comparable scheme considered in other economies. Moreover, it is important to ensure neutrality between the sources of energy use for electricity generation. Accordingly, nuclear energy should not be precluded for consideration in Australia’s future energy mix.
15. **Infrastructure provision – effective private sector participation and cost benefit analyses:** The role of government as basic infrastructure provider, coupled with active private sector involvement, is important to provide the backbone for Australia’s productivity growth. Thus it is important that infrastructure investment decisions are made after thorough cost benefit analyses to examine the economic, environmental and social consequences, with the information available in public domain;
16. **Education and training investment:** Continuous and adequate investment in education and training is essential to effectively equip the Australian workforce with the essential skills to meet the demands of employers. Skilled labour is of course more productive and will assist the development, adoption and application of technology.
17. **Securing a flexible labour market:** It is also essential that labour market regulation is flexible and adaptable to changes in the domestic and global economy conditions in order to foster higher labour productivity growth.
18. Therefore it is important that government intervention in the market system does not unnecessarily create impediments that will stifle Australia’s productivity growth. If Australia could sustain half of the productivity growth improvement achieved during the 1990s, real cumulative GDP for the next four decades would be some \$2000 billion higher than if average productivity growth rates slipped back to the levels recorded during the 1970s and 1980s (PC, 2005a).



## 2. AUSTRALIA’S PRODUCTIVITY PERFORMANCE

19. This section summarises Australia’s productivity performance to date from an aggregate perspective as well as an industry perspective. We also gauge Australia’s productivity growth relative to other high-income OECD countries, in particular the US.
20. The two most commonly discussed measures of productivity are labour and multifactor productivity. Labour productivity is a measure of the amount of output that can be produced for a given labour input, that is, per hour of work. Multifactor productivity (MFP), on the other hand, measures the amount of output that can be produced keeping all inputs (usually labour and capital) in fixed supply. Thus, labour productivity growth is influenced by capital deepening (increases in the capital – labour ratio) and MFP growth, which reflects improvements in efficiency.
21. Australia’s average productivity growth has slowed significantly since 1998-99. In the most recent productivity cycle<sup>1</sup>, between 1998-99 and 2003-04, both labour productivity and multifactor productivity (MFP) fell 1.1 and 1.2 percentage points respectively from the peaks recorded during previous cycle.
22. As of 2007-2008, Australia’s MFP growth has been below average for the fourth successive year. MFP is estimated to have fallen by a total of 1.0 per cent since 2003-04 due to a very strong growth in demand for inputs – both labour and capital (as shown in Figure 1). Over this period, output growth has continued at around the long run average rate of 3.3 per cent.<sup>2</sup>

**Figure 1: Growth in output, inputs and multifactor productivity**



Source: Productivity Commission, <http://www.pc.gov.au/research/productivity/estimates-trends/trends> accessed on 5 August 2009.

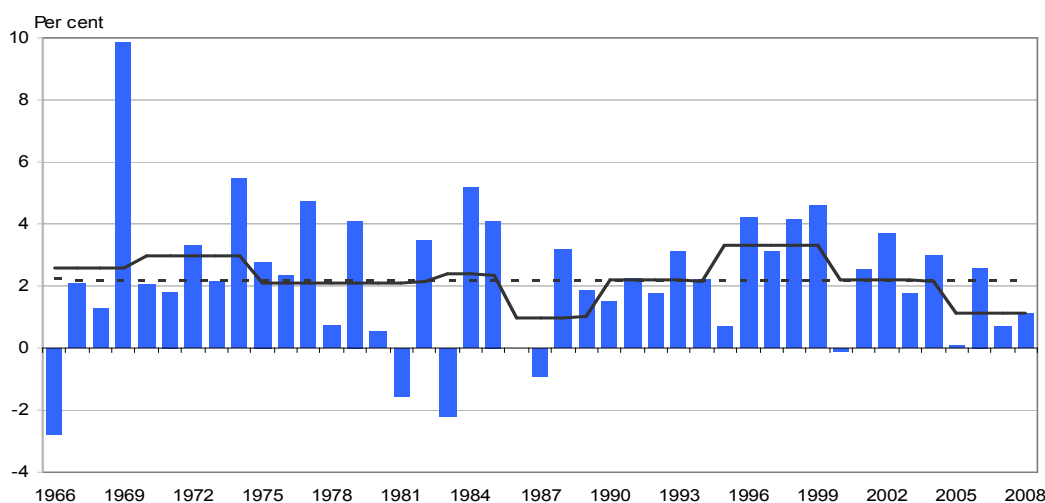
<sup>1</sup> Productivity cycles are the internal between productivity peaks, as identified by the Australian Bureau of Statistics (ABS).

<sup>2</sup> <http://www.pc.gov.au/research/productivity/estimates-trends/recent-movements> accessed on 5 August 2009.

## 2.1 An aggregate perspective

23. After a fairly mediocre performance during the 1970s and 1980s, Australia’s productivity grew rapidly during the 1990s. In particular, productivity growth in the late 1990s cycle (1993-94 to 1998-99) was stronger than during any comparable period in the previous three decades. Since then, productivity growth has slowed towards its long-term average rate during the early 2000’s cycle (1998-99 to 2003-04) and has fallen below its long-term average since 2003-04. (Figure 2).

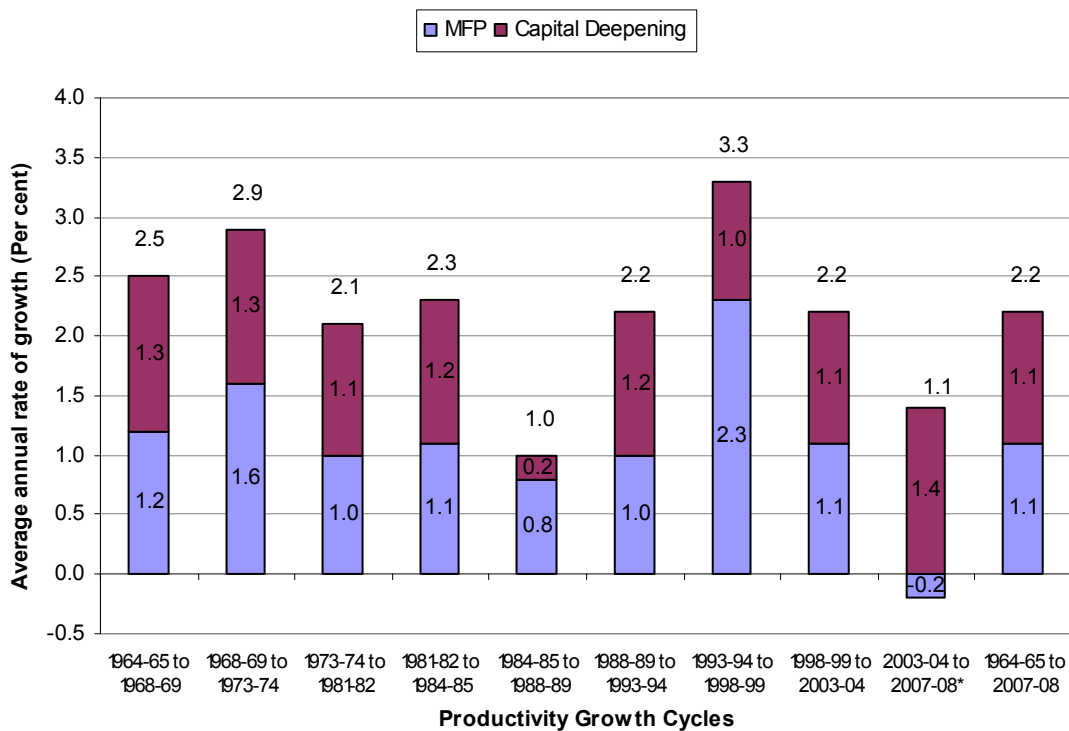
**Figure 2: Annual productivity growth**



Note: The column represents annual growth rates in labour productivity; the solid line represents annual average growth rates over the ABS ‘productivity growth cycle’; and the dotted line represents the annual average growth rate since 1964-65.

Source: ABS, Cat no. 5204, *Australia Systems of National Accounts, 2007-08*

24. Figure 3 shows the average annual growth rate of Australia’s labour productivity over productivity cycles since 1964-65. We focus on the average annual growth rate over the productivity cycle instead of year-on-year changes to neutralise the spurious influence of the business cycle.

**Figure 3: Growth in labour productivity over productivity cycles**

Note: Productivity cycles are the intervals between productivity peaks, as identified by the ABS. Thus, \* indicates that the 2003-04 to 2007-08 cycle is incomplete.

Source: ABS, Cat no. 5204, *Australia Systems of National Accounts, 2007-08* except for capital deepening which is equal to labour productivity growth minus the MFP growth (Parham, 2005).

25. The figure shows that Australia’s productivity surged in the 1990s, with the growth rate reaching historic high level of 3.3 per cent in the 1993-94 to 1998-99 cycle, compared with an average of 2.2 per cent in the 1988-89 to 1993-94 cycle and 1.0 per cent over the cycle from 1984-85 to 1988-1989.
26. Table 1 shows that MFP growth was the major contributor to the surge in Australia’s labour productivity growth. With the rate of capital deepening stabilising at around 1.1 per cent a year, better MFP growth or improved efficiency has accounted for all of the acceleration in Australia’s labour productivity growth.
27. The record MFP growth of 2.3 per cent a year accounted for around two-thirds of labour productivity growth during the 1993-94 to 1998-99 productivity boom cycle, more than a full percentage point above its long run average of 1.1 per cent (see Table 1). MFP accelerated from around 1.0 per cent in the previous three cycles between 1981-82 and 1993-94.

**Table 1: Growth in productivity and contributing factors (per cent per year)**

<b>Productivity Cycles</b>	<b>Labour Productivity</b>	<b>MFP</b>	<b>Capital Deepening</b>	<b>output</b>	<b>Hours Worked</b>	<b>Capital Services</b>	<b>Combined Capital and Labour</b>
1964-65 to 1968-69	2.5	1.2	1.3	5.1	2.5	5.9	3.9
1968-69 to 1973-74	2.9	1.6	1.3	4.6	1.6	5.1	2.9
1973-74 to 1981-82	2.1	1.0	1.1	2.1	0	3.3	1.1
1981-82 to 1984-85	2.3	1.1	1.2	1.8	-0.5	3	0.7
1984-85 to 1988-89	1.0	0.8	0.2	4.1	3.1	3.7	3.3
1988-89 to 1993-94	2.2	1.0	1.2	1.7	-0.4	2.6	0.7
1993-94 to 1998-99	3.3	2.3	1.0	4.6	1.2	3.7	2.2
1998-99 to 2003-04	2.2	1.1	1.1	3.1	0.9	3.4	2
2003-04 to 2007-08*	1.1	-0.2	1.4	3.3	2.2	5.4	3.6
<b>1964-65 to 2007-08</b>	<b>2.2</b>	<b>1.1</b>	<b>1.1</b>	<b>3.3</b>	<b>1.1</b>	<b>3.9</b>	<b>2.2</b>

Note: \* 2003-04 to 2007-08 is an incomplete productivity cycle.

Source: ABS, Cat no. 5204, Australia Systems of National Accounts, 2007-08 and Productivity Commission estimates

28. However since then Australia’s labour productivity has followed a declining trend, with labour productivity growing by 2.2 per cent in the early 2000s cycle (i.e. 1998-99 to 2003-04) and MFP growing by 1.1 per cent per year.
29. Table 2 shows that labour productivity growth has been unusually weak in recent years. Labour productivity only grew by 1.1 per cent in 2007-08 (historical average 2.2 per cent), while MFP fell by 0.4 per cent (historical average 1.1 per cent).
30. Table 2 also shows MFP has dropped below average for the fourth successive year, with MFP is estimated to have fallen by a total of 1.0 per cent since 2003-04. The decline in productivity has resulted from a very strong growth in demand for inputs – both capital and labour.
31. Since 2003-04, hours worked in the market sector<sup>3</sup> has grown by 2.2 per cent a year (historical average 1.1 per cent) and capital services has increased by 5.4 per cent a year (historical average 3.9 per cent). Over this period, output growth has continued at around the long-term average rate of 3.3 per cent (see Table 1).

<sup>3</sup> Five industries are excluded from the market sector: Property and business services; Government administration and defence; Education; Health and community services and Personal and other services. These industries are excluded because their outputs are not marketed and/or because their outputs are derived either wholly or primarily by using either deflated input cost data or hours worked as indicators of output (ABS, Cat. No. 5204.0).

**Table 2: Annual growth in productivity since 2004-05**

Productivity/Components	2004-05	2005-06	2006-07	2007-08	Long-term average 1964-65 to 2007-08
Labour Productivity	0.1	2.5	0.7	1.1	2.2
MFP	-0.6	0.3	-0.3	-0.4	1.1
Capital Deepening	0.7	2.3	1	1.6	1.1
output	3	2.8	3.6	3.8	3.3
Hours Worked	2.9	0.2	2.8	2.7	1.1
Capital Services	4.6	5.6	5.3	6.3	3.9
Combined Capital and Labour	3.6	2.6	3.8	4.3	2.2

Source: Productivity Commission, <http://www.pc.gov.au/research/productivity/estimates-trends/trends> accessed on 5 August 2009.

32. In summary, Australia’s labour productivity growth during the 1990s was due to stronger MFP growth or improved efficiency rather than additional capital deepening. The same pattern emerged during the productivity slowdown in 2000s which is mainly due to the slowdown in MFP growth.
33. It is of interest to observe that the rate of capital deepening has been relatively stable over 1964-65 to 2007-08, and variations in Australia’s labour productivity growth have been due to variations in MFP growth. This observation has an important policy implication, that is, to achieve higher labour productivity growth, measures need to be taken to improve market efficiency instead of merely accumulating capital and additional labour (or hours worked).

## 2.2 An industry perspective

34. In this section, we will discuss the sources of the aggregate productivity surge during the 1990s and the slowdown since 2000. Table 3 and Figure 4 show that during the 1993-94 to 1998-99 productivity boom cycle, MFP grew rapidly in a new set of services industries – wholesale trade and finance & insurance in particular, but also communication services, electricity, gas & water supply, retail trade, construction and transport & storage. Agriculture also contributed. However other traditional contributors, mining and manufacturing sector, did not contribute to the surge in the 1990s.

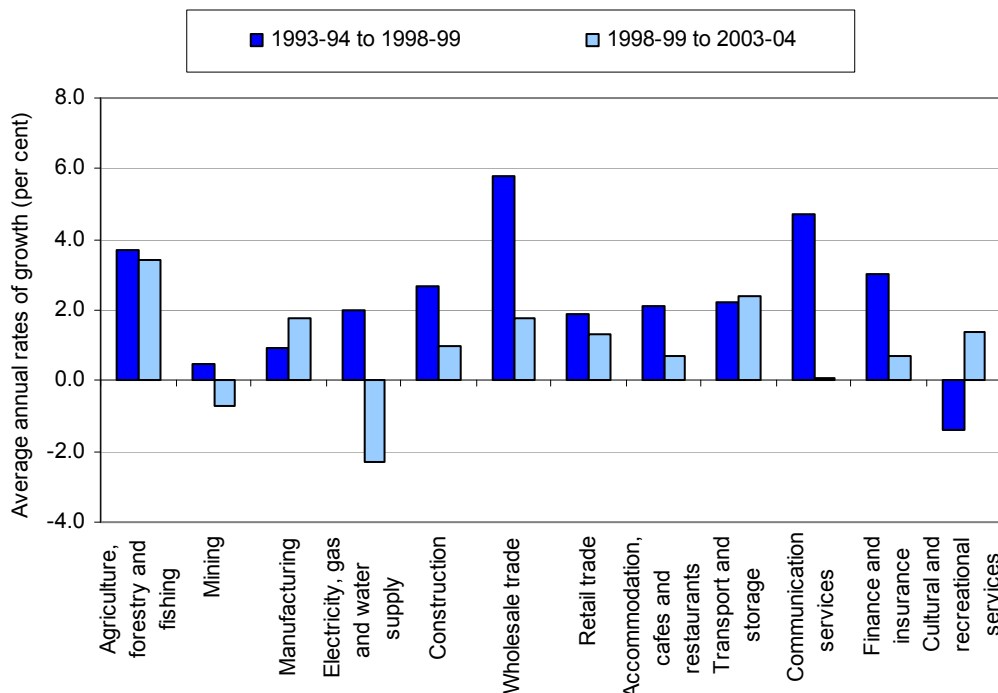
**Table 3: MFP growth by industry**

MFP index	1993-94 to 1998-99		1998-99 to 2003-04		2003-04 to 2007-08*		1974-75 to 2007-08
	Growth	Contribution	Growth	Contribution	Growth	Contribution	Growth
	%	ppt	%	ppt	%	ppt	%
Agriculture, forestry and fishing	3.7	0.2	3.4	0.2	-1.4	0.0	2.2
Mining	0.5	0.1	-0.7	0.0	-4.8	-0.4	-0.3
Manufacturing	0.9	0.1	1.8	0.3	-0.8	-0.2	1.2
Electricity, gas and water supply	2.0	0.1	-2.3	-0.1	-4.2	-0.1	1.2
Construction	2.7	0.3	1.0	0.1	1.0	0.1	1.1
Wholesale trade	5.8	0.5	1.8	0.2	0.3	0.0	0.8
Retail trade	1.9	0.2	1.3	0.1	0.6	0.0	0.9
Accommodation, cafes and restaurants	2.1	0.0	0.7	0.0	-0.2	0.0	-0.7
Transport and storage	2.2	0.2	2.4	0.2	0.8	0.1	2.1
Communication services	4.7	0.3	0.1	0.0	3.0	0.1	3.8
Finance and insurance	3.0	0.3	0.7	0.1	2.2	0.4	0.9
Cultural and recreational services	-1.4	-0.1	1.4	0.0	0.2	0.0	-0.6
<b>Market Sector</b>	<b>2.3</b>		<b>1.1</b>		<b>-0.3</b>		<b>1.1</b>

Note: \* 2003-04 to 2007-08 is not a complete cycle.

Source: Productivity Commissions <http://www.pc.gov.au/research/productivity/estimates-trends/trends> accessed on 5 August 2009.

35. Since then, consistent with a fall in aggregate productivity, MFP growth has slowed sharply across all industries except for manufacturing, transport & storage and cultural & recreational services, which recorded a rise in the MFP growth during the 1998-99 to 2003-04 cycle compared to the 1993-94 to 1998-99 cycle (see Figure 4).

**Figure 4: MFP growth in selected industries over the last two productivity cycles**

Data source: Productivity Commission, <http://www.pc.gov.au/research/productivity/estimates-trends/trends> accessed on 5 August 2009.

