MANAGING TOUGH AND UNPREDICTABLE TIMES AND EMERGING STRONGER

January 2009

Ai Group’s Submission to the 2009-10 Federal Budget
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Executive Summary

Budget Strategy

The deterioration of global conditions and the sharp slowdown in the domestic economy call for an additional fiscal stimulus of around the same magnitude as provided by the Government’s Economic Security Package announced in October 2008. Expansionary fiscal policy should work alongside further interest rate reductions and appropriate interventions to facilitate a return to healthy functioning of credit markets to bring forward and strengthen recovery from the current downturn.

This recommendation is made in the context of considerable uncertainty over the immediate direction of the international economy and in particular over the extent of the downturn in China – now our largest trading partner. In the face of this uncertainty, the Government needs to retain a high degree of flexibility over the timing and extent of policy initiatives. An announcement of additional fiscal expansion need not wait until the May Budget should conditions warrant earlier action. Nor should the Budget be regarded as the last opportunity to introduce new stimulatory measures over the course of 2009-10.

In addition to measures specifically aimed at countering the downturn, the Budget should make key investments in the longer-term drivers of growth.

Budget Snapshot

Ai Group proposes:

- A direct stimulus through additional personal income tax cuts;
- Harnessing the tax system to deliver cash-flow relief to distressed businesses and encouraging business expenditure on capital equipment, training, research and development and export market development;
- Putting in place a new drive to renew public infrastructure to accelerate much-needed repairs and upgrades to existing infrastructure;
- Selective boosts to training, education and the development of business capabilities;
- A range of initiatives to build longer-term productivity and workforce participation by investing in innovation; energy and broadband infrastructure; education and training; greenhouse gas abatement and export market development.

While a budget deficit is expected and indeed desirable in the current circumstances, the need to stimulate the economy should not serve as a reason to introduce or maintain inefficient programs. Indeed, Ai Group proposes that the Budget should continue the process of rigorous assessment of programs and re-prioritisation of outlays in order to generate greater public sector efficiency.
Fiscal Stimulus

The next 18 months are looking extremely difficult for the international and domestic economies. In this context the 2009-10 Budget should deliver a strong fiscal stimulus to the domestic economy in addition to the already-scheduled personal income tax cuts and the foreshadowed expansion of infrastructure spending. Ai Group proposes an additional stimulus of similar magnitude to the Economic Security Package announced in October 2008.

Ai Group proposes further stimulating consumer spending by bringing forward to July 2009 key components of the personal income tax cuts currently scheduled to take effect in 2010. These will add to the tax cuts already scheduled for July this year.

To complement the boost to consumer spending, additional measures should be introduced to deliver a boost to business cash flows and encouragements for near-term capital investment and expenditure on training; research and development and export market development. Ai Group proposes targeted tax relief to businesses experiencing losses in the 2008-09 and 2009-10 years and measures to encourage business capital investment and business spending in these select areas in the 2009-10 year.

Ai Group also proposes a Commonwealth-funded, nation-wide drive to renew public infrastructure over two years that accelerates work on repairing and upgrading existing public infrastructure owned by Commonwealth, state and local governments and agencies.

These measures would be in addition to any increases in pension payments: measures that would also impart a fiscal stimulus in 2009-10.

Boosting Training and Business Capabilities in the Downturn

In previous downturns, training and capability development budgets are often reduced as businesses pay less attention to longer-term priorities in order to concentrate on more immediate concerns. Ai Group proposes increasing momentum on improving skilling opportunities so that unemployed people and existing workers are able to improve their skills during the downturn.

Ai Group proposes the following temporary measures to retain the strength of the apprenticeship system for the duration of the economic downturn:

- Doubling commencement incentives from $1,500 to $3,000 in traditional trade areas;
- Reintroducing 12 month progress payments with a further $1,500 to encourage continuation of apprenticeships into next stage;
- Fund Group Training Companies to take up all eligible ‘out-of trade’ traditional apprentices to support and case manage job rotation, accelerated training and work placement;
- Extend access to Youth Allowance to all out-of-trade traditional apprentices as an income support arrangement allowing training completion, whilst being case managed by a Group Training Company.
To further reinforce training and capability development Ai Group also proposes:

- Measures in support of young people at risk of not completing year 12 or equivalent training qualifications; and
- Increasing the resources and the reach of the Enterprise Connect program to double the number of businesses receiving services during the 2009-10 and 2010-11 years.

