



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

**I**n January, ACCI released a major position paper on Australia's manufacturing industry which noted that contrary to the views of some, it is not chronically sick and that many manufacturers have maintained advantages over even the lowest cost countries. The future of Australian manufacturing lies with policies that strengthen the overall economy and enhance a business' ability to compete, rather than the old, failed policies of government intervention and protectionism.

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

Australia has followed a path of engagement rather than retreat by embracing the world through lower tariffs and lower barriers to inflows of international capital.

These economic changes have been insurmountable for some manufacturing businesses while others have reaped the benefits of globalisation.

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

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

The manufacturing sector contains success stories that defy a negative view of its future.

Australia has industries within the manufacturing sector which maintain comparative and competitive advantages over even the lowest cost countries.

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

The manufacturing sector, like all sectors of the economy, needs a strong macroeconomic environment to utilise and fully develop foreign investment, free trade agreements,

skills and infrastructure. Manufacturers must also be given incentives to produce R&D to remain competitive as well as opportunities to commercialise such developments.

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

ACCI's Position Paper highlights that:

- while manufacturing's share of the Australian economy has been steadily declining as the economy has grown, the sector still accounts for 12.5 per cent of the national economy or output of \$96 billion and averages around 1.5 per cent growth per annum;
- Australia has followed a path of engagement with international markets through lower tariffs and reducing barriers to inflows of international capital;
- the rise of low cost production centres for simply transformed manufactures, combined with lower tariffs, has pushed some Australian firms offshore or out of business;
- Australian manufacturers have become more outwardly focussed, manufacture higher value goods, develop niche products for global markets or mass-produced goods for global supply chains;
- manufacturing is a vital part of the Australian economy and will remain so into the foreseeable future;
- difficulties faced by manufacturers should not be used as an excuse to revert to policies of protectionism and intervention, such as higher tariff walls, providing

greater subsidies or picking winners; and

- the future of manufacturing lies with policies that strengthen the overall economy and support competition such as sound taxation and industrial relations policies, initiatives to address skill shortages, policies to increase investment in infrastructure, innovation, research and development, continued support for trade negotiations that reduce tariff and other barriers in other countries, as well as the implementation of recent undertakings to reduce regulatory burdens on businesses.

### AUSTRALIA'S MANUFACTURING SECTOR TODAY

Like many industrialised countries, Australia's manufacturing sector has suffered declining output as a proportion of Gross Domestic Product (GDP) and a declining proportion of employment relative to the total labour market.

Taken at face value this could be misconstrued as symptomatic of an ailing industry that is no longer relevant to the Australian economy. ACCI does not support this proposition.

In fact, while the proportion relative to GDP diminishes, the manufacturing sector continues to grow. Since 1975 manufacturing industry value added has increased from \$60.5 billion in the year to June 1975 to \$96 billion in the year to June 2006.

Over the last 30 years manufacturing growth has averaged 1.5 per cent per year (see Figure 1).

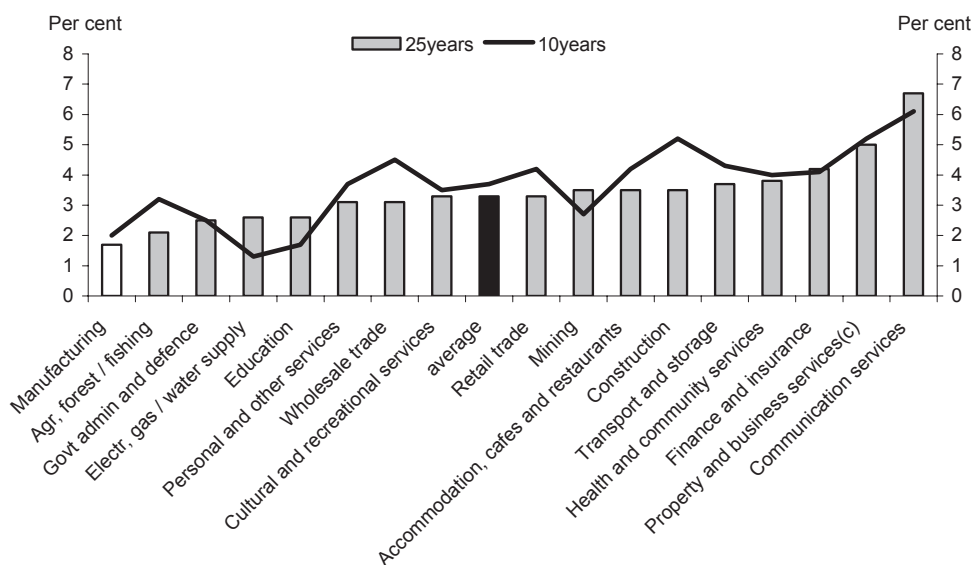
Australia, as a small, open economy, has for its betterment long instigated policies designed to encourage competition between both domestic and international companies. The results have been a higher standard of living for Australians and a more dynamic, competitive, efficient and skilled economy. Australian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

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

Imports of manufactured goods have increased by 7.0 per cent over the last decade, while manufactured exports increased by 4.4 per cent over the same period.