36. MFP has fallen sharply in recent years for mining industry. Between 2000-01 and 2006-07, MFP declined by 24.3 per cent. The fall in mining productivity has contributed substantially to a slowdown in market sector productivity growth, since mining sector generates a substantial proportion of market sector output<sup>4</sup> (Topp et al., 2008).
37. The increase in world mineral prices has raised resource rents (revenues in excess of the costs of extraction) and encouraged miners to increase the rate of extraction. Higher commodity prices and resource rents enable and induce:
- extraction of more marginal deposits, which require more effort and costs per unit of output extract. Moreover, existing operations can be continued longer than otherwise would be the case; and
  - more costly production while the capacity of mines is constrained. Since mines are usually run at or near full capacity, output can only be increased by using less efficient methods in the short to medium term, i.e. increase more labour and intermediate inputs per unit of output.
38. Over the four years to 2007-08, the number of hours worked in mining increased by 47 per cent and the volume of capital services consumed increased by 38 per cent, while volume of mine output has risen by only 16 per cent. Over this period, mining subtracted 0.4 percentage points per year from market sector MFP growth (see Table 3).
39. Moreover, although higher commodity prices have encouraged miners to invest in expanding exploration for new deposits or existing mine expansion, there are usually long lead times between investment in new capacity in the mining sector and the corresponding output extraction. Thus, any investment in new mining capacity will only generate positive effects on MFP in the future when output from previous new investment comes into stream. In the short to medium term, the lag in output response will have an immediate adverse effect on MFP during the investment phase.
40. Productivity in electricity, gas & water supply (EGW) industry has also declined in recent years, with average annual MFP falling 4.2 per cent per year since 2003-04 and subtracting 0.1 percentage points per year from market sector MFP growth (see Table 3).
41. Rapid investment in new capacity has occurred to address concerns over water security and meet the increased in energy demand due to strong growth in

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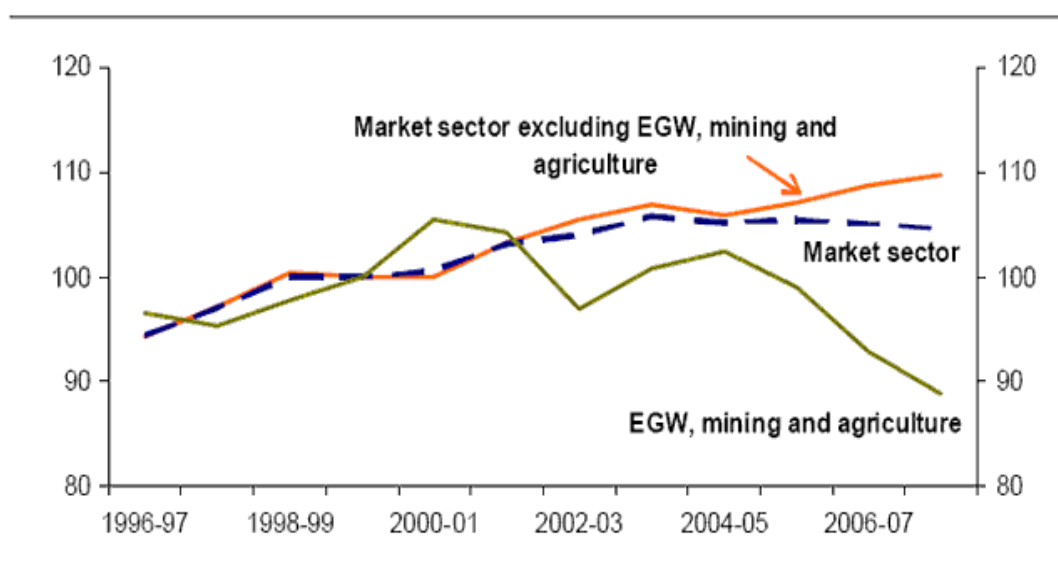
<sup>4</sup> Mining sector contributed around 8.5 per cent of gross value added in 2006-07.

population and household income. Over the past four years, the rates of investment in EGW industry have been around twice the normal levels. The industry has also been affected by drought which has affected the output of water supply industry and some power plants have also been affected<sup>5</sup>.

42. Figure 5 shows the divergence between the productivity performance of the EGW, mining and agriculture industries and the remainder of the market sector in recent years. It is evident that MFP for market sector excluding these three industries has continued to grow since 2003-04, albeit at a much slower pace as compared to previous cycles.

**Figure 5: MFP in the market sector excluding EGW, mining and agriculture.**

Index 1999-2000 = 100



Source: Productivity Commission, <http://www.pc.gov.au/research/productivity/estimates-trends/trends> accessed on 5 August 2009.

## 2.3 International comparison

43. International comparison of labour productivity growth rates and levels can provide a clearer assessment of Australia’s productivity performance over time. However, it is important to note the significant measurements uncertainty due to differences in definition, scope and statistical methods across countries and business cycle in each economy.
44. For Australia, US productivity growth provides the most relevant ‘frontier’ or aggregate benchmark to use when examining Australia’s productivity performance. The United States can still be broadly interpreted as the world productivity leader in technology and efficiency at an aggregate level, although some European countries such as Norway have reported higher labour

<sup>5</sup> <http://www.pc.gov.au/research/productivity/estimates-trends/recent-movements> accessed on 5 August 2009.

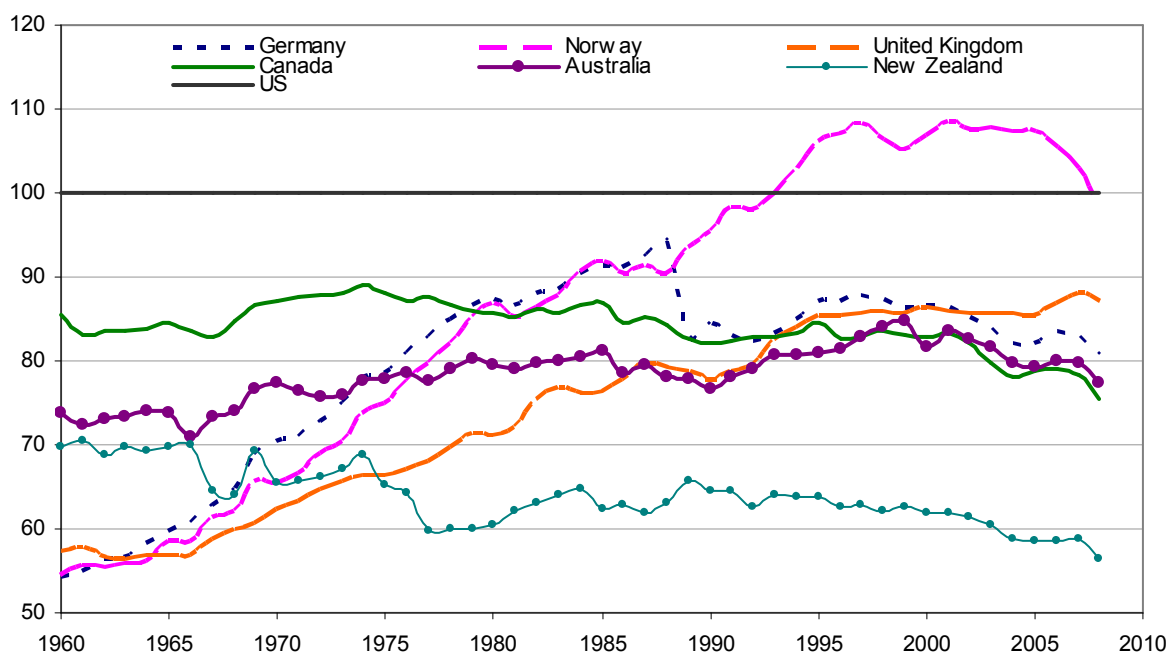


productivity due to non-technological factors – policies constraining employment and industry mix, i.e. access to mining resources (Dolman, Parham and Zheng, 2007).

45. Figure 6 shows that the last four decades were a period of catch-up to the leader - US and convergence in productivity levels. European countries, in particular, started to catch-up and in some cases such as Norway overtook the US. However, New Zealand has fallen further behind the US.

### Figure 6: Labour productivity in selected OECD countries

GDP per hour worked (at USD 1990 purchasing power parity), US = 100



Source: Data from the Conference Board and Groningen Growth and Development Centre (GGDC), Total Economy Database, June 2009, <http://www.conference-board.org/economics/>

46. In Australia, however, the process of productivity catch-up during the post war period has been slow and a significant gap remains. There was virtually no catch-up during the 1950s and 1960s, with Australia’s productivity remaining at around 74 per cent of the US level. There was some steady catch-up in the 1970s and the first half of 1980s, in part because US productivity growth declined. Australia’s ranking in labour productivity growth slipped from third in the 1950 to fifteenth in 1990 (see Table 4).
47. There was further catch-up during the 1990s productivity boom cycle, when Australian productivity accelerated sooner and faster than that of the US, reaching a peak of around 85 per cent of the US level during 1999. However, it has slipped back since as Australia’s productivity slowed, while in the US the rapid pace of the late 1990s has been maintained.

48. Despite the fall in Australia’s productivity growth in recent years, strong terms of trade growth following the increase in commodity prices has continued to contribute to Australia’s GDP per capita, which reach 81 per cent of the US level in 2008 (see Table 4)<sup>6</sup>.

**Table 4: Australia’s rankings among 23 OECD countries**

	1950	1960	1973	1990	2000	2006	2008
<b>GDP Per Hour Worked</b>							
Australia's rank	3	4	8	15	14	8	15
% of US Level	73	74	76	79	82	80	77
<b>GDP Per Capita</b>							
Australia's rank	5	6	10	13	9	8	7
% of US Level	78	78	77	74	76	79	81
<b>Annual Hours Worked</b>							
Australia's rank	21	21	19	9	9	8	8
% of US Level	101	99	96	100	97	97	98

*Source: See Figure 6.*

49. Although there has been a relatively stable and sizeable productivity gap at the aggregate productivity level, Australia’s productivity performance relative to the US has varied widely at the industry level.
50. Table 5 shows that Australian industry performance broadly fall into industries that have:
- matched or exceeded US levels and growth rates, i.e. participated in frontier shifts – mining, construction and transport & storage;
  - not attained US levels but have exceeded US growth rates in certain periods, i.e. partially caught up – electricity, gas & water, communications, retail trade and finance & insurance; and
  - not matched US levels and growth rates, i.e. fallen further behind – manufacturing and wholesale trade.

<sup>6</sup> The peak of Australia’s GDP per capita relative to US in 2008 needs to be interpreted with care as it might due to the fact that US economy entered into recession in December 2007.

**Table 5: Catch-up in Australia’s productivity levels, 1979 to 2003**

	Growth rate in the United States	Australia’s growth rate relative to the United States	Australian labour productivity		
			1979	1998	2003
	per cent per year	percentage points per year	per cent of US level		
Agriculture, forestry and fishing	3.7	-0.8	94	69	78
Mining	2.7	0.3	186	203	199
Manufacturing	3.7	-1.3	83	71	60
Electricity, gas & water	3.5	1.1	41	71	53
Construction	-0.8	2.2	74	111	124
Trade	2.6	-0.1	62	60	60
Wholesale trade	4.3	-1.0	55	33	43
Retail trade	2.5	0.2	60	73	63
Accommodation, cafés & restaurants	0.3	0.1	85	84	87
Transport & communications	2.5	-0.6	98	95	85
Transport & storage <sup>a</sup>	2.3	-2.5	179	95	98
Communications	2.9	3.0	41	114	83
Financial & business services	0.4	-0.5	97	90	85
Finance & insurance	2.6	0.3	62	73	67
Property & business services	-0.5	-1.1	120	96	93
Public services	-0.2	0.9	100	124	124
Other services	1.4	-0.6	83	71	72
<b>Whole economy</b>	<b>1.6</b>	<b>0.1</b>	<b>84</b>	<b>89</b>	<b>87</b>

<sup>a</sup> The unusual pattern in transport and storage productivity reflects unusual patterns in the GGDC’s Australian price deflators.

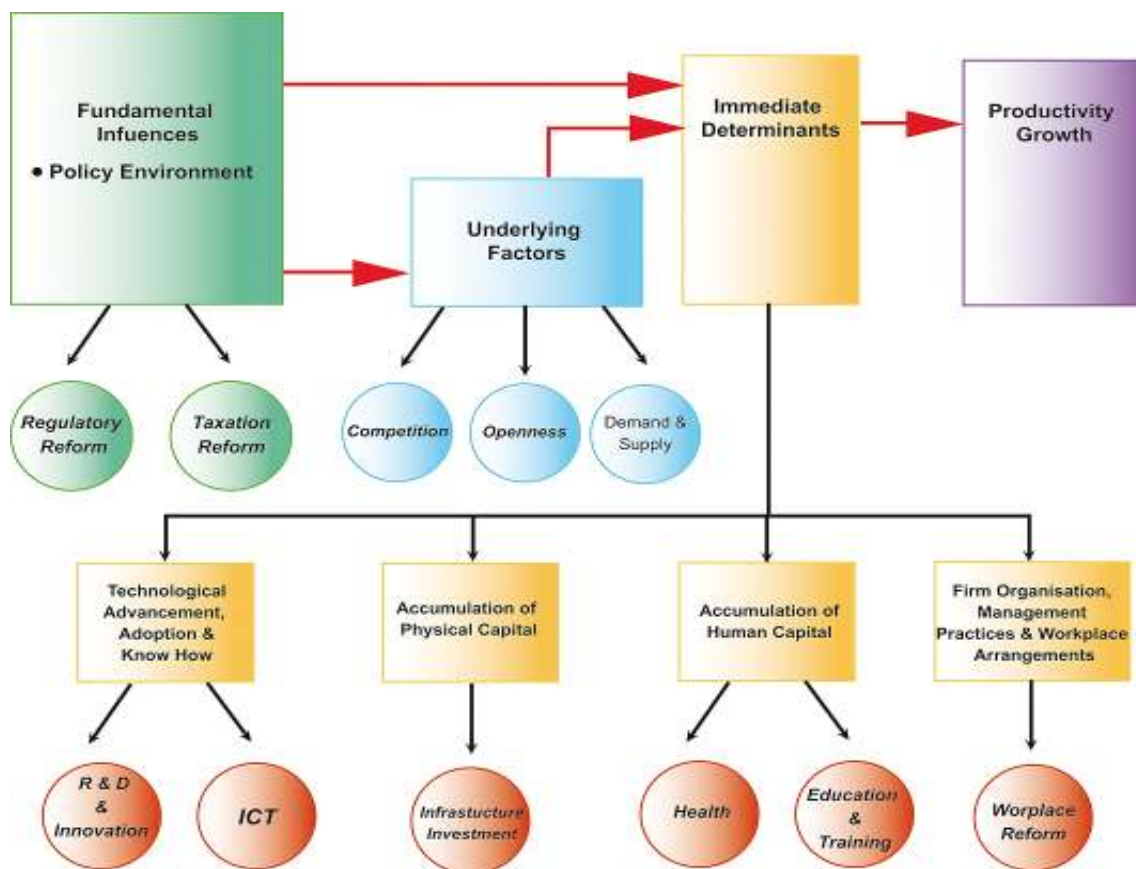
Source: Dolman, Parham and Zheng (2007)

51. Australia is by no means the only developed country that has not caught up with that of the US. However, in contrast to the experience of European countries such as Netherlands, France and Norway, which have fully caught up with US productivity levels, Australia’s aggregate productivity level only managed to keep pace with US labour productivity growth over the previous five decades.
52. Australia’s historical catch-up has been most significant within the utilities, communications and finance industry, which is consistent with the precedent of international convergence concentrated on non-tradable sectors (i.e. services industries). However, very large productivity gaps have persisted in other sectors of the economy, especially manufacturing and wholesale trade.
53. There are many layers of possible explanations as to why large productivity gaps persist between Australia and US. We will explore some of the possible causes in Section 3 below.

### 3. A FRAMEWORK OF MAJOR PRODUCTIVITY DETERMINANTS

54. This section presents a brief discussion on the major determinants that are considered to influence Australian productivity growth over the medium to long run. This section provides a basic framework for considering policy and its direct and indirect implications for productivity, which will be discussed in further detail from Section 4 onward.

**Figure 7: A framework of major productivity determinants**



Note: Adapted from PC (1999).

55. Adopting the framework discussed in Productivity Commission (1999)’s Commission Research Report on *Microeconomic Reforms and Australian Productivity: Exploring the Links*, Figure 7 presents the major determinants of productivity growth, which can be classified into three main categories:

- **Fundamental influences** are the policy, social and institutional environment which affect productivity in general and indirect manner. They establish the general backdrop which can affect productivity

through underlying factors or immediate determinants, especially over the long run. These include regulatory and taxation reforms;

- **Underlying factors** have an indirect effect on productivity by promoting the immediate determinants. They help to determine the extent to which the immediate determinants evolve and encourage productivity improvement. These include market competition, trade openness and demand and supply conditions; and
- **Immediate determinants** are factors that have close and tangible links to input/output relationship in production function. These factors include technological advancement and diffusion, accumulation of physical and human capital and firm organisation, management practices and workplace arrangements.

56. It is important to note that the list of determinants outlined in Figure 7 is by no means exhaustive. Instead, it is intended to demonstrate some of the major drivers of Australia's productivity growth based on past experiences and provide a basic framework for policy discussion and recommendation.

### 3.1 Fundamental influences

57. Fundamental influences provide an essential and necessary platform to determine the productive potential of an economy and the extent to which this potential is realised over the long run. In this regard, three interrelated factors come into play – government policy, institutions and what is known as 'social capability' (PC, 1999).

58. **Policy** direction and certainty are crucial in creating an environment conducive for productivity growth. Government policies can affect the emphasis given to economic objectives and the development of productivity enhancing capabilities (for example, investment in education and training and infrastructure). The stability and certainty of policy settings can minimise the risks investors face in making long-term investment decisions that promote productivity growth. Thus, clear and stable government policies combined with good policy formulation process can limit the extent to which limited resources being directed to rent seeking activity instead of promoting productivity growth.

59. **Institutions** are the 'rules of the game' both formal (e.g. constitutions, legislations, regulations) and informal (e.g. ethics, codes of conduct) which govern the way economic agents interact. From an economic point of view, institutions affect performance by governing interaction between

governments, firms and individuals and thus affecting the costs of production and exchange as well as incentive to be productive.

60. **Social capability** generally refers to the general concept which refers broadly to the economic capabilities of a nation and the orientation of its people toward achieving further economic development. Although the concept is intangible, it can cover the technical capabilities of nations to adopt new production technique and the abilities of communities to embrace change in their cultural values and way of life.
61. Strong government policy and the domestic institutional framework have seen Australia weather the recent global financial crisis better than other comparable developed nations. Strong fiscal balance before the crisis has enabled the Government to provide timely economic stimulus to cushion the fall in demand.
62. However, to ensure the sustainability of the Government budget in the future and the ability to fund its reform agenda on Australia’s health, education and taxation system and etc. which will enhance Australia’s productivity, the Government needs to impose strict discipline to rein in its spending and improve the efficiency of public sector.
63. Government regulation is an important feature of modern societies. It facilitates many everyday transactions and can help deliver economic, social and environmental outcomes that may not have been attained in a free market mechanism. However at the same time, complying with regulations cost individual and business time and money, which can be used for more productive activities.
64. Thus, unnecessary and poorly designed regulation can impose excessive compliance costs on businesses, restrict competition and distort the efficient allocation of economic resources. PC (2006) estimates that a 20 per cent reduction in Australian compliance costs consistent with *National Reform Agenda* (NRA) would result in a saving of as much as \$8 billion in 2005-06 values or 0.8 per cent of GDP per annum. We will discuss the progress of Australia’s regulatory reform to date and business concerns on regulation burden in **Section 4** below.
65. We will also discuss the potential benefits of taxation reform in **Section 5**. Further taxation reform is necessary to ensure Australia’s taxation regime remains internationally competitive. Competitive tax system will ensure efficient resource allocations especially capital which is highly mobile, as well

as promote innovation, risk taking and entrepreneurship. Interaction between taxation and transfer system can also affect labour force participation.