**Investing in the Drivers of Growth**

Current attention is rightly focused on managing the fallout from the global downturn. As indicated in Ai Group’s 2008 report *How Fast Can We Grow? Mark III*, Australia’s current economic vulnerability stems not only from the global financial crisis and its aftermath, but also from a more entrenched slowdown of domestic growth prospects. In framing the 2009-10 Budget the Government should, therefore, not lose sight of the ongoing need to nurture the longer-term drivers of growth. This third dimension of Ai Group’s 2009-10 submission proposes a range of initiatives aimed at building longer-term productivity and workforce participation through investments in innovation; energy and broadband infrastructure; education and training; greenhouse gas abatement and export market development.

**Public Sector Efficiency**

The final dimension of Ai Group’s Budget proposals is for the Government to maintain a rigorous scrutiny of all programs and to re-prioritise expenditure to extract greater value for taxpayers’ money. Ai Group also advocates an extension of the efficiency-improving directions proposed by the Gershon Review on the Commonwealth Government’s use of information and communications technology.

**Budget Outcome**

Ai Group expects the combination of the deterioration in economic conditions to mean that the starting point for the 2009-10 Budget could be an operating deficit of between $5 and $10 billion. We anticipate that the net impacts of measures outlined above would see the operating budget record a deficit in 2009-10 of between $15 and $20 billion with a strong likelihood that it would remain in deficit in 2010-11.

While this sobering outcome would represent a sharp departure from recent budget results, Ai Group does not regard it as inappropriate in the context of the current downturn. The present situation calls for a significant public sector stimulus to demand and it would be irresponsible to reduce aggregate public sector spending or to raise tax rates in an attempt to run a balanced or surplus budget. Australia has, in comparison with other countries, an exceptionally low level of public sector debt and a budget deficit would be both responsible and manageable.

At the same time Ai Group cautions against a relaxation of disciplined fiscal policy and urges the Government to shape its fiscal stimulus measures so they are fully in keeping with its own commitments to maintain a budget in surplus over the medium term and to maintain rigorous scrutiny of budgetary programs.
Summary of Ai Group Budget Proposals

Fiscal Stimulus Measures

- Bring forward part of the personal income tax reductions currently scheduled to take effect from July 2010.
- Introduce a loss tax refund for small and medium-sized businesses making losses in the 2008-09 and 2009-10 years.
- Provide additional tax deductions for business expenditure on training, research and development and export market development in 2009-10 and extend the capital allowance measures announced in December 2008 for a further year (i.e. in relation to contracts to purchase or build assets entered into between 1 July 2009 and 30 June 2010).
- Put in place a new drive to renew public infrastructure to accelerate infrastructure repairs and upgrades by Commonwealth, state and local government departments and agencies.

Boosting Training and Business Capabilities in the Downturn

- Measures to facilitate training of existing employees and unemployed people.
- Reinforce the apprenticeship system.
- Invest in extending the education and training attainment of “at risk” young people.
- Increase the reach and resourcing of the Enterprise Connect program.

Investing in the Drivers of Growth

- In the vital area of innovation, Ai Group proposes, either as part of the Budget or earlier, a comprehensive Innovation Statement that builds on the broad thrust of *Venturous Australia – building strength in innovation*, the report of the Cutler Review of the National Innovation System.
- Ai Group proposes that the Government complements the support for infrastructure renewal being undertaken by Infrastructure Australia, with additional measures to ensure that the rollout of the National Broadband Network improves access to high-speed broadband and with key encouragements to investment in our ageing electricity generation capacity.
- Ai Group supports additional spending across a select range of areas as part of a national effort to underwrite sustained improvements in our education and training performance.
- Ai Group also supports accelerated depreciation for investments that reduce the greenhouse gas emissions intensity of Australian industries.
- In addition we propose maintaining and improving the effectiveness of Australia’s export support programs (including the Export Market Development Grant Scheme, the Export Finance and Insurance Corporation and AusTrade).

Public Sector Efficiency

- Maintain a rigorous scrutiny of all programs.
- Extend the proposals of the Gershon Review on public sector use of ICT.
Macroeconomic Outlook

The global economic outlook for the next 18 months is certainly the weakest since the early-1990s and may be as bad as any downturn since the Second World War.

The world economy looks set to record, if not an actual recession then certainly a phase of “growth recession” (in which the pace of growth, while positive, is so low that it produces increases in net unemployment). Outlooks for global growth in 2009 range from slightly negative to not much more than 2 per cent driven by significant downturns in the industrialised economies of the US, Japan and Europe compounded by a severe reduction in growth amongst the emerging economies.

OECD Composite Leading Indicators

The OECD Composite Leading Indicators (CLIs) provide early signals of fluctuations in global economic activity. The latest CLIs available were published on 12 January 2009 recording November 2008 data. These data present a gloomy picture with falls in the most recent indicators for the OECD as a whole and for the major emerging economies.

This picture is made gloomier still when the November 2008 CLIs are compared with the September 2008 data. Table 1 contrasts the year on year change in CLIs to September 2008 and to November 2008 along with the associated growth outlooks.