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

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



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

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

In 2004-05 Australia's R&D expenditure measured \$15.8 billion - a 19.4 per cent increase on the previous year. Investment in R&D by business recorded \$8.4 billion, up 21.5 per cent, while government spending remained relatively flat at \$2.55 billion. The largest contributor to Business Expenditure on Research and Development (BERD) is manufacturing, accounting for 49.3 per cent or \$3,451.1 million. Manufacturing also accounted for 45.3 per cent of all capital expenditure on R&D, at \$237.4 million, in 2004-05.

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

## THE DUTCH DISEASE AND MANUFACTURING

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

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

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

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

## GOVERNMENT SUPPORT AND MANUFACTURING

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

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

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

## GLOBAL SUPPLY CHAINS AND MANUFACTURING

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

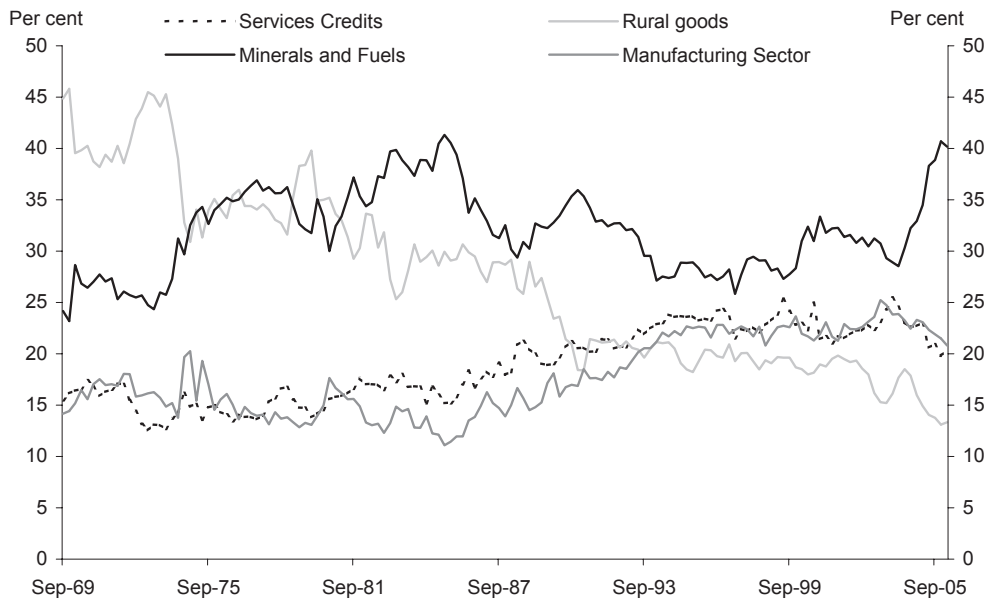
The Government has an important role in making Australia an attractive destination for global manufacturing companies looking for a location to invest based on research and development capabilities, skills, taxation, regulation, energy and infrastructure (see Figure 2).

## INTERNATIONAL TRADE AND MANUFACTURING

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

ACCI strongly supports continuing removal of international trading barriers, but believes that reductions in Australian tariffs must be considered in the context of

**Figure 2**  
**Proportion of Exports by Sector**



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

a whole of government industry policy.

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

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

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

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

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

Commerce and industry supports the two-pronged recommendation by the Jollie Review of the Export Market Development Grant Scheme to maintain current

levels of program funding, index its budget to inflation to preserve its real value and introduce a smoothing arrangement where funds not expended in one year of the program can be retained and made available elsewhere over the life of the Scheme, especially in unexpectedly high demand years.

## RESEARCH AND DEVELOPMENT AND MANUFACTURING

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

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

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

## SKILLS DEVELOPMENT AND MANUFACTURING

All businesses require access to skilled employees particularly when competing with international firms.

Australian policies must be directed towards overcoming the skills shortage currently faced by businesses, including manufacturing businesses.