## 3.2 Underlying factors

66. Underlying factors help to shape up the extent to which the immediate determinants of productivity growth evolve. A change in firm organisations and management practices or adoption and development of new technologies might not occur without the catalyst – competition. Access to overseas technology and new management style may not be possible without openness to trade and investment.
67. It is often argued that competition provides the basic incentive to improve productivity performance. It provide incentives for firms to adopt the latest technology or industry best practices and innovate in order to gain product and/or price advantage over their competitors. This will enable them to gain market share or even to survive. Competition also coerces firms and industries to rationalise, modernise and operate within ‘value networks’ to gain from specialisation, economies of scale and the distribution of risks.
68. Trade and investment openness is an important determinant of productivity growth. Apart from the competitive element;
- inward foreign direct investment often brings with it technology, production methods and human expertise;
  - imports of final products, intermediate goods, capital equipment and machinery can have technology embodied within them that would not otherwise be available;
  - intra-industry trade leads to specialisation between countries in production of goods and services to which they have a comparative advantage; and
  - development of foreign markets to trade and outward foreign investment can bring the volume of sales and access to ideas which can assist with the exploitation of economies of scale (PC, 1999).
69. General demand and supply conditions, such as the strength and pattern of demand for goods and services, factor endowments, demography and prices, can affect the accumulation of human capital, the merits of different production techniques and the merits of adopting and developing new technologies.

70. We will discuss the benefits of competition and trade openness in further details in **Section 6**.

### **3.3 Immediate determinants**

71. Immediate determinants are the factors which have direct and tangible links to productivity and growth.
72. Technological advancement is often view as the key driver behind productivity improvement and sustained economic growth over the long run. Technological advancement encompasses the invention of ideas, innovation, which bring ideas into the realm of commercial viability, and diffusion (actual application in production processes).
73. The uptake of information and communication technology (ICT) in the 1990s have also increased the MFP growth in Australian services industries such as the wholesale and retail trade as well as finance industries (see Section 2.2 above). We will further discuss the significance of technological advancement including R&D and innovation on Australia’s productivity growth in **Section 7**.
74. Accumulation of physical and human capital is also essential in promoting productivity growth.
75. Geographically Australia is a remote and sparsely settled country with a small domestic market of 22 million people largely fragmented into capital cities separated by vast distances. Australia’s average population density is around 10 per cent of the US and a little more than 1 per cent of the UK (Dolman, Parham and Zheng, 2007) The negative consequences of sparse market fragmentation (such as higher transportation costs or less factor mobility) can only be ameliorated, with effective investment in better infrastructure such as port, rail and road as well as policy and investment strategies that encourage both efficiency within transport modes and appropriate choices between modes. **Section 8** will discuss scope to improve policy in some of these areas.
76. Improvement in health quality through disease prevention and better healthcare can lead to significant gains in quality of life for many Australians. Health condition can affect workforce participation and impact an individual’s ability to earn income rather than relying on government benefits.
77. Education and skills contributes to productivity by improving the capabilities of labour. There exist an indirect link between accumulation and application of knowledge and the advancement of technology and innovation. An additional



year of schooling can increase the workforce participation rate by around 0.5 per cent for males and 4 per cent for females (PC, 2006).

78. Dowrick (2003) argues that an increase of 0.8 in the average years of schooling of Australian labour force to 11.4 years would increase Australia’s annual GDP growth by one third of a percentage point – through human capital deepening and more rapid adoption of new technology. We will discuss human capital investment greater details in **Section 9**.
79. Changes in firm organisation, management practices and workplace arrangements can promote productivity growth. For example, lean production techniques can bring productivity improvements through complete and continuous review of production systems, efficient supply arrangements, timely inventory management and quality assurance (PC, 1999).
80. Greater flexibility in workplace arrangements and the shift to more decentralised bargaining structures to determine wages and conditions in Australia’s workplace have diverted more attention on opportunities to improve productivity within enterprises (PC, 2005a and Valadkhani, 2003). We will discuss the relationship between Australia’s workplace reform and productivity growth in **Section 10**.

## 4. REGULATORY REFORM

81. Regulation is pervasive in modern societies however well targeted and designed regulation can generate significant benefits – delivering economic, social and environmental outcomes that may not have been achieved through a *laissez-faire* system. However, unnecessary or poorly formulated and implemented regulation can expose business to excessive compliance costs, stifle market competition and distort resource allocation in the economy. Thus to ensure that regulation delivers the greatest net benefit to the economy, it needs to be properly justified, and well designed to avoid imposing unnecessary compliance costs.
82. Significant productivity gains have been made since the 1980s from regulatory reforms, directed at:
- sharpening incentives to be more productive through increasing competition from domestic and overseas sources;
  - opening the domestic economy to trade, investment and technologies from overseas<sup>7</sup>; and
  - providing greater flexibility e.g. more flexible labour markets to adjust production process and business operations to improve productive capabilities.
83. These reforms included deregulation of access to finance, floating the currency, establishing the independence of Reserve Bank Australia, marked reductions in trade barriers and restrictions on foreign direct investment, commercialisation and privatisation of government business enterprises, and increasing labour market flexibility (Parham, 2003).
84. Salgado (2000) found a positive link between Australia’s structural reforms and productivity growth. Relative to the rates in the 1980s, his estimates suggested that reforms, which have included deregulation initiatives, have lifted Australia’s trend total factor productivity by between 0.5 and 0.9 percentage points in the aggregate level during the 1990s productivity boom cycle.
85. To consider more opportunities for productivity improvements there also needs to be a focus on the stock of existing regulation, the growth of new regulation and the associated compliance costs. According to PC (2006), the

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<sup>7</sup> Section 6 below will discuss the benefit of trade openness and competition in further details.

compliance costs of regulation are significant and could be as high as 4 per cent of GDP per annum – up to \$35 billion in 2005-06.

86. Regulation is also rarely reviewed. Instead in many circumstances ineffective regulation continues to be applied, reducing business flexibility, decision-making ability, investment, innovation, competitiveness, and productivity. While ineffective and overly intrusive regulation is an obvious problem, initially good regulation, in a dynamic market economy, can also evolve into stifling regulation. Clearly all regulation must be reviewed on a regular basis.
87. Developing effective processes for introducing regulation will significantly reduce the overall cost of regulation to the Australian economy. Implementing an agreed and transparent regulatory framework will ensure more considered and careful regulation. It will provide a barrier against knee jerk and reactionary legislation.
88. Action must also be taken to review, revise and reduce existing legislation.

#### **4.1 Regulatory development in Australia**

89. Regulation not only includes the ‘black-letter law’ of legislation, statutory instruments and by-laws, but also ‘quasi-regulation’ and government instruments such as industry codes of conduct and mandatory rules (PC, 2006). All of these regulations impose significant obligations and costs on business.
90. According to PC (2006), p. 136:
- ‘...Between 2000 and 2004, as many pages of Commonwealth Government legislation were passed during the period 1901 to 1969... This growth has added to the already ‘large’ stock of existing regulation. The Regulation Taskforce noted that there are more than 1500 commonwealth Acts of Parliament and around 1000 statutory rules in force, as well as unknown quantity of Commonwealth ‘subordinate’ legislation...’*
91. The recent PC (2008b) *Performance Benchmarking of Australian Business Regulation: Quality and Quantity* showed that despite significant differences across jurisdictions in the processes of developing and reviewing regulations, some commonality emerged:
- there are few mandatory requirements for consultation on regulatory proposals. Only Western Australia and COAG require stakeholder consultation for all types of proposals;
  - the proportion of regulatory proposals actually subjected to regulatory impact analysis or compliance cost estimation is generally low. In 2006-

07, e.g. only 21 per cent of new Commonwealth Bills and 9 per cent of Victorian Bills were subject to analysis, while no information was available for new regulations proposed in New South Wales. Moreover, only the Commonwealth, Tasmania and Queensland require regulatory analysis to be made public;

- few jurisdictions enable business to interact with regulatory bodies online. For example, few have facilities for online lodgement of forms, renewal of licences, and payment of fees and charges; and
- few regulators will allow business licensed in another jurisdiction to operate in their jurisdiction without obtaining a separate licence.

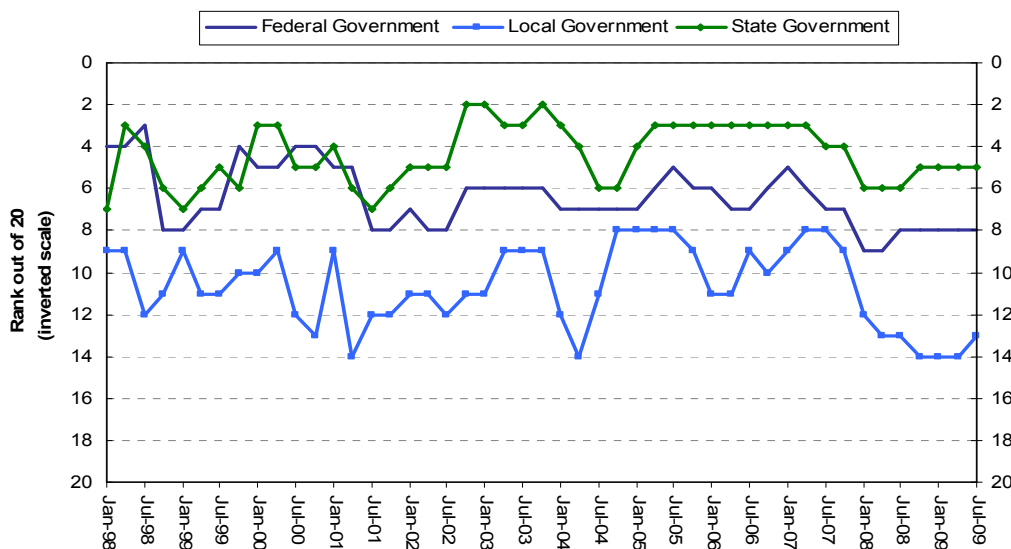
## 4.2 Regulatory compliance costs

92. Regulation imposes compliance costs on business by requiring them to undertake activities and provide information to government and third parties. Compliance costs incurred by business often exceed the level necessary to achieve the policy objectives. Excessive compliance costs can often arise due to:

- an unnecessarily high frequency of reporting or providing similar information to a number of government organisations or levels of government;
- overlaps and inconsistencies between jurisdictions;
- inconsistencies in definitions and criteria; and
- regulation that is redundant or not justified by policy intent (PC, 2006).

93. Government regulation, particularly federal and state, consistently rates in the *ACCI Survey of Investor Confidence* top ten out of the twenty major constraints to investment in plant and equipment. Overall businesses are more likely to indicate that state government regulation is a major constraint on regulation followed by federal and local government regulation, as demonstrated by Figure 8.

**Figure 8: Regulation as a major impediment to business investment**



Source: ACCI Survey of Investor Confidence, July 2009

94. As part of an international study, the OECD (2001) estimated that Australian compliance costs for SMEs – covering tax, employment and environmental regulation to be approximately \$17 billion (2.9 per cent of GDP) in 1998.
95. The report also noted the overall detrimental effect of regulation on business. “The cumulative effect of regulations from multiple institutions and jurisdictions is to slow down business responsiveness, divert resources away from productive investments, hamper entry into markets, reduce innovation and job creation, and generally discourage entrepreneurship”.
96. While regulations apply throughout the economy, there are specific reasons why small businesses suffer disproportionate regulatory costs. These include:
  - regulatory cost makes up a large proportion of overhead costs and net margin. At the firm level it often implies a direct reduction in profitability and retained earnings. This may affect investments and the return to shareholders;
  - the nature of the compliance cost. Administrative costs tend to be fixed, so that changes in sales have no effect on the costs in the short-run. In other words, if sales go down but the costs remain unchanged this causes the “break-even” point to be raised; and
  - diversion of entrepreneurial attention. In small companies the owner, senior manager or director has to deal with the paperwork while they instead could focus attention on business management (OECD, 2001).

### 4.3 Improving regulation: ACCI recommendations

97. Effective regulatory reform can significantly improve government performance and desired social and economic outcome. However unjustified, poorly designed and/or implemented regulation can unnecessarily increase costs and prices and hence reduce consumer choice, impede innovation and stifle productivity growth. While these costs are not explicit, they nevertheless indirectly affect producers and consumers and thus affect economic efficiency (allocative, technical and dynamic efficiency<sup>8</sup>), investment decisions and opportunities for growth.
98. Thus ideally business related regulation should be carefully formulated, open to all stakeholders for consultation, elicit the most cost effective intervention from policymakers and include provisions for reviewing past regulations.
99. In order to achieve a situation where regulations are minimal and yet effective, ACCI recommends that:
- the program of reform should proceed on the assumption that regulation is the least appropriate way in which to address issues of concern to the Government. It should be the last resort after all other options (education, publicity, moral persuasion, industry self-regulation and other approaches) have been fully assessed and judged to be ineffective;
  - policymakers should ensure that the regulatory decision-making process is transparent, leads to fair outcomes and involves consultation processes that are accessible and responsive to business and the community;
  - a new regulatory culture should be adopted to understand businesses process and the burden created by regulatory compliance. There should be commitment to provide a ‘business friendly’ operating environment;
  - No new business regulation should be contemplated without a thorough and independent cost benefit analysis (including the full cost of the proposed regulation to business) and no regulation should be introduced without full consultation with the business sector. The cost benefit analysis should be in the form of a **Regulation Impact Statement (RIS)** which assesses the total cost to business of compliance, fees and paperwork and compares this total cost to business with the estimated

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<sup>8</sup> *Allocative* efficiency is the extent to which resources are used in way that maximise community wellbeing; *technical* efficiency is the extent to which goods and services are produced with the minimum required inputs; and *dynamic* efficiency is the extend to which limited resources can be used to produce more output over time and the extent to which production can be altered effectively and at a minimum cost in response to changes in economic conditions.

benefits of the proposed regulation. The process and the result should be made public. It is evident that:

- the RIS process must precede, rather than follow, the consultation process so that the analysis used in balancing the costs and benefits can be adequately assessed by stakeholders. The effective use of RIS must be incorporated into a broader commitment of regulation that encompasses transparency, adequate consultation and responsiveness to the needs of the private sector as well as the community;
  - currently, once a proposed policy or regulatory response has been established, the RIS is used as a justification for the policy rather than a process to carefully examine the proposed regulatory actions. The RIS process has not worked as effectively as hoped by policy makers and businesses alike. Draft RIS fail to be made public in timeframes, which allow for broad, in-depth stakeholder comment from businesses; and
  - politically sensitive regulations that have a significant impact on business are more likely not to have had their RIS adequately completed. In times where communities and businesses require informed debate, political expedience may elicit a response that circumvents or taints the credibility of the RIS process. At this point it is essential that the cost benefit analysis component of the RIS process be at arms length from the policy-making area of government.
- Automatic revocation (through ‘sunset clauses’) should apply to all subordinate legislation after a period not exceeding 10 years and earlier if triggered by an appeal process. A RIS should apply to any attempt to renew ‘sunset’ regulation. Independent reviews of Acts of Parliament embodying business regulation (and associated programs) should be carried out at least every 10 years.
  - If new or amended regulation or forms of self or co-regulation are considered appropriate, they must be done with the minimal level of intervention consistent with being effective. This applies to the regulation itself, the taxes or charges imposed by regulation and the costs of administration and compliance with the regulation imposed upon the regulating agency and upon business. Where some form of regulation is considered necessary, it should be developed within a context where:

- ❑ national standards and codes (including mirror and template regulation) are encouraged so that the regulation is ‘business neutral’ for all businesses regardless of location unless justified by differing conditions in different jurisdictions;
- ❑ conflicts, inconsistent rulings and overlaps between regulation and regulatory systems of different levels of government are identified and addressed. Similarly, differing interpretations of national regulations by different State or Territory agencies must be addressed;
- ❑ co-regulation and self regulation schemes do not proceed without a full analysis of the regulation. Simply transferring a regulatory scheme from the Government to the business sector is not acceptable and the preferred approach is to conduct a regulation review prior to any total or partial devolution to an industry body;
- ❑ world’s best practice for regulation and regulatory systems are identified and become the benchmark; and
- ❑ regulation reviews are carried out in a strategic and focussed fashion with an emphasis on industry by industry reviews and priority given to industries of major economic importance to the States and Territories along with a review of regulation which is seen as an impediment to small business.

100. The ACCI 2005 position paper entitled  *Holding Back the Red Tape Avalanche: A Regulatory Reform Agenda for Australia*  provides a comprehensive plan and discussion to reduce the impact of the escalating volume of business regulation, which has an unintended detrimental impact on productivity<sup>9</sup>.

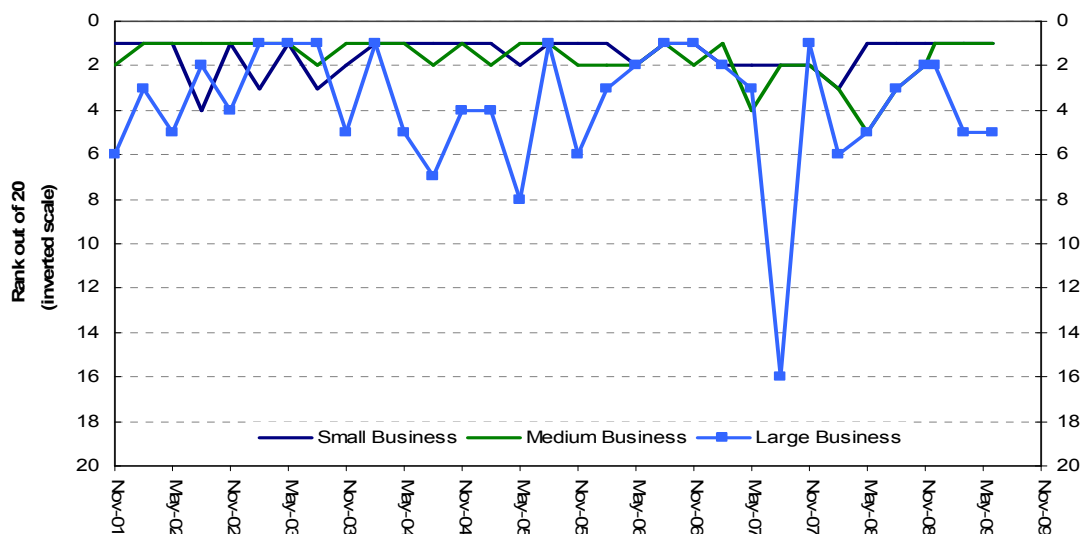
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<sup>9</sup> The ACCI position paper can be downloaded from ACCI website at:  
[http://www.acci.asn.au/text\\_files/Discussion%20Papers/Regulation%20Policy%20Framework%20Electronic%20Copy.pdf](http://www.acci.asn.au/text_files/Discussion%20Papers/Regulation%20Policy%20Framework%20Electronic%20Copy.pdf).



## 5. TAXATION REFORM

101. In the next decade Australia’s economy will continue to experience the long process of intergenerational change, which has significant impacts for our future economic growth and living standards. Moreover, given the current era of globalisation with freer capital and labour mobility, there is an increasing pressure for Australia to remain competitive. An important element in addressing the above challenges is through the creation of an efficient, simple and equitable tax-transfer system.
102. According to the *World Economic Forum – Global Competitiveness Report 2008-09*, Australia was ranked 18<sup>th</sup> out of 134 countries in terms of overall competitiveness. However looking into greater detail, Australia was ranked 85<sup>th</sup> in terms of the government regulation burden and 88<sup>th</sup> in terms of the total tax rate. Thus, continuing tax reform remains key to enhancing Australia’s competitiveness and economic growth.
103. ACCI believes Australia needs a tax system that supports the achievement of important economic and social objectives. Australia’s competitiveness should be assisted and not impeded by the tax system.
104. Tax revenue should be adequate to meet elected governments’ reasonable expenditure needs, consistent with the exercise of fiscal responsibility principles. The tax system should be such that all taxpayers feel confident and satisfied in complying with it.
105. A sustainable tax structure will only be achieved through an integrated package of reform across all significant Commonwealth and State tax bases in the form of a balanced package covering consumption, income and assets.
106. ACCI’s comprehensive surveys of our membership continue to nominate business taxes and government charges as a major constraint on investment. This is particularly the case for small and medium sized enterprises, therefore the direction of our tax reform priorities strongly supports this sector. Further ACCI believes that reduction in the overall tax burden is an important driver of economic growth.
107. It is evident from Figure 9 that small and medium businesses continued to rank *Business Taxes and Government Regulations* as one of the top five impediments to business investment (out of 20 constraints) since 2001.