<table>
<thead>
<tr>
<th>Table 1: OECD Composite Leading Indicators</th>
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<tr>
<td><strong>Year on Year Change</strong></td>
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<td>OECD Area</td>
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1 The Asia 5 is China, India, Indonesia, Japan and Korea.
Perhaps the most disturbing element from an Australian perspective is the sharp declines in the leading indicators and growth outlook for China and the Asia 5 grouping (China, Japan, India, Korea and Indonesia). In both cases the growth outlook fell sharply between September and November going from “downturn” to “strong slowdown” over the two months.

All of the major OECD economies, the OECD as a whole and the major emerging economies of Russia, China and India have an outlook characterised as a “strong slowdown.” Only Brazil avoids this fate although its outlook also slipped between September and November.

A glimmer of less distressing news is that the year on year change in CLIs for four of the G7 countries were lower for the year to November compared with the year to September. It would be wrong to read too much into this given that these positive differences were all very small and were not sufficient to stem a worsening of the CLI for the G7 as a whole which was more decisively influenced by the worsening of indicators in the remaining (and three largest) G7 economies of the United States, Japan and Germany.

This global outlook is having, and will continue to have, detrimental impacts on the Australian economy. Importantly for Australia, China’s economy, which has provided a significant boost to Australian incomes through the impact of its demand for commodities such as iron ore and coal, is facing a sharp slowing in economic growth. This and the flow-on effects of reduced Chinese economic activity in other regional economies will lead to a reduction in demand for Australian exports and commodity prices, leading to a significant decline in Australia’s terms of trade and consequently reduced income flows.

In this global climate, new investment across the economy and particularly in the mining sector is likely to be significantly below earlier expectations and we are already seeing significant job losses in a broad cross-section of industries.

**The Domestic Economy**

In November 2008, the Reserve Bank of Australia published its revised growth forecasts. They point to a sharp slowdown in the Australian economy with a recovery gathering momentum very gradually from the second half of 2009 and into 2010. The RBA’s GDP growth forecasts are for:

- 1½ per cent for the year to December 2008;
- 1½ per cent for the year to June 2009;
- 1¼ per cent for the year to December 2009;
- 2 per cent for the year June 2010;
- 2½ per cent for the year to December 2010; and,
- 3 per cent for the year to June 2011.

These forecasts compare adversely with average annual growth of 3.2 per cent over the period 2000-08 and 3.9 per cent for the years from 1992 to 2000.
In addition to the international outlook discussed above, another factor adding to the pressure on domestic activity is the likelihood that consumers will continue to rebuild savings and reduce the high levels of indebtedness that have built up over recent years. This is likely to further constrain household spending - adding to the negative pressures facing Australian businesses and reducing the incentive to invest, particularly at a time when capacity utilisation is likely to fall.

The likely slowdown in investment, consumer spending and export markets will lead to higher levels of unemployment, though this is likely to be tempered to an extent by the desire of firms to hold on to skilled workers.

The injection of over $10 billion into the hands of low and middle income households through its Economic Security Package announced by the Government in October 2008 is acting to help shore up the economy at a particularly difficult time.

In particular the indications are that these additional funds have helped buoy retail spending in recent months when outcomes would otherwise have been far more disappointing. Ai Group expects that the impacts of this package will continue to be felt in coming months as the retail impacts are transmitted upstream and because it is likely that many consumers will have decided to pace their extra spending over a period of several months rather than spend it all at once.

Notwithstanding the favourable impacts of the Economic Security package, Ai Group anticipates that the economy will slow by more than the Reserve Bank’s latest expectations. We expect the economy will slow considerably with GDP growth of around 0.5 per cent in calendar 2009 and 1.1 per cent in the financial year 2009-10. This is largely due to further declines in the outlook for emerging economies including China and the continued deterioration in Ai Group’s sectoral indicators of business conditions.
Ai Group’s regular reports indicate that the economy is slowing significantly

The Australian Industry Group’s monthly indicators of activity in manufacturing, services, and construction continue to point to a weak economic outlook over the first half of 2009. Ongoing declines in new orders are likely to drive weaker production and employment over the next few quarters.

Ai Group’s measure of manufacturing activity, the Australian Industry Group – PricewaterhouseCoopers Australian Performance of Manufacturing Index (Australian PMI®) fell for a seventh month in a row in December, though at a slightly slower pace than in November. November’s Australian PMI® recorded its lowest level in 16 years, as did the survey’s measure of capacity utilisation. The latter suggests a period of softer investment activity in the sector.