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

- Employers seek quality outcomes from the Vocational Education and Training (VET) sector. It is therefore important that the Institute for Trade Skill Excellence provides employer endorsements for high performing schools in Registered Training Organisations (RTOs).
- ACCI advocates further reform of the highly successful Australian Apprenticeships program. The Australian Apprenticeships program currently caters for a range of formal workplace training arrangements with one set of incentives and regulatory arrangements applying. Over the past six years the underlying concept of an apprenticeship, that is structured learning in a work-based environment, has become well established outside the trades.
- ACCI believes that there is an opportunity for a new strategic positioning of the Australian Apprenticeships program in the VET system to revitalise its role in meeting the skills needs of those entering the labour market, those already in the existing workforce or those who are on income support.
- It is imperative that the incentive arrangements, which currently apply across all industries, be maintained. However, it would be timely to extend the arrangements to cover all levels of New Apprenticeship pathways, including at the higher levels of Australian Qualification Framework levels V and VI.
- The National Skills Shortages Strategy (NSSS) has funded a range of industry-developed and managed projects that have identified significant issues regarding the recruitment, training and retention in occupations in shortage of suitably skilled workers across a range of industries.
- Australian Technical Colleges will provide an innovative approach to encourage young people to merge employment and learning options during their secondary senior years and will further help to raise the esteem of VET pathways in the community. Clearly identifiable industry leadership will be important to the

success of the Colleges.

- ACCI believes that further sites for Australian Technical Colleges should be investigated, especially in regional areas experiencing skill shortages.
- ACCI members support the policy directions of the Government in the broad area of welfare reform and are particularly interested in programs that connect the various government agencies dealing with a specific issue taking a whole of government approach.
- ACCI believes that the concept of providing Job Network clients with an opportunity to take up a Australian Apprenticeship is critical in providing unemployed persons with dual opportunities of work and gaining skills, and providing targeted interventions to address the supply of skills problems.

## FOREIGN DIRECT INVESTMENT AND MANUFACTURING

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

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

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

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

## WORKPLACE RELATIONS AND MANUFACTURING

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

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

These reforms will kick start another round of productivity growth. We are confident that this will mean lower unemployment than would otherwise have occurred and a continuation of real wage growth.

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

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

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

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

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

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

## TAXATION AND MANUFACTURING

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

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

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

## ENERGY AND MANUFACTURING

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

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

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

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

## REGULATION AND MANUFACTURING

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

believes that the aim of improving regulation can be achieved and has developed a position paper *Holding Back the Red Tape Avalanche*, which addresses regulation of economic significance affecting commerce and industry.

The specific features of the ACCI approach are as follows:

- tabling in Parliament an annual regulatory budget that provides a cost and benefit analysis of all business-related regulations, as measuring the cost of regulation is the first step in controlling its growth;
- all regulatory budgets should be placed on a centralised website. This will help to inform the public of the amount of regulation being created and the amount of regulation required to be complied with;
- the Office of Regulatory Review (ORR) should be moved from the Productivity Commission (PC) to the Department of the Prime Minister and Cabinet. The new body, which would be known as the Prime Minister's Regulatory Reform Unit (PMRRU), should be headed by a Chief Executive chosen from the business community;
- a modeling unit located in the PC should be created to develop a standardised costing tool to be applied to all new regulatory proposals. Line departments will be required to apply this costing tool to objectively measure the compliance costs of their regulatory bids. We consider this initiative has been addressed through the development of the Business Cost Calculator; and
- regulation that does not pass the Regulatory Impact Statement (RIS) process as determined by the PMRRU must not be allowed to proceed.

## INFRASTRUCTURE AND MANUFACTURING

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

ACCI has also recently adopted a new Infrastructure Policy. In summary, the policy argues that:

- infrastructure is vital to Australia. It is essential to improving Australia's economic performance,

education and training, national security, social cohesion and enhancing our built and natural environment;

- infrastructure needs should be addressed by the private sector where possible, with the Government assisting investment through a facilitative tax and regulatory system;
- the private sector is generally more efficient at developing and operating infrastructure. Government investment should only be used when there is clear and demonstrated market failure and after a thorough cost benefit analysis has been undertaken;
- where government involvement in infrastructure is required, governments should make full use of partnerships with the private sector to reduce costs;
- the tax and regulatory system should provide appropriate incentives to investment while restricting monopoly power. Reforms should continue under National Competition Policy, in line with the recommendations of a recent inquiry by the Productivity Commission; and
- ACCI does not support proposals for an independent National Infrastructure Council or similar to take over decision making on infrastructure projects, but we do support proposals for greater coordination in infrastructure regulation.

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

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

## CONCLUSION

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

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

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

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

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

Some recent calls for a new manufacturing sector policy are in many cases simply a euphemistic appeal for a return to the past.

The future of manufacturing does not lie in raising tariff and non-tariff barriers nor in the pursuit of large,

industry-specific, taxpayer-funded grant schemes.

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

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

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

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

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

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

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

A hard copy of the paper is available from the ACCI Secretariat or electronically from the ACCI website at [www.acci.asn.au](http://www.acci.asn.au).