**Figure 9: Business Taxes and Government Charges as major constraint to investment**

Source: ACCI Small Business Survey, August 2009.

## 5.1 The need for taxation reform

108. Taxes have significant efficiency costs, so tax reductions will increase the efficiency and productivity of the Australian economy. To ensure sustainable economic growth, with wages growth not translating into inflation, it is absolutely essential that productivity start growing again. One of the most significant ways to further improve productivity is through tax reform.
109. Almost all taxes have an efficiency cost on the economy. Some Australian studies on the efficiency costs of taxes are summarised below:
- Campbell & Bond (1997) found that the efficiency costs of taxation are at least 19-24 percent. This means that a reduction in tax by \$1 has an economic return of 19-24 percent, which is a very high rate of return.
  - Findlay & Jones (1982) found that the efficiency costs of taxation are between 23 and 26 percent.
  - Freebairn (1995) found broadly similar results if sticky wages and the demand for labours are included in models.
  - Diewert & Lawrence (1998) found that a cut in Australian taxes on capital would have a return of 48 percent.
110. Other studies show that the efficiency costs are even larger when taxpayers reduce their taxable income (i.e. tax minimisation):

- Parry (2002) found that legitimate tax minimisation increases the efficiency costs of taxation to around 30 to 50 percent. Parry does not include tax evasion, which he suggests could increase this cost by 5 to 10 percent.
- Feldstein (1999) found that personal taxes have an efficiency cost of 204 percent in the US when tax minimisation is included, with the cost even higher for higher income earners.
- Fortin & Lacroix (1994) found that legitimate tax minimisation means income taxes have an efficiency cost of 39-53 percent. Incorporating tax evasion through the cash economy increases the efficiency cost by between 2 and 5 percent, but this cost is larger at higher income tax rates.
- Cebula (1997) found that a one percent increase in the US personal tax rate increased the size of the cash economy by 1.4 percent.

111. While taxes can reduce the static efficiency of the economy, taxes can also have a long run adverse effect on growth. Table 6 below, adapted from Leach (2003), summarises some literature about the negative effect of tax on growth. In general, previous studies found that a 1 percent tax reduction can increase economic growth by at least 0.1 percent per year.

**Table 6: The negative impact of taxation on economic growth**

Study	Coverage	Effect of 1 percent cut in tax
Cashin (1995)	23 OECD countries over the 1971-1988 period.	output per worker increases by 2%
Engen & Skinner (1996)	US modelling together with a sample of OECD countries.	GDP growth increases by 0.08% to 0.12%
OECD - Leibfritz, Thornton & Bibbee (1997)	OECD countries over the 1965-1995 period.	Increase GDP growth by 0.05% to 0.1%
OECD (1997) additional model simulations	European Commission Quest 2 - model simulations.	Increase GDP by 2.4%
Bleaney, Gemmell & Kneller (2000)	17 OECD countries over the 1970-1994 period.	Increase GDP growth by 0.41%
Bassanini & Scarpetta (2001)	21 OECD countries over the 1971-1998 period.	Increase GDP growth by 0.3% to 0.6%
PricewaterhouseCoopers (2003)	18 OECD countries over the 1970-1999 period.	Increase GDP growth by 0.2% to 0.4%

112. ACCI considers that continuing tax reform plays an important role in encouraging investment in education and training (or human capital). Some studies supporting this include:
- Milesi-Ferretti & Roubini (1998) found that personal income taxes reduce growth because they reduce investment in human capital.
  - Lucas (1990) showed that income taxation lowers the return to human capital and reduces the incentive to accumulate human capital.
  - King and Rebelo (1990) and Rebelo (1991) found that an increase in the income tax rate decreases human capital accumulation and economic growth.
113. There are a number of other reasons why efficiency figures would underestimate the cost of taxes, including:
- uncertainty, which increases the negative effect taxes have on the incentive to invest – see Agliardi (2001);
  - existing inefficiencies in the economy, such as monopolies, externalities, regulations (particularly on the labour market) and trade restrictions. Browning (1994) argued that a large number of non-tax distortions substantially increase the efficiency and welfare costs of taxes. Under plausible parameters, the welfare/efficiency cost of taxes is 40 percent higher when pre-existing inefficiencies are included; and
  - the effect of taxes on innovation, risk taking and entrepreneurship (Gentry and Hubbard, 2004).

## 5.2 Taxation Reform: ACCI recommendations

114. Australia’s taxation systems (across different jurisdictions) reflect the level of income redistribution that should occur and the balance between private and public provisions of goods and services. Consequently, they affect economic agents’ decisions and incentives as well as distribution of income between different social groups and across different jurisdictions.
115. In 2006, Australia had a higher tax to GDP ratio than the US and Japan, which reflects the greater role of government in the Australian economy. As a share of GDP, the total tax burden in Australia on capital is around 11 per cent (fourth highest in the OECD); the total tax burden on labour is 12 per cent

(fourth lowest in the OECD) and the total burden on consumption is 9 per cent (also fourth lowest in the OECD)<sup>10</sup>.

116. Based on the *International Comparison of Australia’s Taxes* Report (2006) and *Architecture of Australia’s Tax and Transfer Systems* (2008), Australia is clearly uncompetitive on capital gains tax (CGT). Among the OECD-10 countries, Australia has one of the higher top personal tax rates on capital gains, notwithstanding the 50 percent discount available for gains on assets held for at least 12 months. We imposed the highest withholding tax on interest earned from ordinary bank accounts and the third highest CGT on shares.

117. It is important that Australia’s taxation system promotes productivity growth, for example, through encouraging labour market participation, increasing incentives to invest and save and increase Australia international competitiveness.

118. Thus, ACCI recommends:

- a better regulatory assessment process for tax administration and better consultation mechanisms through the introduction of a Tax Administration Impact Statement (TAIS) administered by the Inspector General of Taxation;
- reduction in top marginal individual income tax rates to better align with the company tax rates, since:
  - ❑ the efficiency costs of high top marginal tax rate are greater than average as higher income earners are more responsive to taxes than lower income earners;
  - ❑ reducing the top tax rate will reduce the tax rate on capital. Tax theory generally shows that capital taxes are very inefficient because they reduce growth – see Atkeson et al. (1999);
  - ❑ there are many tax avoidance opportunities created by having significant differences between the top personal tax rate and the company tax rate, for example replacing dividend distributions with loans from the company; and
  - ❑ there is also evidence that high taxes on skilled workers discourages investment (Büttner & Wamser, 2006) and reduces productivity growth (Eichler et al., 2006).

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<sup>10</sup> Australian Government 2008, *Architecture of Australia’s Tax and Transfer System*, Canberra.

- introduction of a stepped rate CGT, where the proportion of the capital gain that is taxed diminished over time. It is important for Australia’s to have a competitive CGT as:
  - ❑ capital is very mobile internationally. Relatively high tax rates on capital are detrimental because of this mobility;
  - ❑ it decreases the efficiency of markets, as CGT discourages asset turnover (the lock-in effect). Due to CGT, owners of assets are discouraged from selling those assets even when it would be efficient, because of the large CGT bill they would have to pay. This decreases market liquidity. The lock-in effect also means that investors do not shift their funds to investments (such as high growth firms) that offer the highest rate of return;
  - ❑ it discourages capital formation. The increase in CGT in the US in 1986 was found to reduce the capital stock by between 2 and 4 percent (Henderson, 1989);
  - ❑ a constant-rate CGT without inflation indexation means a gradual increase in effective tax rates the longer an asset is held (Ernst & Young, 2006);
  - ❑ it discourages the financing and start-up of new businesses, particularly in high-tech industries (Moore & Silvia, 1995);
  - ❑ it discourages entrepreneurs from selling equity to outside parties. This discourages growth and efficiency in firms that have just passed the start-up phase (Chari, Golosov & Tsyvinski, 2003); and
  - ❑ it reduces incentives for entrepreneurs and therefore reduces welfare for the economy as a whole. Keuschnigg & Nielsen (2004) showed that lower CGT is a better way of promoting entrepreneurial activity than subsidized interest, direct investment subsidies, or public credit guarantees.
  
- reduction of high effective marginal tax rates in particular on low and middle income earners to encourage greater workforce participation. High effective marginal tax rates produced by the combined effect of withdrawal of government benefits and the progressive income tax system can discourage people on welfare to return to work; and

- harmonisation of payroll tax towards its gradual abolishment. Non-neutralities in the payroll tax regimes of Australian jurisdictions can have pervasive effects on competition through its effect on the locational decisions of firms. Payroll tax also negatively affects employer’s decisions to expand business operation and increase wages and employment. Thus payroll tax is not only the one of the most punitive taxes on businesses, but also one of the most regressive taxes on workers.

119. More details on ACCI taxation policy are available on *ACCI Taxation Reform Blueprint* (2004)<sup>11</sup>.

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<sup>11</sup> <http://www.acci.asn.au/TaxBluePrintMain.htm>

## 6. COMPETITION AND TRADE OPENNESS

120. High trade barriers and various regulatory and institutional restrictions on competition in the domestic market during the 1970s and 1980s led to significant inefficiencies across the Australian economy. These restrictions also created a business culture that focussed on securing government preference rather than on achieving a competition edge through effective costs management, innovation and responsiveness to customer demand and requirement.
121. Microeconomic reforms since the 1990s including liberalisation of Australia’s foreign trade and investment, National Competition Policy agenda and taxation reforms have promoted competition and gave Australian firms more international focus. These reforms have contributed significantly in increasing Australia’s economic growth, productivity and standard of living.

### 6.1 Benefits of trade openness

122. Given a small domestic market, openness to trade is one of the important drivers for Australian productivity growth. In addition to assisting technological transfer to domestic economy, trade can substitute the lack of large domestic market to some extent in order to foster competition and exploit economies of scale.
123. Openness to trade promotes output and productivity as:
- it allows countries to specialise in activities in which they have comparative advantage or can exploit economies of scale;
  - it can encourage stronger import competition which can stimulate innovation and promote transformation of inefficient firms and activities;
  - it drives the uptake of ICT which contributes to the improvement of business efficiency and the changes in business operations as well as management practices; and
  - more trade can promote accumulation and transfer of knowledge as a foundation of imitation and innovation, especially through foreign direct investment (Parham, 2004).
124. The Australian economy has become much more open over the past two decades, with the trade to GDP ratio increased from 27 per cent in the mid-1980s to around 45 per cent in 2007. The stock of foreign direct investment in



proportion to GDP has also increased from around 17 per cent in the mid-1980s to 30 per cent in recent years.

125. Progressive relaxation of trade and investment barriers has been one of the major contributors. For example, effective rate of assistance for manufacturing have declined steadily from about 20 per cent in the mid-1980s to about 4.5 per cent in 2007-08 (PC, 2009).
126. PC (1999) observed a strong productivity response of whitegoods manufacturers to reductions in high trade protections in the 1980s, in contrast to slower productivity growth in automotive and textile, clothing & footwear (TCF) industries, for which high government assistance was maintained.
127. PC (2008a) estimated that the existing regime of scheduled reductions in tariff to 5 per cent and removal of budgetary support by 2015 for TCF sector will increase real GDP and wider economic wellbeing by around \$70 million and \$60 million respectively per year.
128. This estimation does not include the policy-induced productivity growth in TCF sector. Reduction in trade assistance will generate more competition and thus spur significant increase in TCF innovation and specialisation in higher value-added activities such as fashion design, marketing, research and development as well as stock management and logistics.

## 6.2 Importance of competition

129. Competition is the underlying dynamics which drive economic efficiency contributing to wealth creation and improved living standards. Conversely, impediments to competition reduces the pace and the dividends of economic development and growth. Interventions which impede competition in pursuit of political and social objectives often impose greater costs than benefits upon the economy and often disadvantage those they purport to help.
130. For example in wholesale and retail trade industry<sup>12</sup>:
  - continuing deregulation of trading hours increased competition across retail industry;
  - the emergence of megastores and specialty stores intensified competition in the clothing and recreational retailing;

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<sup>12</sup> See Johnston et al. (2000).

- lower tariffs coupled with the impact of Korean entry level cars led to increase in import competitions especially in the small car market; and
  - the growth of independent networks increased competition in fuel retailing.
131. All the above developments foster competition, contribute to lower prices and increase product choices which benefits society as a whole.
132. Increased competition either from domestic firms or from imports brought improvements in resource allocation and technical efficiency in order for firm to gain market share or even to survive. Thus, competition provides impetus for productivity growth through:
- implementation of industry best practices;
  - greater product specialisation and rationalisation of plants and equipments as well as encouraging greater economies of scale;
  - investment in technology and know-how;
  - greater R&D and innovation effort;
  - improved management practices and work arrangements; and
  - greater emphasis on skill developments.
133. Moreover, greater competition also forces firms to be more adaptive to changes and more responsive to external shocks, such as those coming from new entrants and price wars. As a result firms in competitive markets may have become more adaptive in general.
134. Many studies indicate that microeconomic reforms, including the implementation of National Competition Policy (NCP) since 1995, have been a major contributor to Australia’s productivity surge in the 1990s.
135. Previous estimates by the Industry Commission suggested that major elements of NCP could potentially generate a net benefit equivalent to 5.5 per cent of GDP. PC (2005a) estimated that the observed productivity and price changes in key infrastructure sectors in the 1990s, to which NCP and related reforms have directly contributed, have increased Australia’s GDP by 2.5 per cent or \$20 billion.
136. NCP and other related reforms have contributed to price reductions especially for business. According to PC (2005a):

- average real electricity prices Australia-wide have fallen by 19 per cent since the early 1990s;
- real port charges fell by up to 50 per cent during the 1990s;
- average telecommunications charges have fallen by more than 20 per cent in real terms since the mid-1990s; and
- there were significant reductions in rail freight rates in the second half of the 1990s, ranging from 8 per cent for wheat, to as much as 42 per cent for some coal traffic.

137. Competition has also contributed to improvements in service quality and reliability as well as expansion in the range of products and services available to consumers. More competitive markets also accelerated the adoption of new technologies and introduction of new products by firms to differentiate themselves from the mainstream and enable them to capture niche markets.

### **6.3 ACCI recommendations**

138. While past reforms on trade liberalisation and competition have delivered significant benefits to Australian economy, it is not the time now to relax and simply receive the dividends from the past reforms. There is a need for further reform to enable continuity in achieving higher living standard across Australia in the face of some major challenges that lie ahead:

- increasing integration with the world’s economy, in particular the emergence of China and India as major global economies, will heighten competitive pressures especially for the manufacturing sector, although it will also provide significant new opportunities for Australia; and
- Australia’s ageing population will reduce workforce participation and substantially increase demands for health and aged care systems which will put significant pressures on government budgets. Policy initiatives to improve Australia’s productive capacity and increase household incomes are essential to meet the costs of an ageing population.

139. Therefore ACCI recommendations include:

- the active promotion of a comprehensive round of multilateral trade negotiations;
- strengthening Australia’s representation within key international fora whose activities and programmes affect Australia’s interest in global trade and commerce;

- follow through the legislated tariff reductions as scheduled;
- the adoption under the auspices of the World Trade Organisation of effective and transparent competition policies which reinforce trade and investment liberalisation;
- promoting legislation/regulation review and reform, which delivers a substantial reduction in the burden thereof on commerce and industry;
- promoting level playing field all businesses, including government procurement activities;
- encouraging access to essential facilities or infrastructures in ways which stimulate competition in otherwise restrictive markets; and
- ensuring consistent application of competitive neutrality rules, including action to identify and/or obviate inappropriate implementation.

## 7. TECHNOLOGICAL ADVANCEMENT

140. Technological advancement is a prime source of productivity growth. Improvement in technology enhances productivity by reducing inputs, changing production processes, and improving management systems.
141. For example, PC (2005c) indicated that technological advances have contributed to productivity improvement in the agriculture sector:
- the development of more advanced farm machinery and equipment, such as the development of mechanical harvesting of wine grapes allowed broadacre style harvesting , pruning and spraying of vines brings significant reductions in the costs of harvesting grapes;
  - the development of improved herbicides, fertilisers and other chemicals which improved yields;
  - genetic modification has created opportunities for raising the productive potential of plants and animals, for example, by enhancing their resilience;
  - greater use of information technology and the internet to monitor global market trends, communicate and interact with suppliers throughout the supply chain, access weather forecasts and use satellite imagery in developing farm plans.
142. Technology advancement not only comes from domestic R&D, but also through R&D spillovers from foreign countries through international trade. It is most evident in ICT diffusion. Although Australia has historically been less able to extract productivity gains from ICT production or manufacturing, Australia has become a high ICT user. In 2000, Australia ranked third (behind the US and Finland) among OECD countries on expenditure on ICTs as a proportion of non-residential investment.
143. ICT development has increased productivity in Australia’s services industries such as wholesale and retail trade industries during the 1990s, in which innovation such as product bar-coding and scanning devices have reduced the errors and worked hours as well as improvised the inventory management systems.
144. Dowrick (2003) found empirical evidence that domestic R&D and spillovers from foreign R&D are equally important for Australia’s productivity growth. He showed that a 0.2 percentage point increase in foreign and domestic

research intensity<sup>13</sup> would each increase Australia’s MFP growth by one-tenth of a percentage point.

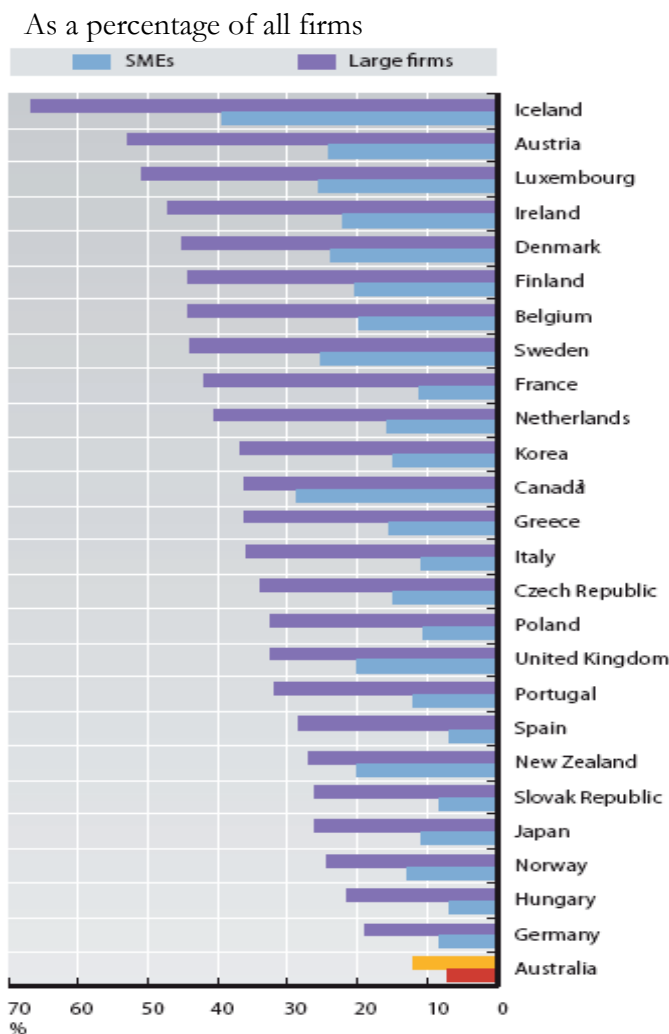
## 7.1 Innovation and R&D

145. Innovation in business is an important driver of competition and productivity growth. Innovation enables firms to differentiate their products and services from those of low-cost producers in integrated global and deregulated markets.
146. In the era of globalisation and rapid technological progress, continuous innovation through products and services improvement and development is the only sustainable strategy for firm to thrive and survive in a competitive market.
147. Innovation is more widespread than often envisaged. It not only covers R&D but also the non-technical and non-R&D innovation, which occurs every day in the way businesses operate, meet the needs of their customers, and organise their employees and processes (Cutler Review, 2008)
148. Australia devoted fewer resources to R&D, both in government and business expenditure, compared to other leading OECD countries, with business expenditure on R&D at 1.04 per cent of GDP in 2005 – 50 per cent lower than the OECD average of 1.53 per cent (OECD, 2007).
149. Australia ranked the lowest among OECD countries in terms of percentage firms that introduce new-to-market product innovations, with only 7 per cent of SMEs and 12 per cent of large firms introducing novel innovations (see Figure 10 below).
150. However, care must be taken in relying on measurable R&D expenditure as a proxy for total national innovation, since organisational innovation is very important in the services industry as well as SMEs but weakly reflected in R&D expenditure as well as in patents data (Cutler Review, 2008, p.7).

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<sup>13</sup> R&D expenditure as a proportion of business sector GDP.

**Figure 10: Firms with new-to-market production innovation by size, 2002-2004**



Source: OECD (2007)

Note: SMEs: 10-249 employees for European countries, Australia and Japan (persons employed); 10-99 for New Zealand, 10-299 for Korea, 20-249 for Canada.

151. Nevertheless, around 41 per cent of Australia’s firms are technologically innovative and non-technological innovation was undertaken by 31 per cent of firms. Increasing user-driven and market inspired innovations have occurred in services industries in particular, whereby innovation is created by firms transforming their business offering and capabilities in order to solve customer problems more creatively.
  
152. It is important to note the difference between innovation and invention. R&D only forms an input into the innovation process. Commercialisation is crucial in determining whether an R&D efforts leads to a successful innovation. It is often the case that innovation fails to go anywhere because effective path to market and the end-user fail to materialise. If innovators are successful in commercialising their R&D inventions, these products, services or processes

are likely to be adopted, imitated and built upon by others, i.e. the process of diffusion.

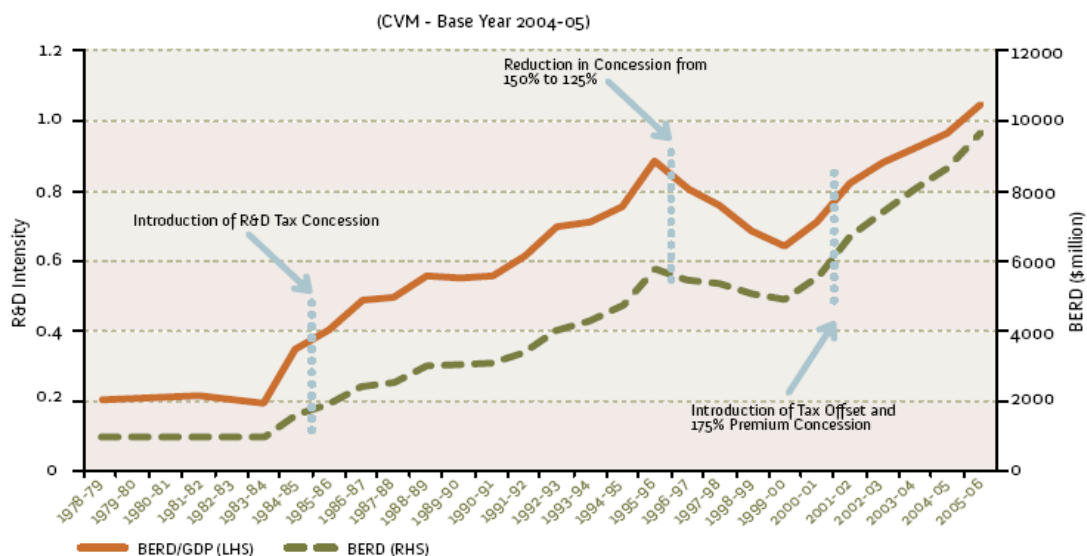
153. Thus, the announcement by the Federal government 2009-10 Budget to provide \$200 million in seed funding to establish the Commonwealth Commercialisation Institute and ongoing funding of \$85 million per year is an important commitment to support for commercialisation.

154. The R&D Tax concession was introduced in 1985 and it is the largest single government innovation layout, currently amounting to over \$500 million annually (Cutler Review, 2008). The tax concession provides an increased deduction (150 per cent in the period 1985-96, 125 per cent thereafter) to be claimed on the volume of R&D expenditure, and this then reduces tax payable with tax loss firms entitled to carry the additional tax deduction forward. In 2001, two new elements have been introduced:

- the Tax Offset – gives small firms in tax loss the option of receiving an early cash payment based on their eligible R&D expenditure, rather than a future entitlement to a deduction; and
- the 175 per cent International Premium – gives companies belong to a multinational enterprise group for additional R&D expenditure on behalf of a grouped foreign company above a rolling three-year average of expenditure.

155. Figure 11 suggests that there exists a strong correlation between the availability of the Concession and a steady increase in business expenditure on R&D.

**Figure 11: Long run trends in business research expenditure**

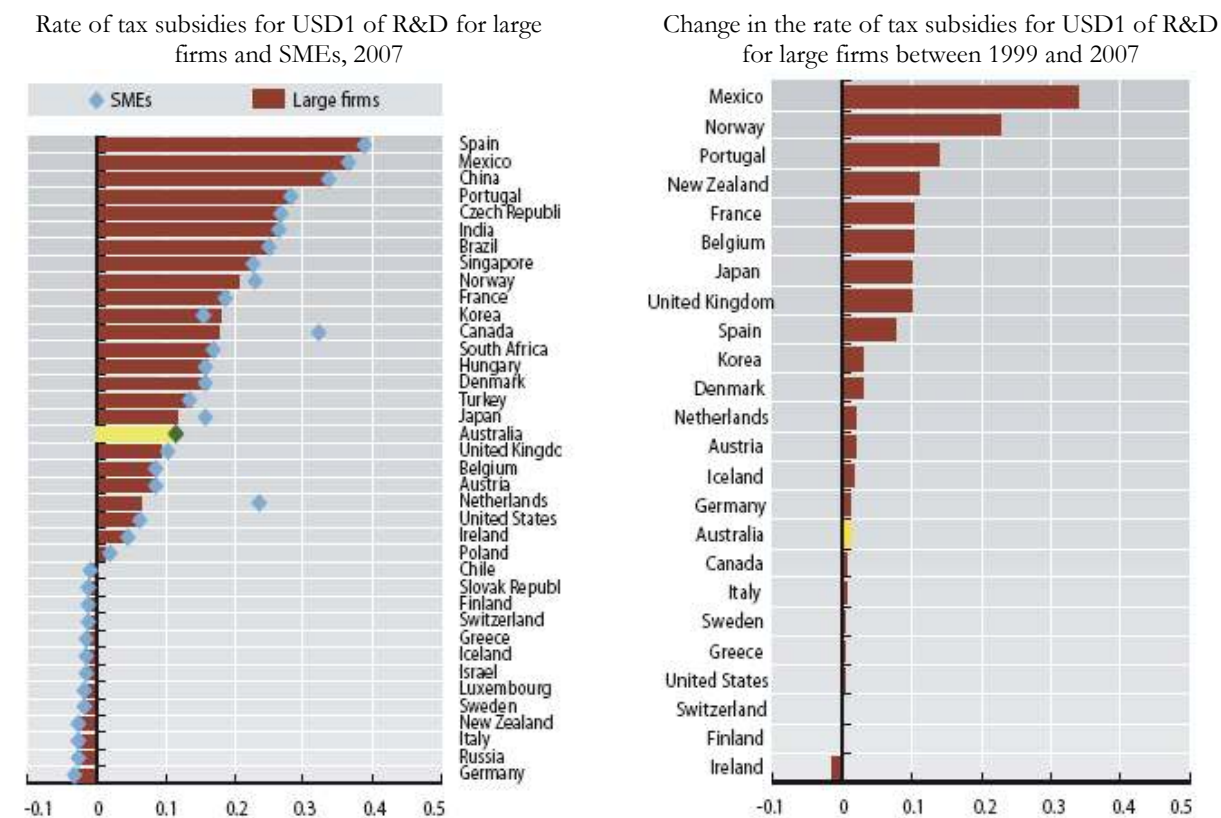


Source: *Cutler Review (2008, p. 103)*



156. It is also evident that the falls in corporate tax rate since 1985 have eroded the effective value of the Concession. Cutler Review (2008, p. 104) indicated that the Concession would need to be raised to well over 175 per cent to regain its original direct incentive value.
157. It is evident from Figure 12 below that Australia’s tax subsidies for R&D are relatively low (both level and growth) compared with other OECD countries in 2007.

**Figure 12: Rate of tax subsidies for USD 1 of R&D – level and growth**



Source: OECD (2007)

158. In the 2009-10 Federal Budget, the government announced a simplified R&D Tax Credit to replace the R&D Tax Concession from 2010-11, which provides:
- a 45 per cent *refundable* credit (equivalent to a Tax Concession of 150 per cent) for firms with an annual turnover of less than \$20 million; and
  - a 40 per cent *non-refundable* credit (equivalent to a Tax Concession of 133 per cent) for firms with a turnover of more than \$20 million (including those that are foreign-owned).

## 7.2 ICT development

159. While Australia cannot access productivity gains from ICT production as in US, Australia has become a high ICT user. In 2000, Australia ranked third (behind the US and Finland) among OECD countries on share of ICT investment as a proportion of non-residential investment, with Australia investing 22.5 percent of total non-residential investment in ICT compared to 8.3 per cent in 1980 (Colecchia & Schreyer, 2001).
160. Colecchia & Schreyer (2001) estimated that the contribution of ICT to Australia’s output growth increased from 0.27 percentage points during the period 1980-85 to 0.79 percentage points during the period 1995-2000.
161. As an importer of ICTs, Australia has benefited from a sizable terms of trade gain through the rapidly declining prices of ICTs. The Australian Treasury stated that ICT prices have fallen in Australian dollar terms by 9.5 per cent a year between 1985 and 2001 (Parham, 2003).
162. Increased in ICT use had contributed above-average MFP growth in finance & insurance, wholesale trade, retail trade and construction industry during the 1990s.
163. As indicated in Table 7, the uptake in ICT has provided opportunities for businesses:
- to undertake existing task more efficiently, cheaply and effectively by substituting ICTs for other inputs, especially labour; and
  - to develop and introduce new value-adding and efficiency-enhancing products and services, process and organisational structures.
164. For example, ICTs development in Australia’s wholesale and retail trade sector has contributed to rapid MFP growth during the 1990s through<sup>14</sup>:
- widespread adoption of product numbering (i.e. barcode) and scanning devices;
  - Enterprise Resource Planning (ERP) system which integrate each department in an organisation, e.g. from marketing to accounts, ordering and finance forecasting; and

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<sup>14</sup> See Johnston et al. (2000).

- development of ‘just-in-time’ inventory management system, including automatic replenishment orders based on stock levels.

**Table 7: Area and nature of impact of ICT uptake on firm performance**

Key area of impact	Nature of impact
1. Labour	- Staff reduction in some cases, but not all. - A shift to more highly skilled labour.
2. Facilities and outsourcing	- Reduction of some in-house facilities and outsourcing of certain functions, sometimes overseas.
3. Production and distribution processes	- Greater consistency and enhancement of product quality. - Increased mechanisation and automation of routine tasks.
4. Management practices	- More timely and accurate management of information. - Improved communication and reporting systems. - Improved inventory management.
5. Product characteristics and mix	- Increased scope for product innovation, including the development of customised products and services.
6. Relationship with customers and suppliers	- Better and more frequent communication with customers and suppliers. - Greater responsiveness to customer needs and more certainty in new product design.

Source: Adapted from *PC(2004) p.57*.

### 7.3 ACCI recommendations

165. While Australia recorded high ICT investment as a proportion of non-residential investment among OECD countries, Australia is lagging behind in terms of resources which both business and governments devote to R&D and innovation. Nonetheless, the nature of our economy including its size, the propensity to adopt and modify technology from overseas and the absence of large industrial complexes serving a domestic market can make international comparisons very difficult.
166. Given the importance of R&D and innovation in Australia’s future productivity growth, ACCI:
- welcomes the announcement of the simplified R&D tax credit from 2010-2011. However, it is important that the definition of eligible R&D expenditure should align with those under the Concession systems for business certainty and consistency;
  - recommends that it is important to ensure that the real value of the R&D tax credit does not erode overtime due to changes in the taxation system;

- recommends that more incentive and assistance have to be focussed on commercialisation such that new R&D ideas and products can be diffused and new invention has value to economy;
- recognises the importance of international collaboration in R&D and innovation and thus global connections need to be created and supported by active policy mechanism.

## 8. INVESTMENT IN INFRASTRUCTURE

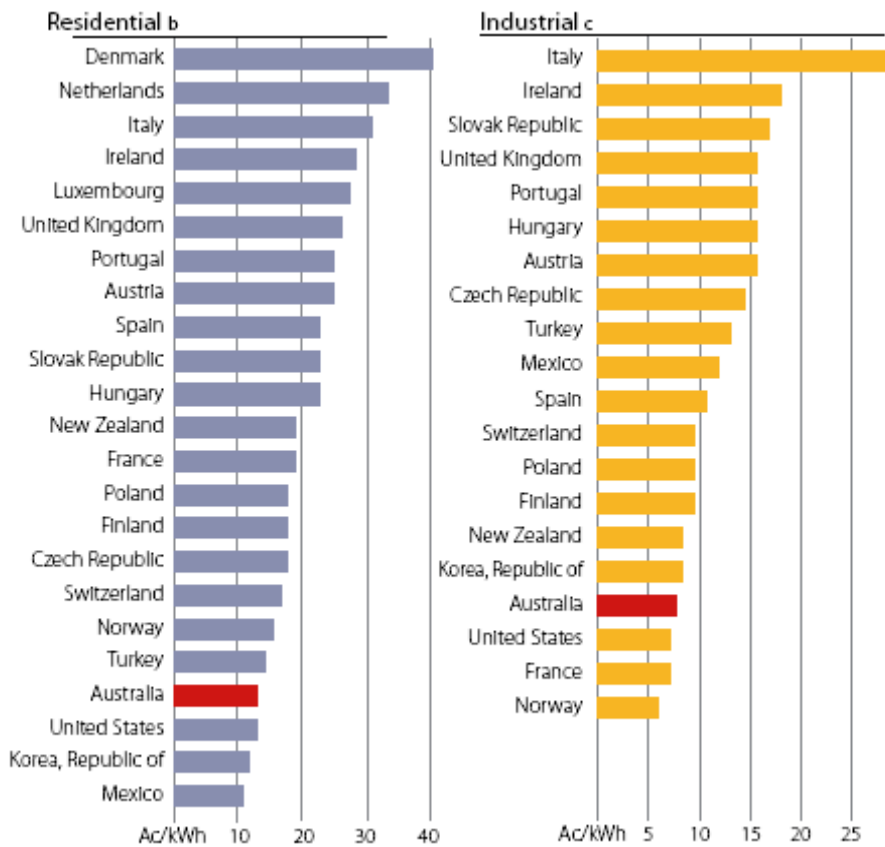
167. Infrastructure development is at the very core of economic growth. Infrastructure is made up of those large-scale projects which allow various economic activities to blend into a single efficient structure. These include but are not restricted to power generation, transport networks, telecommunication and other utilities. For Australia’s national economic prosperity and productivity growth, it is imperative that infrastructure is constantly developed at rate comparable to its demand and with other highly developed nations.
168. Infrastructure has been often provided by the public sector due to its large-scale and requiring immense amounts of capital investment during its initial outlay. Aschauer (1989) argued that public investment in ‘core’ non-military structures such as highways, streets, airports, electrical and gas facilities, mass transits, water systems and sewers, play an important role in the course of economic growth and productivity improvement.
169. Moreover, the geographical disadvantages flowing from the dispersed and sparse settlement fragments of the Australian economy can only be ameliorated through effective infrastructure network including freight transport policy.

### 8.1 Energy

170. Australia’s international competitiveness and economic and social well-being depend on reliable, affordable and sustainable energy supplies. They are important inputs for most business activities and are essential for supporting basic quality of life.
171. Over the last decade, the Australian energy sector has undergone significant reform through the National Competition Policy (NCP). The NCP electricity and gas reforms have been focussing on efforts to create an efficient national energy market in Australia. Despite the progress made under NCP, more needs to be done to realise the COAG’s vision for a national energy market. The National Electricity Market (NEM) is still largely a series of regional markets with limited transmission links and interconnection and the gas markets is immature and developing (PC, 2005a).
172. Nevertheless, NCP reform in electricity has brought about substantial price reductions which benefited businesses more than households. While electricity charges for households increased by 4 per cent, businesses experienced 27 per cent price reductions between 1990-91 and 2003-04. This partly reflects intentional ‘rebalancing’ of prices between businesses and households to more closely reflect the costs of providing services to each sector (PC, 2005a).

173. Australian electricity prices are among the lowest among the OECD countries as depicted in Figure 13.

**Figure 13: Electricity prices in selected OECD countries, 2007**



Source: *Energy in Australia 2009*

Note: **b** Australian price is based on ABS residential electricity price index. **c** Australian price is based on ABS commercial electricity price index, which may overestimate the industrial price.

174. Given the abundance of coal reserves along the eastern seaboard and its relative low cost, the majority of Australia’s electricity is produced using coal which accounts for 84 per cent of all fuels consumed by generators in 2006-07.

175. Thus, the recent proposed Carbon Pollution Reduction Scheme (CPRS) to reduce Australia’s greenhouse gas emissions is expected to transform Australian energy production and consumption over the next decades. The transformation will not be possible without a very substantial investment commitment to meet the growth in demand and the orderly replacement and refurbishment of the existing capital stock.

176. A poorly constructed CPRS which exceeds commitments adopted internationally may damage Australia’s economic position and compromise the

relative competitive advantage Australia achieves through less expensive energy costs.

177. A range of policy measures have also been introduced to encourage the uptake and development of renewable energy, such as wind, solar and hydro electricity generations. These measures include the Australian Government’s Mandatory Renewable Energy Target (MRET), in which the Australian Government committed to ensuring 20 per cent of Australia’s electricity supply comes from renewable energy sources by 2020.

### **8.1.1 Energy: ACCI recommendations**

178. In order to ensure affordable, clean, efficient and sustainable energy supplies, it is important to:

- further strengthen competition in electricity generation sector;
- provide cost-reflective price signals to end users for better demand management and full retail contestability;
- achieve a nationally coordinated approach to energy markets regulation across Australia. Improved regulatory governance could help reduce regulatory risk for infrastructure investment, business compliance costs and regulatory administration costs;
- ensure consistent, predictable and commercially attractive regulatory, institutional and governance frameworks to facilitate timely energy investment;
- ensure appropriate new transmission network investments and upgrades of existing distributional network to better manage the risk of congestion and sudden surge in demand;
- ensure neutrality between the source of energy use for electricity generation. Accordingly, nuclear energy should not be precluded for consideration as part of Australia’s future energy mix; and
- note the market distortion created by the Mandatory Renewable Energy Target (MRET) which will result in higher energy prices and economic inefficiency. Thus, upon the implementation of an emissions trading scheme, the MRET should be gradually unwound.

## 8.2 Freight and passenger transport

179. Given Australia’s distance and remoteness from the global market and the sparseness of population settlement, greater infrastructure requirements per head of population to connect large sparsely populated areas outside of capital cities affect the overall productivity performance of Australia.
180. Thus it is crucial that Australia’s businesses and households have access to an efficient and cost effective freight and passenger transport system, in order to ameliorate the consequences of market fragmentation and the dispersion of Australia’s population hubs.
181. The movement of urban freight is dominated by road transport, reflecting its suitability for door-to-door pick-up and delivery. It is forecasted that Australia’s road freight tonnages will increase by 70 per cent in the next 20 years (PC, 2005a). Growth in this magnitude will cause significant negative externalities including road congestion, noise pollution as well as greenhouse gas emissions.
182. Therefore, it is important to promote an Australian freight transport system that encourages efficient mix of transport modes and provides a seamless movement of freight along the entire logistics chain. In order to achieve this outcome, PC (2005a) has identified the following key impediments that need to be resolved:
- the lack of competitive neutrality across transport modes;
  - the quality and capacity of inter-modal connections; and
  - continuing barriers to efficiency and productivity within individual transport modes
183. The disparities in the freight transport pricing and the standard of infrastructure across transport modes need to be addressed to promote neutrality in the choice of transport mode. Underpricing of road freight transport coupled with poor quality of rail infrastructure along some transport corridors has caused the current overuse of road transport.
184. In order to maximise the efficiency of the national freight network along the logistics chain, it is essential to identify and address any bottlenecks that may restrict the seamless transfer of freight across different transport modes.
185. Bottlenecks in Australia’s rail infrastructure have also contributed to the decline in mining industry productivity between 2000-01 and 2006-07 (Topp et



al., 2008). The constraints in rail and port infrastructure intensified as supply chains become more congested due to the recent mining boom.

186. The congestion in east coast coal handling systems, for example, has resulted in the implementation of queue management scheme, where coal companies allocated rail network quota between them as a short-term measure to ensure the certainty of their export capacity. Although it provided a temporary solution, the system led to significant inefficiencies, whereby companies that did not fill their quota were not always able to reallocate the unused quota to other companies and caused underutilisation in the logistics chain.

187. Australia’s rapid population growth especially in the main capital cities as well as inefficient public transport system has also caused significant increase in the use of private motor vehicles. Private vehicles now account for 93 per cent of total urban passenger kilometres travelled via all transport models and over 80 per cent of total passenger kilometres travelled (PC, 2005a).

188. The high rate of private motor vehicles usage has caused significant externalities including:

- traffic congestions in major capital cities, which cost the economy around \$13 billion per year and this cost is estimated to rise to almost \$30 billion a year by 2015 (PC, 2005a); and
- the high level of energy consumption, greenhouse gas emissions, and considerable noise and air pollutions in some urban areas. Australia’s transportation sector is the third largest greenhouse gas emitters, contributing around 14 per cent of Australia’s net greenhouse gas emissions in 2006.

189. Thus it is important to improve the efficiency and accessibility of alternative passenger transport options including public transport and taxis services to reduce the usage of private vehicles.

### **8.2.1 Transport: ACCI recommendations**

190. PC (2006) estimated that a 5 per cent improvement in road and rail freight transport productivity and a 10 per cent productivity improvement in container ports could generate a potential cost saving of about \$2 billion and \$160 million in 2005-06 dollars term respectively.

191. Thus it is important:

- to ensure that the importance of continuous improvement in transport infrastructure is widely recognised and that adequate investment

planning, evaluation and expenditure are in the pipeline through the economic cycle;

- to encourage greater private sector involvement in Australia’s infrastructure development by ensuring that the private sector is actively encouraged by governments to become participants at all stages of the infrastructure development process. Most importantly the legislative and taxation obstacles should be phased out to increase private sector infrastructure involvement;
- to ensure that all infrastructure proposals, particularly those that involve outlay of public funds, are subjected to a rigorous and transparent cost-benefit analysis which examines the net economic, social and environmental benefits of any projects;
- to conduct a sound and transparent audits of Australia’s infrastructure stocks on a regular basis to identify and address potential bottlenecks;
- to establish transparent benchmarks or targets of appropriate infrastructure service level to meet the user-demand and improve accountability, e.g. the maximum freight transit times allow from mines to ports; and
- to reduce the level of intrusive government regulations which raise the cost of infrastructure provision while providing no additional safeguards or benefits to the community. This includes greater harmonisation of regulatory processes across different jurisdictions.

## 9. HUMAN CAPITAL INVESTMENT

### 9.1 Introduction

192. Australian industry needs a skilled, flexible and motivated workforce that further contributes to productivity gains and drives economic growth. Ensuring that the available workforce has the skills and knowledge required to meet the skills needs of employers is a prominent issue for business and industry in Australia.
193. Addressing increasing unemployment following the global financial crisis and driving productivity growth need to be the central focus of governments and the Australian business community. In a year of economic uncertainty, it will be necessary to ensure every effort is made to secure jobs and drive productivity gains across all industries. The actions of today must set the foundations for economic strength for future years.
194. If the training momentum is not maintained or increased, there is a danger that Australia could find itself in the perverse situation of exacerbated skills shortages during a time of weakened labour market demand. This could prolong the economic downturn rather than providing a way for the Australian business community to expand activities to return to economic prosperity.
195. There is a great risk to the future growth of Australia’s productivity during a cyclical rebound if new apprentices are not recruited and existing apprentices do not complete their trades training.

#### 9.1.1 ACCI recommendations

196. ACCI believes that in the drive for economic growth and productivity, we need to ensure that a number of key objectives are adhered to. They are to:
- **ensure that training initiatives are driven by industry need** - the business community has a major role in ensuring that government effort is focused on those sectors of the economy where it is most needed and can provide maximum benefit to industry and the broader economy;
  - **secure jobs now and into the future** by ensuring that there is a best fit between the skills base required within the workplace and the training effort;
  - **plan for future skills needs** so that as Australia emerges from the Global Financial Crisis we have the required pool of skills and knowledge to drive productivity and economic growth;

- **encourage the retention of apprentices** through targeted incentives that encourage employers to retain apprentices for the duration of their training; and
- **ensure a strategic focus on job outcomes** which does not result in ‘churning’ more highly qualified individuals.

## 9.2 Workforce participation and social inclusion

197. Government policy should be set to maximise the potential for all Australians to be competitive in the employment market.
198. The Commonwealth Government has committed to working in partnership with business, employee associations, the not-for-profit sector and the wider community to develop employment opportunities for groups who are under-represented in the Australian workforce. The Commonwealth Government’s approach to increasing workforce participation through the new employment services contract includes supply-side policy measures that address the barriers to participation. The supply side measures include ensuring the provision of childcare for those returning to the workforce and further investment in skills and education to upgrade skills and ensure that new and returning entrants into the workforce have current skills. Demand strategies that encourage employers to provide employment opportunities for these groups through targeted incentives have also been mooted.
199. ACCI stresses the importance of involving employers in developing strategies that will ultimately lead to sustainable employment outcomes for those outside the workforce. Job Service Australia (JSA) Providers need to work with employers to ensure that jobseekers have both the required skills and a work ready attitude to ensure smooth transitions into the workforce.
200. It will be necessary for the Commonwealth Government to develop regionally focussed Labour Market Adjustment Programs (LMAPs) to target newly unemployed workers from major retrenchments. The LMAPs will need to offer intensive career transition support to newly unemployed workers that identify new career paths for the candidate, recognising the skills of the candidate through Recognition of Prior Learning processes, offers training to upskill the candidate and, if necessary, re-location support if the employment base in the candidate’s region is unable to sustain employment levels. Relocation assistance will be particularly important for regions with a strong resources sector presence but with few other employment prospects.
201. The Federal Government has stated that one third of training places under the Productivity Places Program will be for people currently outside the workforce. In many cases, those currently outside the workforce face multiple

barriers to engaging in employment or training activities. Intensive support is often required to assist those people engage with further education and training and ultimately, the transition from welfare into sustainable employment. The delivery of targeted vocationally specific literacy and numeracy development as well as a concentration on generic employability skills will be required before this group can progress into employment or further education.

### 9.2.1 AC CI recommendations

202. The Commonwealth Government needs to ensure that Job Services Australia providers are adequately resourced and connected to ensure that those currently outside the workforce have access to programs and initiatives that will facilitate transitions into the workforce.
203. To the best extent possible, State and Territory employment based programs should complement and harmonise with Commonwealth programs. Overlap and duplication of services should be avoided and national consistency should be the desired goal, while allowing for regional variations and local delivery.
204. The strategic provision of careers information, advice support and products needs to be integrated across the full range of employment services to ensure better targeting of education and training dollars.

### 9.2.2 Employment for people with disabilities and mental health issues

205. According to the Australian Bureau of Statistics, some form of disability affects about one in five Australians<sup>15</sup>. At 30 June 2007, there were around 714 200 recipients of the Disability Support Pension, 116 600 recipients of the Carer Payment, 407 900 recipients of the Carer Allowance, and around 54 900 recipients of the Mobility Allowance.<sup>16</sup>
206. The opportunity cost to the community of not employing People with a Disability (PWD) is considerable. According to the Australian Institute for Health and Welfare “*Where there is unmet demand for employment services, pressure may be placed on other service types. For instance, if people with a disability cannot access sufficient support to find or keep work they may leave the labour force, potentially increasing demand for community access services (as an alternative source of day-time activity) and*

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<sup>15</sup> ABS,

<http://www.abs.gov.au/websitedbs/c311215.nsf/20564c23f3183fdaca25672100813ef1/29ac3ed8564fe715ca256943002c4e3c!OpenDocument>, 24 June 2008

<sup>16</sup> Source: FaCSIA (unpublished); DEWR (unpublished); quoted in Phillips, J., *Disability support and services in Australia*, APH Background Note, 16 June 2008 (online publication)

*respite and accommodation support services (where people require informal or formal assistance to remain at home during the day). Timely access to employment support is particularly important for school leavers and for people with psychiatric disability exiting crisis care delivered through the health sector<sup>17</sup>.”*

207. Current workforce development strategies do not identify employment of PWD as an option for meeting current and future needs. There is a lack of understanding about the skill levels of PWD and the extent of disability and the impact it might have in the workplace.

### **9.2.2.1 ACCI recommendation**

208. The Commonwealth Government needs to support the employment of PWDs through providing business focussed tools, workshops and networking for business and industry. Practical “how to” approaches, written in business language, not bureaucratic jargon, would also improve the chances of increasing employment outcomes.

### **9.2.3 Indigenous employment and training**

209. ACCI recognises the shared responsibility of all Australians, including business and industry in developing a responsive Australian employment, education and training system that takes account of:

- the importance of Indigenous community leadership seeking genuine employment, education and training outcomes;
- a reduction in welfare dependency through mutual obligation and development of appropriate strategies to encourage employment in the general labour market;
- the recognition of the diverse location of Indigenous peoples in Australia, particularly in rural and remote communities;
- the considerable potential that Indigenous Australians have in contributing to the national economy; and
- the role business can play in offering more jobs to Indigenous job seekers.

210. ACCI has a long standing commitment to equal employment opportunities for all groups in the community and for non-discriminatory employment practices by employers.

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<sup>17</sup> Australian Institute of Health and Welfare, June 2007, *Current and future demand for specialist disability services*, Canberra, p100

211. ACCI supports the priority being attached by Aboriginal and Torres Strait Island people to economic independence and supports the objective of increasing participation by these people in private sector employment.
212. We recognise that measures aimed at growing Indigenous participation in the private employment sector are positive steps to creating and maintaining an economic base within Indigenous communities and a move away from welfare dependency for many Indigenous Australians.
213. In the modern business environment of productivity and efficiency, workers are required to perform many different tasks and be able to understand the holistic goals of the organisation, they must be adaptable to change, able to fit into many differing roles across the scope of the organisation and be able to adapt to new technology and work practices quickly.
214. The Department of Education, Employment and Workplace Relations (DEEWR) funded the development of the Employability Skills Profiler (ESP), which objectively assesses a job seeker’s generic or transferable skills and shows how well the job seeker’s skills fit with the skills required by over 1000 job types.
215. ESP shows how well the job seeker’s skills fit with the skills required for their job preferences, as well as other jobs that they may be suited to but may not have previously considered. Where the job seeker’s fit with a particular job type could be improved ESP also offers training advice.
216. ESP improves job seeker confidence and motivation by demonstrating that they do possess skills that employers look for. ESP assists consultants by encouraging the job seeker to either refine or broaden their job search. ESP reports may also be used to market job seekers to employers<sup>18</sup>.
217. Employability skills development courses, when combined with Vocational Education and Training (VET) competencies can be used to prepare Indigenous Australians for the workforce and used as a vehicle for job placement that often leads to permanent employment.
218. Employability skills development programs also prepare Indigenous Australians for entry into New Enterprise Incentive Scheme (NEIS) programs and establishing their own business.

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<sup>18</sup> <http://www.workplace.gov.au/workplace/Organisation/ServiceProvider/ESP/>

219. Many Indigenous communities own and control vast tracts of land used to varying degrees by those communities to generate income but that potentially could provide even greater sustainable employment and economic growth for the community.
220. While it is understood and respected that land holds spiritual significance for Indigenous communities, making better economic use of land could yield value for communities to build an economic base “in country”.
221. Land, combined with traditional knowledge, has the potential to be a valuable asset, which if the full commercial potential can be realized, may translate into creating wealth and employment opportunities for the community on an ongoing basis rather than one off project type activities.
222. To provide security of employment, an economic base needs to be established and developed in country. There are many potential industry bases that could be considered in remote and regional Australia – horticulture, agriculture, pastoral activities, mining and cultural activities.
223. These industries are already successful in some rural and remote areas and with business planning could be expanded in a more systemic way. All stages of the business cycle need to be considered from researching, planning, marketing and financing.
224. There is a space in building Indigenous economic bases that is not fully utilised by tapping into existing business and industry networks. The establishment of Indigenous enterprises in partnership with existing business people, either directly or indirectly could take place in a more organised way to build up economic activity “in country”.
225. The report *Overcoming Indigenous Disadvantage Key Indicators 2009*<sup>19</sup> suggests that self employment is one way that Indigenous people can reduce dependence on government welfare and improve self reliance.
226. It also enables them to participate in the economy and improve their economic wellbeing. Indigenous business has the potential to contribute to economic participation and development for Indigenous people.

### 9.2.3.1 ACCI recommendations

227. The special focus on developing Indigenous small businesses recognises the need to encourage private sector participation both in employment and

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<sup>19</sup> [http://www.pc.gov.au/data/assets/pdf\\_file/0003/90129/key-indicators-2009.pdf](http://www.pc.gov.au/data/assets/pdf_file/0003/90129/key-indicators-2009.pdf), p 8.33



entrepreneurial endeavour. This will assist natural business leaders within the Indigenous community to develop and provide role models for their communities in building sustainable economic bases and real employment opportunities in the future. Consideration of tax driven incentives and other initiatives maybe appropriate to encourage partnership approaches to the development of Indigenous businesses.

228. The Australian Government should utilise the ESP to assist Indigenous Australians in identifying their employability strengths to connect to targeted training pathways including preparing for self-employment pathways.

### **9.3 Schools and transitions**

229. Successful transitions from school to the world of work and beyond are of critical importance for Australia’s youth and society in general. National Centre for Vocational Education Research (NCVER) research shows that part time and casual employment have a particularly positive effect on the transition to successful post-school activities for school leavers. There are very few people in Australia who will not participate in paid or unpaid work at some point in their lives, and an understanding of the world of work and access to quality education that recognises the contribution that employment can make to an educational outcome contributes strongly towards achieving successful transitions. Beyond the development of employability skills, the wider value to the student participation in a structured social environment is very real. Similarly there are positive benefits to society from a school to work transition based on learning through employment participation.
230. Business and industry have successfully developed such partnerships with schools and training providers at a local level. Considerable success is often achieved in mentoring programs that target socially and educationally disadvantaged students and partnering them with business or community leaders.
231. A strong skills foundation for individuals supported by the implementation of an effective schools and transition education system is an essential combination to build vital future world-class skills and maintain Australia’s competitiveness in a global market in the 21<sup>st</sup> century.
232. Leaving school early reduces a student's chances of successful labour market outcome, placing them at considerable disadvantage. By comparison, those who complete Year 12:
- have an increased employment participation;

- higher income levels;
- are likely to have shorter periods of unemployment;
- are more likely to participate more in further education and training; and
- have, on average, better health than those who leave school early.

### **9.3.1 ACCI recommendation**

233. It is essential that an engaging and broad ranging curriculum that includes strong elements of Vocational Education and Training be developed. This will help capture the interest of students to make them want to continue schooling as opposed to artificially boosting school retention and lowering the quality of outcomes by placing restraints on access to external employment and training pathways for those who wish to leave school early.

## **9.4 Careers advice**

234. Career development becomes increasingly important for public policy as education and employment policies seek to widen choices and to create systems which can respond to varying needs of the individual across a lifespan. The delivery of career education in schools is seen as vital to assisting young people at an early age to identify employment pathways and thus make appropriate subject choices whilst at school, as well as in making decisions about their future education and training.

235. The importance of career development in assisting young people to make a successful transition from school to further education, training and employment has been highlighted in various reports and agreements in recent years.

### **9.4.1 ACCI recommendations**

236. ACCI proposes that:

- the organisation and delivery of career education and advice services across the country must be subject to strategic leadership with stakeholders incorporating national consistency for delivery of career education and advice services and workforce qualifications;
- there be a national vision for career guidance that includes a strategy for delivering lifelong access to career guidance involving both government and industry stakeholders;

- there needs to be greater diversity in the types of career services that are available and in ways that they are delivered, including greater diversity in staffing structures, wider use of self-help techniques, and a more integrated approach to the use of information and communications technology (ICT);
- policymakers need to explore the scope for facilitating measures, including appropriate incentives, designed to encourage the development of career guidance services within the private and voluntary sectors;
- the career guidance workforce needs to be professional with the need for minimum qualifications for occupational service. Improved access to appropriate workforce training is required; and
- jurisdictional data related to the delivery of career education and advice must be made available to the public and subject to systematic discussion and inquiry for development of effective public policy of career services.

## **9.5 Vocational Education and Training pathways**

237. ACCI considers that the centrality of business and industry must remain the core premise in Vocational Education and Training (VET). The purpose of VET is to prepare students for the rigours of the workplace and provide them with the skills and knowledge to allow them to actively participate in the Australian workforce and effectively contribute to productivity growth in the workplace.
238. The inflexibility and mismatch of skills that often occurs in Australian VET most often stems from the supply driven approaches of funding models applied by governments and training providers. VET funding models need to ensure that Registered Training Organisations (RTOs) have the capacity to effectively transfer the relevant skills to boost the skills base of the Australian population, increase workforce participation and feed the labour needs of Australian industry. In order to achieve this, it is essential that funding in VET be driven by demand from business and industry and the individual.
239. The pathways undertaken by individuals as they move between the varying education sectors and work are diverse. The journey from education to employment is no longer a continuous trajectory involving predetermined progression and an easily identifiable ladder of opportunity. As such, traditional supply driven models of funding can lead to individuals not having access to the training that they desire and a mismatch of skills to what is required to assist them in employment.

240. The core principle of funding VET must be to ensure that training allocations are driven by direct demand from business and industry. Funding should be attached to the individual learner, either through the employer for existing workers, or through a JSA provider or school, in consultation with employers for new entrants. Funding should be focussed on achieving a vocational outcome in line the skills needs of business and industry and the aspirations of the individual as opposed to the institutionally based funding we have at present which focussed on a Unit of Competency outcomes determined by the provider and the State Training Authority (STA).

### **9.5.1 ACCI recommendations**

241. ACCI proposes that the Government:

- provide a fair distribution of funds between public and private providers who provide accredited training in priority areas ;
- build a clear, easily understood and administered system for the recognition of prior learning as a means of encouraging learners to take up vocational qualifications; and
- provide an appropriate balance between government, the enterprise and the individual in funding VET without a compulsory levy being imposed on employers.

## **9.6 Upskilling existing workers**

242. Productivity gains can be driven through upskilling the existing workforce to ensure that there is a best fit between the skills base required within the workplace and the existing workforce. This can be achieved through the rollout of phase two of the Productivity Places Program (PPP) and the engagement of Australian business and industry to ensure that the training directly matches the skills needs of employers.

243. The federal government needs to secure the current workforce and drive productivity growth through programs that will effectively upskill existing workers. This can be achieved through ensuring a demand driven approach through the implementation of phase two of the PPP being driven by the identified skills needs of Australian industry and not a supply driven approach tied to existing course offerings of RTOs.

244. One approach to minimising training costs and maximising return on investment in training is increased commitment to upskilling existing workers to trade level or higher-level qualifications. In many cases, existing workers have a sound level of knowledge of the work environment and the required

job specific skills base. Existing workers also have had exposure to the industry and, unlike many new entrants into the industry, will have formed an understanding of the nature of the work and preconceived expectations of their employment within the industry, and thus have an increased likelihood to complete training. The Support for Mid-Career Apprentices Program needs to be more widely publicised amongst employers and the benefits of upskilling existing employees made more explicit.

245. The Commonwealth Government needs to consider changes to the current stipulation that Australian Apprentices (not in areas of skill shortage) are not eligible for incentives if they have ‘a prior qualification within the last 7 years’ to encourage more existing workers and re-entrants to undertake adult apprenticeships.
246. The Federal Government needs to ensure that the skills needs of small and medium enterprises (SMEs) are adequately met by the PPP. Eligibility for the Productivity Places Program should be broadened, especially where employers are looking at combining options that include training for existing workers with reduced or flexible working hours where permitted by industrial relations regulations.
247. All Australian businesses must have access to effective business planning and workforce development and diagnostic tools and training needs analysis (TNAs) and assistance. Access to TNAs and workforce development and diagnostic tools in the workplace would enable many businesses to identify areas of potential productivity growth and facilitate training for existing workers to meet the skills needs or enable the business to hire new staff.
248. Increased access to TNAs and workforce development and diagnostic tools would facilitate the better use of and access to Recognition of Prior Learning (RPL) to recognise the skills of existing workers. In 2007, 50 000 out of the 1.1 million VET students in Australia received RPL for all or part of their training. Increasing effective RPL pathways could effectively decrease training cost to Government by reducing the training cost and effort by RTOs.
249. One of the keys to success for phase two of the PPP will be in how it engages with small and medium enterprises (SMEs). ACCI welcomes the engagement of Industry Skills Councils in working with large enterprises to meet skills and training needs under Phase two of the PPP but has assessed that there needs to be a greater emphasis put on the skills needs of SMEs.
250. Business and industry associations are well placed to work with SMEs to identify skills needs and advise on training opportunities to address those

needs and could play a brokerage role in this respect in a similar way already adopted by the Rudd Government in relation to employment services.

### **9.6.1 ACCI recommendations**

251. Provide Australian businesses with access to effective business planning and workforce development and diagnostic tools and TNA assistance.
252. Under the PPP, place a greater emphasis on the skills needs of SMEs.
253. Business and industry associations must have a major role in ensuring that training is made available in those sectors of the economy where it is most needed, those sectors of the economy that will drive productivity and economic growth and provide employment opportunities for Australian workers.
254. There is also a role for Skills Australia to work with State and Territory Agencies to identify infrastructure and community projects to ensure that money spent in supporting the business community is well targeted, meets current project requirements and leads to long term skill sustainability.

## **9.7 Apprenticeship training**

255. There is mounting evidence that employers are becoming reluctant to hire apprentices in the current economic climate. Many employers are struggling to retain skilled staff and do not want to risk taking on new staff, especially those who are not yet fully productive in the workplace.
256. Not only should the government be doing all it can to support employers in assisting apprentices to complete their training, but also they should be encouraging employers to take on new apprentices through the use of incentives and strong support services.
257. Apprenticeship training should prepare people for specific occupations to be pursued immediately after the completion of their qualification, but it should also prepare apprentices for further learning. Thus it is important to ensure that training includes promoting the willingness to learn and fosters personal development.
258. To work in the modern knowledge society, employees must be able to plan, carry out and check their work in an integrated manner; apprenticeship training must be oriented towards this aim. Apprenticeships must promote employability in a changing work environment. It must include strong technical skills directly relevant to the needs of industry along with generic

skills such as strong language, literacy and numeracy and employability skills that will guarantee the portability of the apprentice’s skills base.

### **9.7.1 Incentive payments**

259. Current levels of incentives for businesses under User Choice and Targeted Initiative Funding only meet a small proportion of the total costs of training an apprentice, which is estimated to cost around \$128,000. Reform of current incentives for training is needed to streamline the payment framework, minimise administration and maximise the benefits gained from publicly funded training incentives.
260. Consideration should be given to restructuring the way in which apprenticeship incentives are paid. By increasing the percentage of the incentives paid upfront to employers and staggering payments to support cash flow during the time when an apprentice is least productive (i.e. in their first two years of training), greater support would be provided to the employer during the initial years of the apprentice training.
261. The incentives for Certificate III Apprenticeships need to be increased across all streams. The incentives at all stages should be increased to a total of \$14,000 with \$10,000 during the life of the agreement but with an emphasis on the first two years and \$4,000 on completion.
262. ACCI supports additional incentives being paid to employers to take on an out of trade apprentice and/or an unemployed person from an identified high risk group such a high unemployment region, Indigenous or Person with a Disability (PWD).
263. Another measure ACCI sees considerable value in is payroll tax exemptions for apprentice wages. In addition to an exemption on apprentice wages, ACCI proposes that a reduction of 25 per cent on the overall payroll tax liability be put in place for all businesses employing more than 6 per cent of their workforce as apprentices.

### **9.7.2 ACCI recommendations**

264. ACCI proposes that:
- apprentices’ strong technical skills be directly relevant to the needs of industry along with generic skills such as strong language, literacy and numeracy and employability skills that will guarantee the portability of the apprentice’s skills base;
  - the level of incentives to employers of apprentices is raised to \$14,000;

- additional incentives are provided where an apprentice completes his/her training in a reduced timeframe; and
- State and Territory governments exempt apprentice wages by 25 per cent on the overall payroll tax liability where a business employs more than 6 per cent of their workforce as apprentices.

## 9.8 Skilled migration

265. ACCI advocates for the government to develop an integrated and transparent population policy. The policy should bring together a range of stakeholders and deal with the key issues of the level of immigration required and the appropriate categories of permanent and temporary stay visas, incentives for Australians to have children and the potential impact of these policies on services in metropolitan, regional and remote areas.
266. A National Population Policy should go beyond issues of population size, to encompass a broader framework which includes *inter alia* policies for education and training, infrastructure, the environment, employment and workforce planning, and regional development planning.
267. Coordination at the highest levels of multiple governments will be required to bring these areas together holistically given that they interact on multiple levels, the macroeconomic level and on individuals.
268. ACCI also highlights the importance of the 457 visa program to Australian business and the need for it to be streamlined, for better utilisation of the humanitarian program to deal with unskilled labour shortages, in pressing for an increase in the level of permanent skilled migration and in seeking greater transparency in the reporting of the net intake of skilled migrants within this program.

### 9.8.1 ACCI recommendations

269. The Commonwealth and State and Territory governments should work collectively to develop an Australian population policy based on a cross portfolio approach, bringing together data from education, training and migration in a strategic and synthesised plan.
270. ACCI continues to advocate for flexibility in 457 visa criteria, balanced with integrity safeguards that will enable a swift and efficient response to meeting labour market needs. The effectiveness of the 457 and other visas in meeting business needs should be reviewed on a regular basis to measure delivery of labour supply to the business community in changing economic circumstances.



## 10. WORKPLACE RELATIONS

### 10.1 Introduction

271. Labour market reform is obviously an important sub-set of microeconomic reforms and therefore highly relevant for this Committee to consider within the context of the inquiry terms of reference. The section attempts to trace a number of key reforms and discuss this with reference to its effect on productivity.

272. It is essential that labour market regulation is flexible and adaptable to changes in the domestic and global economy. In today’s modern economy, these changes take place much more quickly and dramatically than previously were the case, and as such, firms must be able to react with respect to their workforce in a similar fashion.

### 10.2 Workplace relations reforms

273. The history of industrial relations reform in Australia spans over 100 years<sup>20</sup>. In summary, the most significant reforms started in the 1990s by virtue of the 1992 and 1993 reforms which entrenched collective based enterprise agreements as an alternative means to labour regulation through industrial awards.

274. The two most significant recent policy reforms occurred in 1996 and 2005 by amendments to the *Workplace Relations Act 1996* (WR Act), and the passage of building and construction industry laws, as contained in the *Building and Construction Industry Improvement Act 2005* (BCIIA). In addition, the former Coalition Government’s *Independent Contractors Act 2006* also went some way to reduce employment laws applying to independent contractors. These reforms had a positive impact on productivity, as well as levels of unemployment across Australia.

275. In 2008 and 2009, further significant reforms were made to workplace relations laws, through the passage of the *Fair Work Act 2009* (FW Act) and associated legislation. This was the first time in over 100 years that workplace relations regulation was completely re-written. Whilst most provisions have commenced on 1 July 2009, new “modernised” industrial awards and National Employment Standards (NES) will commence on 1 January 2010. There is also legislation to substantially repeal the BCIIA.

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<sup>20</sup> Pages 3 to 8 of the *Econtech* report (August 2007) *The Economic Effects of Industrial Relations Reforms since 1993* provides a broad summary of key changes from 1993.

### 10.3 Impact of past reforms

276. On 10 August 2007 ACCI released an report it commissioned from *Econtech*, titled “*The Economic Effects Of Industrial Relations Reforms Since 1993*”<sup>21</sup>.
277. The terms of reference were to analyse what would be the economic impact should all the major industrial relations reforms in Australia from 1993 onwards be reversed. These reforms include the *Industrial Relations Reform Act 1993*, the *Workplace Relations Act 1996* and the *Workplace Relations Amendment (WorkChoices) Act 2005*.
278. In summary, the *Econtech* report found that:
- the Australian industrial relations reforms from 1993 onwards are estimated conservatively to have reduced the structural unemployment rate by at least **1.77 percentage points**;
  - the industrial relations reforms from 1993 onwards are estimated to increase labour productivity by **1.4 per cent**; and
  - the strong growth in labour productivity since 1992/93 supports the view that industrial relations reform has boosted productivity.
279. Whilst the ACCI commissioned research was published before the Government implemented its Fair Work system, it must be noted that many elements of the former reforms were retained, including prohibitions on unlawful industrial action, pattern bargaining, secondary boycotts, strike pay, and qualifying periods for unfair dismissal.
280. However new bargaining rules, transmission of business, removal of small business exemptions for unfair dismissals, right of entry, re-regulation of awards and removal of individual agreements, were identified by business as likely to have negative implications for employment and labour market flexibility. These matters were identified in detail by the ACCI employer network during various Senate Committee inquiries into the Fair Work Bill and associated legislation during 2008 and 2009<sup>22</sup>.
281. Recent comments by Reserve Bank of Australia Governor, Glen Stevens, before this Committee on 14 August 2009 also indicates the positive contribution flexible labour market conditions has had on the economy:

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<sup>21</sup> [http://www.econtech.com.au/information/Industry/EcontechAugust2007\\_ACCI.pdf](http://www.econtech.com.au/information/Industry/EcontechAugust2007_ACCI.pdf)

<sup>22</sup> A copy of all ACCI submissions on the Fair Work legislation can be found here:  
<http://www.acci.asn.au/SubmissionsMain.htm>

*“Mr Stevens—By anybody’s reckoning, the arrangements in the labour market that we have today—and it is not just the black letter law legal arrangements, but also the whole set of attitudes on the part of all the participants—are different to the bad old days. Even by the early 1990s, there had been a fair amount of change in that direction. What I would also say is that I think that this generally more flexible set of arrangements overall was helping in the boom, too.*

...  
*Mr Stevens— Whether it turns out to be chronic unemployment—that is, long lived—will hinge mostly—The best way to prevent that is going to be a growing economy, a flexible set of labour arrangements and an economy that is well in balance.*

...  
*Mr Stevens—Generally, the set of arrangements that we have had in place in recent years has resulted from a lot of reform over a long period that have made this all work better. We see the advantages of that. Ultimately, labour market arrangements are about where the sustainable unemployment rate is.”*

282. The IMF has also commented on Australia’s workplace relations reforms, commenting that “... inflexible labor markets have been among the most important causes of Australia’s declining productivity performance and have contributed to the increase in structural unemployment”<sup>23</sup>.
283. The OECD’s 2006 *Employment Outlook* and 2004 *Country Report* for Australia provided support for continuing reform to Australia’s labour market of the character pursued by former reforms.
284. What is undisputed is that the combined past reforms did correlate with a significant decline in the unemployment rate<sup>24</sup> and industrial disputes. Furthermore, OECD reports did indicate that a level of flexibility of Australia’s labour laws would have positive effects on productivity<sup>25</sup>.
285. OECD studies and reports<sup>26</sup> have consistently recommend countries to<sup>27</sup>:

<sup>23</sup> Singh, A, Felman, J, Brooks, R, Callen, T & Thimann, C (1998), *Australia: Benefiting from Economic Reform*, IMF, p.3.

<sup>24</sup> *An increase that cannot be solely attributed to the mining boom, given that only a small proportion of total employment growth has come from mining, and almost half of the employment growth is in ‘non-mining states.’*

<sup>25</sup> OECD *Employment Outlook for 2006*. ACCI commented on this report in “OECD Support for Labour Market Reform” can be found here: [http://www.acci.asn.au/text\\_files/issues\\_papers/Trade/June%2006%20-%20OECD%20Labour%20Market%20Reform.pdf](http://www.acci.asn.au/text_files/issues_papers/Trade/June%2006%20-%20OECD%20Labour%20Market%20Reform.pdf)

<sup>26</sup> OECD Report, *Implementing The OECD Jobs Strategy Lessons From Member Countries’ Experience* (2002) <<http://www.oecd.org/dataoecd/42/52/1941687.pdf>>; OECD Report, *Micro-Policies for Growth and Productivity*, (2007) <<http://www.oecd.org/dataoecd/6/40/38151918.pdf>>

<sup>27</sup> These policy goals are re-affirmed by subsequent reports. See for example, the OECD’s *Boosting Jobs And Incomes – Policy Lessons From Reassessing The OECD Jobs Strategy* (2006) <<http://www.oecd.org/dataoecd/47/53/36889821.pdf>>

- increase flexible work practices through flexible labour markets;
- increase flexibility of working-time (both short-term and lifetime) voluntarily sought by workers and employers;
- make wage and labour costs more flexible by removing restrictions that prevent wages from reflecting local conditions and individual skill levels, in particular of younger workers;
- reform employment security provisions that inhibit the expansion of employment in the private sector; and
- reduce payroll taxes.

286. Following the repeal of many provisions of the former reforms, in 2008, the OECD’s *Economic Survey of Australia* noted (at p.8):

*“The simplification and gradual decentralisation of industrial relations since the early 1990s has made the economy more resilient. But the pursuit of reforms towards a greater individualisation of labour relations, following the WorkChoices Act in March 2006, did stir much controversy, because of equity concerns. ... While equity concerns need to be addressed, care should be taken not to undermine labour market flexibility. To maintain a close link between productivity gains and wages, the future organisation of collective bargaining must remain within the company framework, as recognised by the government. Harmonising the system of industrial relations across the states is an important goal, but the result must not be alignment on the most restrictive standards.”*

287. As the Fair Work reforms have only commenced in July 2009, no studies can be conducted to measure its effect on productivity. The effect of these new reforms will be felt more acutely over time as they begin to effect participants’ behaviours.

288. Notwithstanding, there are aspects of the Fair Work policy which indicates a level of inflexibility which will have some implications on firm productivity.

## 10.4 Recent policy reform measures

289. ACCI’s *Modern Workplace: Modern Future Blueprint for the Australian Workplace Relations System 2002 – 2010* called for substantive reforms to workplace relations<sup>28</sup>.

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<sup>28</sup> This can be accessed on ACCI’s website: [www.acci.asn.au](http://www.acci.asn.au)

290. It appears that the centralised industrial relations structures which dominated the policy landscape pre-1990s, and the subsequent shift to a more hybrid mix of collective and individual based arrangements for employers and employees and reduced third party involvement of setting wage and conditions, has come full circle:
- the previous reforms of industrial relations which saw the industrial tribunal have a less interventionist role in individual workplaces, has now re-emerged;
  - collectivist structures are now encouraged under the Government’s new industrial relations laws, even though most contemporary and modern workplaces do not organise themselves in such a manner;
  - private sector union coverage is only 14 percent, and yet recent reforms provide for many avenues of union intervention in workplace arrangements, despite the wishes of employees or employers; and
  - collective based awards also re-emerge front and centre, together with a comprehensive range of legislated employment standards.
291. Where work rules are imposed on parties, there will always be doubt that productivity will be improved as there is no necessary consensus between the employers and employees and no direct relationship between the nature of that regulation and the needs of the workplace. Just as a tribunal or Government has limited capacity to create jobs in the private sector, it also has limited capacity to direct employers and employees to work productively and efficiently in exchange for higher pay and conditions. That is for the workforce to achieve on their own accord.
292. Media reports support ACCI member feedback that business is concerned about the impact on the Fair Work changes, including the impact of increased costs under new awards, new employment standards, and re-introduction of unfair dismissal laws on smaller firms. Many “... are also worried that they will bear the brunt of the government’s reforms in the form of higher labour costs and reduced flexibility”<sup>29</sup>.
293. Industry has consistently argued that reforms in workplace relations should:
- allow for flexible employment regulation that also provides an appropriate safety net of terms and conditions for employees;

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<sup>29</sup> *The Australian Financial Review*, “Why Businesses are so wary of labour reforms”, (19 August 2009), pp.60-61.

- provide a basis in which collective or individual agreements in workplaces apply on a voluntary basis and provide wage structures or conditions that reflect local circumstances of employers and employees and eliminate inefficient work practices;
- prevent minimum wage levels impacting negatively on jobs, inflation or the economy;
- allow appropriate exemptions for smaller firms from unfair dismissal laws;
- restrict third party intervention in the workplace;
- only allow industrial tribunals to arbitrate in disputes seriously affecting the public or economy; and
- target particular areas in the economy that requires specialised laws to deal with systemic unlawful behaviour.

294. These reform measures are intended to ensure that living standards, productivity, efficiency and employment levels grow, whilst also providing employee’s with a safety net of employment conditions.

295. Therefore, the following policy matters require re-consideration if productivity improvements are to be gained in the short to medium term.

#### **10.4.1 Industrial awards**

296. The Australian Industrial Relations Commission (AIRC) is currently rationalising thousands of federal and state industrial awards into fewer industry and occupational based awards. Whilst issues concerning overlapping coverage and applications of industrial instruments will be improved, and will have benefits for productivity, there still remains the problem of inflexibility. This is because awards will continue to reflect content that was imposed by a tribunal, during different times in Australia, agitated for by unions, who had little or no interest in productivity concerns for specific firms. The AIRC must have regard to various statutory obligations when it creates these awards, including productivity. However, the process to date has generated instruments that are derived from existing terms and conditions and as such, the so-called modern awards do no more, in many cases, than preserve existing award terms.

297. Industrial awards do not take into account specific differences in individual workplaces or firms. This negatively impacts upon productivity. All types of firms must comply and abide by these instruments, and under all business

conditions. As such, an award does not differentiate between a firm that has 5 employees or 500. A firm that operates in regional Victoria or one that operates in Melbourne. A firm that operates in prosperous times and one that operates during a recession. Firms that operate during late nights, early mornings or weekends to those that operate Monday to Friday, 9 am to 5 pm. The operational and financial capacity of firms will differ and this is what makes awards inflexible employment regulation.

298. Some modern awards have the potential to introduce significant new costs and inflexibilities for employers. This will likely have the affect firm and industry productivity levels.

299. Whilst not comprehensive, the following are a small number of examples that provides an illustration of some in-built inflexibility in award regulation under so called “modern” awards:

- **Part-Time Employment** Modern awards have provisions that restrict the flexibility of part-time employment, including engagement and roster changes;
- **Casual Employment:** The casual loading across all modern awards has been set at 25 per cent, which is significantly higher than the more common loading of 20 per cent. A higher casual loading, like any business cost related to labour, acts as a disincentive to offer employment. Many awards also prescribe a minimum engagement period of 3 hours;
- **Hours** Modern awards ingrain inflexible arrangements when it comes to establishing hours of work. The maximum number of hours an employer is able to roster an employee is often capped at eight, or possibly, ten per day. The inability to agree to longer hours per day can inhibit productivity. Modern awards also do not contain flexible provisions enabling employees to average their hours of work across an extended period, for instance 6 months. These types of provisions are useful in workplaces that have seasonal or fluctuating workloads. They enable employees to work extra hours in some weeks, but less in others;
- **Penalty Rates:** Late night and weekends are significant trading periods in Australian businesses. Typically awards have adopted a series of penalty rates which compensate employees for working ‘unsociable’ hours. This original justification for a penalty rate regime in an award has limited foundation, particular in the retail and restaurant sectors. Modern awards have adopted a more restrictive span of ordinary hours (that is, hours where employers are not required to pay higher rates of pay) and

maintained the penalty rates. These penalty rates are a deterrent to operating outside of this designated ordinary hours; and

- **Dual Regulation** Modern awards also deal with matters dealt with by legislation, such as superannuation legislation. Dual regulation increases red-tape for firms and may impose additional costs.

300. As modern awards will operate on a common rule basis from 1 January 2010, more employees will be subject to award regulation than has ever been the case. It is also likely that some employees that were previously award-free will now be award governed. The extension of regulation can have negative effects for productivity improvements where new inflexible work rules apply.

### 10.4.2 Minimum wages

301. Australia is the only country to have a cascade of multiple minimum wage rates which range from \$543.00 per week to over \$1700.00 per week.<sup>30</sup> It currently has the highest minimum wage in the OECD. On top of these base costs are related on-costs, such as workers compensation premiums, payroll tax, superannuation. Therefore, policy makers should consider more closely Australia’s minimum wage classification system and its effect on productivity.

302. In the Australian Fair Pay Commission’s last decision in July 2009, it stated that it considered “*its main priority in this decision is to protect jobs in the short term and help job seekers to be competitive in the labour market*” (pp.23). It therefore did not award an increase to minimum wage rates. The new statutory criteria under s.284 of the FW Act includes new considerations that *may* shift the emphasis from ensuring that job seekers remain and obtain in employment, to awarding higher increases.

303. A minimum wage set above the level of the marginal value that the worker contributes to the production process will discourage employment and lead to higher unemployment<sup>31</sup>. Increases in pay which are paid by higher labour productivity are the only sustainable way of maintaining and increasing real wages without negatively impacting inflation. This is also true for agreements that are made between employers and employees, which should link wage increases and benefits to higher productivity gains, rather than being a response to actual or threatened industrial action or orders by an industrial tribunal.

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<sup>30</sup> See for example the Medical Practitioners Award.

<sup>31</sup> *Econtech* report (August 2007), p.9.



304. If minimum wage rates for various classifications are higher than the equilibrium, then a firm will not engage additional workers. Firms may often cut-costs in other areas, if there are increases in wage rates, to pay for workers already engaged. If they cannot absorb those costs, they will reduce staff numbers or firm owners increase their hours of work. Wage increases not agreed to by employers have no reference to productivity and efficiency improvements, which is why they can have such a profound impact on individual firms.

### 10.4.3 Enterprise agreements

305. The former policy reforms were based on the premise that the primary responsibility for determining workplace matters should be with the employers and employees at the workplace level.

306. Under the new FW Act, only (collective) enterprise agreements are available, with the ability to make statutory individual agreements removed. There is also an enhanced supervisory role of the tribunal in agreement making and unions have more capacity to become involved in bargaining, even in a largely non-unionised workforce.

307. The Government’s *Regulatory Analysis* to the Fair Work Bill (at xl to xli) provided some detail on why it was shifting the emphasis of workplace determination from a flexible mix of collective and individual instruments to collective<sup>32</sup>:

*r.186. This Bill will place collective bargaining at the enterprise level at the heart of the workplace relations system.*

*r.187. Enterprise agreements can ensure that increases in pay and entitlements are linked to productivity increases at the enterprise. This is due to negotiations at the level of the enterprise better reflecting the financial situation of the enterprise. Furthermore, collective bargaining will shift the focus of negotiations towards boosting productivity.*

*r.188. Collective bargaining under the Bill will be less bound by regulation and red tape and is designed to have a positive impact on labour productivity.*

*r.189. The post-implementation review of the new system will be an important means of assessing the effectiveness of the new bargaining system.*

308. This was further reiterated in the second reading speech accompanying introduction of the bill:

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<sup>32</sup> See further studies quoted in the *Regulatory Analysis*, at r.194-r.198.

*The Bill aims to achieve productivity and fairness through enterprise-level collective bargaining underpinned by the guaranteed safety net, simple good faith bargaining obligations and clear rules governing industrial action.*

309. The above rationale appears to provide, in part, the policy basis for creating a new system based on collectivist structures and on enterprise agreements. It also appears to justify the system design, of associated orders (i.e. majority support, scope orders, good faith bargaining), union involvement in bargaining and new streams of bargaining (i.e. “low-paid” bargaining).
310. Even if there is some evidence of a correlation between collective bargaining and productivity outcomes it does not mean, *ipso facto* that it is beneficial for all firms, or should justify the design of the entire bargaining framework. ACCI notes that the studies quoted by the Government happened under a very different regulatory environment and under former reforms – not under the Fair Work system.
311. Despite collective bargaining being the foci under FW Act, the fact remains, however, that an enterprise agreement doesn’t guarantee increased productivity, efficiency or indeed, any other benefit. It is the extent and nature of collaboration between employers and employees that ultimately determines whether productivity and efficiency is improved. This can be achieved by individual or collective instruments, either registered or unregistered.
312. Enterprise bargaining has been around since 1990s as indicated above, however, it has not been conclusively linked as determining positive productivity improvements in all firms. To reiterate, these studies were associated with a different industrial relations system, not the Fair Work legislation. Therefore, even if there are positive benefits for productivity that does not of itself justify the creation of associated rules governing bargaining, including majority support determinations, good faith bargaining rules, and low-paid bargaining.
313. For example, under the previous system an employer did not have to bargain with employees or a union for an enterprise agreement. However, under the Fair Work changes, an employer must bargain with their employees and unions regardless of their capacity or desire to do so. This will happen where a bargaining representative (deemed by the FW Act to be the trade union), obtains “majority support” by employees in a firm. In that case, the employer must bargain with the employees and the bargaining representatives. Even where an employer and their employees wish to bargain together for an agreement, the union automatically becomes entitled to be part of that bargaining, despite its involvement or wishes of the employees. A union can

also obtain “good faith bargaining orders” against the employer to stop employer and employees voting on an agreement<sup>33</sup>. This has the effect of interfering with the rights of employees and their employer who may wish to implement an agreement that has productivity improvements.

314. Under the changes, an employer must bargain with these persons in good faith or face bargaining orders being made. If an employer breaches a bargaining order, the FW Act can impose an arbitrated outcome. This ultimately places undue pressure on employers to reluctantly agree to bargain and make an agreement where there may not be any productivity benefits, but only increased wages and conditions.
315. Multi-employer Bargaining: Under the previous system, agreements that covered multiple businesses could only be approved if it was in the “public interest”. The rationale was to limit pressure of unions on firms to pattern bargaining where common conditions applied to various enterprises. However, multi-employer bargaining is authorised by the new system, and indeed encouraged for “low paid” workers.
316. In the Minister’s second reading speech, it was stated that:
- The Bill provides a new scheme of bargaining for low paid employees. There is significant evidence that enterprise bargaining benefits employees, employers and the economy and we want more Australians to benefit from it ... The Bill provides for the possibility of a workplace determination in the low-paid stream ...*
317. Therefore, the FW Act allows industry wide pattern bargaining and tribunal ordered agreements to be imposed for so-called “low paid” sectors. This is an entirely new creation in the industrial relation system that will need to be closely monitored over time.
318. There are a number of problems with this new feature. There is no definition of “low-paid” under the FW Act and could include any sector where employees were covered by awards. Different firms within one sector, such as “child care, community work, security and cleaning” as mentioned in the second reading speech, have different operational and financial capacities.
319. The actual process for unions to force employers into participating in the enterprise bargaining process appears similar to the log of claims system of award making. Employers do not have a choice whether to be part of this process, which is ultimately determined by the tribunal. Whilst there is also a

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<sup>33</sup> *ASU v Queensland Tertiary Admissions Centre Ltd* [2009] FWA 53 (unreported); *CFMEU v Australian Precast Solutions Pty Ltd and Abigroup Contractors Pty Ltd* [2009] FWA 68 (unreported);

broad range of criteria for the tribunal to consider before it imposes an industry wide agreement on employers and their employees, only one criterion requires the tribunal to consider is “*how productivity might be improved in the enterprise or workplace concerned*” under s.275 of the FW Act. In essence, there is nothing that would enhance a firm’s productivity by virtue of these new provisions, and as it is akin to awards it is likely to introduce inflexible provisions and higher terms and conditions that will not be off-set by productivity or efficiency gains.

320. Once a union’s application is accepted by the tribunal, employers are also subject to good faith bargaining requirements, which will put pressure on some firms to settle an agreement with unions, in lieu of being forced into low paid proceedings before the tribunal. Once again, there is no guarantee that an agreement forged in these circumstances will do anything to enhance firm specific productivity.
321. Agreement Content: Under the previous system, agreements could only include matters that pertained to the employment relationship. As a result lawful industrial action could not be taken where matters were extraneous to this relationship.
322. Therefore, external factors that unions often wanted included in agreements, and had no bearing on firm efficiency, were not permissible. The new laws now allow agreements to deal with any matter that relates to the employment relationship, as well as the relationship between an employer and union.
323. It will also be important to monitor lost days due to industrial action rises over the coming months and years under the new system due the expansion of the content which unions can bargain and given the enhanced protections and role unions have under the new laws.
324. Awards and agreements: Given that the Government has placed heavy reliance on enterprise bargaining, the Government also appears to admit that awards are somewhat an anti-thesis to flexibility and that new *Individual Flexibility Arrangements* (IFAs) or enterprise agreements are necessary to promote flexibility. Once again, this is another reason to be cautious of allowing awards to play a more dominant role in the labour market<sup>34</sup>
325. IFAs: Since 1996 employers and employees could make a flexible individual agreement in the form of Australian Workplace Agreements (AWAs). The

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<sup>34</sup> Having an enterprise agreement in place, also reduces unlawful industrial action, although doesn’t stop it from occurring.

recent reforms repealed these agreements. The only form of individual agreement that is available at the federal level is in the form of Individual Flexibility Arrangements (IFAs). IFAs do differ from statutory agreements and it remains to be seen whether IFAs will deliver the intended benefit of increased flexibility as was promised by the Government. IFAs differ considerably from AWAs in that the former:

- can only deal with a number of limited matters under awards.<sup>35</sup> AWAs enabled an employer to roll-up all monetary entitlements (e.g. redundancy or paid leave entitlements) into a single rate of pay (or at least simplified rates of pay). This reduced the burden of managing complex payroll administration and record keeping which improves budgeting predictability;
- can deal with all, some or no matters under an enterprise agreement;
- can be terminated by either party (without any requirement to consult with the other party) by giving not less than 28 days notice. The power of an employee to unilaterally terminate an IFA does not give the employer the ability to manage that aspect of the employment with long-term certainty. Adjustments made to pay rates (possibly to simplify payroll administration) can be terminated, and the employer is forced to return to the complexities of the award; and
- cannot be made a condition of employment and thus must be agreed to by both new and existing employees and their employer.

#### **10.4.4 Statutory employment conditions**

326. Under the FW Act New Employment Standards (NES) will operate from 1 January 2010. These statutory minima regulate hours of work, leave arrangements and termination benefits. They operate in conjunction with any awards that may apply and cannot be overridden by either a registered or unregistered agreement. Awards may deal with particular provisions in a certain way.

327. Given that statutory minima operate across different firms, it is important that they operate as flexibly as possible. They should not restrict the manner by which businesses operate as this will affect firm productivity.

328. Award and agreement free employees can deal with in a more flexible manner some conditions under the NES. For example, they are able to cash-out

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<sup>35</sup> Arrangements for when work is performed, overtime rates, penalty rates, allowances; and annual leave loading.

annual leave or average hours of work over a period of time. For award regulated workers, unless the award provides for that flexibility, they must abide by the terms of the NES. Therefore, consideration should be given to those NES matters where awards do not allow flexibility.

#### 10.4.5 Other policy areas

329. Employment Protection: The new employment protection laws significantly impact upon the capacity of employers to manage their workforce. For example, the new *general protections* framework under the recent reforms, introduces concepts such as “adverse action”. This significantly extends existing regulation. Employers who wish to terminate or alter the working arrangements for an employee may be liable under these laws if the employee alleges that action was taken as a result of a “workplace right”. This is an entirely new area of law and avenue for litigation that may impact on the ability of employers to structure their workplace arrangements to enhance productivity capacity.
330. Similarly, the unfair dismissal laws under the FW Act also have the effect of limiting the capacity of a firm to terminate the employment of an employee, where an employee has a right to challenge that dismissal on procedural grounds. A firm who wishes to restructure and make redundancies, may also be required to reinstate the worker if they do not follow certain procedures under the FW Act. This bears no relationship to the actual operational requirements or needs of the firm to restructure.
331. This negatively impacts upon firm productivity in three ways: (a) A firm may be reluctant to terminate an employee for fear of a claim being made and an employee being reinstated; (b) the tribunal may reinstate an employee to the workplace despite not being able to adequately perform duties, (c) a firm may be reluctant to hire necessary staff for fear of not being able to terminate their employment if there are doubts about the ability to terminate those positions. In the *Econtech* report commissioned by ACCI, the authors concluded that “*the assessment of the international and national evidence presented later in this section concludes that there is an adverse impact of unfair dismissal legislation in Australia on the structural unemployment rate and labour productivity.*”
332. Recent reforms introduced a small business exemption (based on 100 employees). However, the small business exemption has been removed by the Fair Work reforms. In its place, are new laws for small business (redefined as firms with under 15 employees) that extends qualifying periods of time, and creates a Fair Dismissal Code when a business does dismiss an employee after those qualifying periods.

## 10.5 Building and construction industry

333. Economic modelling of the operation of targeted laws for the building and construction sector suggest that such laws and institutional frameworks are having a beneficial and positive economic effect. The activities of the Australian Building and Construction Commission (ABCC) are delivering real economic and industrial benefits to both the construction industry, other industries and to the wider economy and society. This is evidenced in the various *Econtech* reports published by the ABCC, and in the feedback of other industries reliant on construction<sup>36</sup>.
334. On 6 May 2009, the third *Econtech/KPMG* report, ‘*Economic Analysis of Building and Construction Industry Productivity*’, into the impact of industrial relations reforms in the construction industry was released. The report is an update of the analysis previously undertaken by *Econtech* in 2007 and 2008.
335. Importantly, the report’s economic modelling estimates a number of positive economic impacts due to the ABCC’s activities and industrial relations reforms:
- GDP is 1.5 per cent higher than it otherwise would be;
  - CPI is 1.2 per cent lower than it otherwise would be; and
  - Improved consumer living standards are reflected in an annual economic welfare gain of \$5.1 billion.
336. *Econtech* also interviewed representatives from four major construction companies. These interviews reported further benefits including, (a) a significant reduction in the number of days lost to industrial action; (b) improved management of occupational health and safety issues and a reduction in their misuse for industrial purposes (c) productivity gains from improved rostering flexibility.
337. Most of these laws will be repealed if the Government’s Building and Construction Industry Improvement Amendment (Transition to Fair Work) Bill 2009 is passed by the Parliament. Therefore, it is important that existing laws and institutions are retained in a substantive way to continue to drive industry specific productivity gains that have a positive impact on the Australian community.

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<sup>36</sup> 2007, 2008 and 2009 KPMG/Econtech reports, *Economic Analysis of Building and Construction Industry Productivity* (series). <<http://www.abcc.gov.au/abcc/PerformanceReports/Productivityandindustryreports/>>

## 10.6 ACCI recommendations

338. The following recommendations follow domestic and international evidence that indicates flexibility is the key to ensuring workplace relations regulations has a positive effect on productivity, as well as other key economic outcomes. Whilst they do not attempt to address policy reform for the long term, they should be looked at as short to medium term microeconomic reform measures that will preserve or improve productivity gains.

- **Modern awards:** Consideration should be given to study the effects of modern awards on firms, certain industries and the wider economy. Provisions that are too prescriptive, inflexible or do not assist in achieving productivity should be reviewed and moderated. The process of creating new awards should not increase costs or introduce inflexibilities on employers. IFAs should be monitored to ensure that they are able to flexibly deal with modifying the application of award terms, in a manner that was intended by the Government;
- **Enterprise Agreements:** Regulation of agreement making should be reviewed and where necessary should be moderated by amending legislation. Agreement making between employers, employees and bargaining agents should be truly voluntary. There should not be any ability to frustrate formal agreement making where a majority of employees and the employer wish to bargain and make an agreement. Agreement making should be flexible to reflect both collectivist and non-collectivist workplaces in Australia;
- **Bargaining/Arbitration:** There should be limited scope for a tribunal to arbitrate and impose a workplace determination. Where the “low-paid” bargaining stream is negatively impacting on firms, this should be moderated by amending legislation. One option may be to require approval by the relevant Minister before unions can make an application. Similarly, there should be limited scope for the tribunal to make orders that restrict an employer’s ability to structure their workplaces in a manner that is beneficial to both the employer and its employees;
- **Statutory Minima:** Statutory minima, such as the NES, must be flexible and adaptable to suit a variety of workplace circumstances. They should be moderated to enable sufficient flexibility should statutory minima cause any negative effects in a given workplace. Modern awards should fully facilitate flexibility of the NES where allowable;



- **Minimum wages:** Minimum wage decisions under the new system should be closely monitored. Changes should be made where decisions are having a negative effect on the economy, including productivity, inflation and jobs;
- **Building and Construction Industry:** Current arrangements in the building and construction industry should not be disturbed. Therefore, the current Bill to repeal most provisions of the BCIA should be re-considered and not progressed;
- **Transfer of business:** Rules on transmission of agreements should be flexible. Inflexible agreements should not apply indefinitely to an in-coming employer; and
- **Employment Protection** Unfair dismissal laws should be monitored to consider the impact of the changes on firms, jobs and the economy. Similarly, the new general protection framework should also be monitored, and where necessary changes made where it is having a negative effect on a firm’s ability to flexibly manage its workplace.

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### **New South Wales Business Chamber**

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### **Victorian Employers’ Chamber of Commerce & Industry**

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### **Air Conditioning and Mechanical Contractors’ Association**

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**Master Plumbers’ and Mechanical Services Association of Australia**

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### **National Electrical and Communications Association**

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### **National Fire Industry Association**

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### **National Retail Association Ltd**

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### **Oil Industry Industrial Association**

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