Chart 2: Australian Industry Group - PricewaterhouseCoopers Australian Performance of Manufacturing Index (Australian PMI®)

The Australian Industry Group – Commonwealth Bank Australian Performance of Services Index (Australian PSI®) has shown a similar pattern of outcomes over recent quarters as that for manufacturing. New orders and sales have continued to fall since mid-2008, with a significant impact on employment in the sector.

A key driver of the deterioration in services sector activity is its relatively greater exposure to consumer spending, which makes up around 60% of GDP. As consumers have tightened their belts in response to the uncertainties provoked by the global financial crisis, and as they have sought to wind back their historically high levels of indebtedness, demand for services has eased significantly.
As reflected in The Australian Industry Group – Housing Industry Association Australian Performance of Construction Index (Australian PCI®), the construction sector shows a similar pattern of easing as the manufacturing and services sectors, though beginning earlier in 2008.

Within the construction sector, housing and apartment activity began to decline in the first quarter of 2008. This reflected the impact of higher mortgage rates following the Reserve Bank’s tightening of monetary policy and low levels of housing affordability. Engineering and commercial construction, in part driven by the strength of mining and infrastructure investment, was resilient for longer, declining from the second quarter of 2008.

The construction outlook remains weak. New orders in December fell at the fastest rate recorded in the 39-month history of the survey and marked the 10th successive month of decline in new orders, indicating substantial contraction.
Recent Ai Group research, *Cash Management – Managing cash flow in troubled times*, which was conducted in conjunction with American Express, assessed the impact of the global financial crisis on Australian firms’ cash flow prospects and cash flow management. The report showed that the crisis is having a negative impact.

- Reflecting the weakening of demand conditions over recent quarters, the greatest degree of concern around cash flow identified by respondents to the survey was in relation to accounts receivable outstanding (53.4% of respondents) and capacity to pay bills on time (28.2% overall and 30.6% of micro and 34.4% of small firms).

The associated decline in labour demand as the domestic and world economies ease is expected to lead to a rise in Australian unemployment to an average in 2009 of around 6 per cent.

**Budget Outlook**

The run of strong budget surpluses is about to come to a sudden halt. The combined impacts of the downturn in the global economy; the sharp fall in Australia’s terms of trade; the drop in asset prices and the slackening of domestic activity will see revenues fall and expenditures rise (for example, spending on age pensions and unemployment assistance).

At the time of the 2008-09 Budget, the estimated 2009-10 net operating budget result was a surplus of $26.4 billion. With 2009-10 net capital expenditure estimated at around $4 billion, the fiscal balance was an estimated surplus of $22.4 billion (1.7% of GDP).

In early November 2008 with the release of the Mid Year Economic and Fiscal Outlook (MYEFO), the 2009-10 estimates were subject to significant revision largely due to a sharp fall in expected tax receipts. The MYEFO estimated the 2009-10 net
operating budget result at a surplus of $12.6 billion. Net capital expenditure was estimated at around $5.5 billion with a fiscal balance in surplus to the tune of $7.1 billion (around 0.6 per cent of GDP).

These estimates were based on:

- Forecast real GDP growth of 2 per cent in 2008-09 and 2¼ per cent in 2009-10 and employment growth of 1¼ per cent and ¼ per cent growth in 2008-09 and 2009-10 respectively;

- Growth forecasts for world GDP in 2008 and 2009 of 3¼ per cent and 3 per cent respectively.

From the vantage point of January 2009, the MYEFO forecasts of early November, particularly those relating to the world economy and most notably the emerging economies, look decidedly optimistic. The latest International Monetary Fund outlook for global growth, for example, is well below Treasury’s November estimates.

Ai Group expects the starting point operating budget for the 2009-10 year to be in deficit by between $5 and $10 billion. Additional changes in the budget are likely to extend this to a deficit in a range of between $15 and $20 billion in 2009-10.
Fiscal Stimulus Measures

Fiscal Stimulus: Personal Income Tax Changes

Tax cuts are scheduled to take effect from 1 July 2009. These were legislated in 2008 as part of a package of tax changes phased in over the 2008 – 2010 period. The scheduled 2009 component will inject approximately $2.5 billion dollars into the economy.

Existing Scale

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Low income tax offset $1,200

Currently Scheduled 2009 Scale

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Low income tax offset $1,350

The tax cuts currently scheduled to take effect from 1 July 2009 deliver an average increase in disposable incomes of less than 1 per cent for the majority of personal income taxpayers.

These tax cuts therefore barely compensate for fiscal drag and in that sense represent a neutral fiscal policy.
One option for additional tax cuts that meets the criteria of being targeted, temporary and timely, is to bring forward to 1 July 2009 all or part of the 2010 tax cuts. Bringing forward all or some of the 2010 tax cuts is a temporary stimulus that would have an additional impact (and cost) only in the 2009-10 year.

The entire 2010 scale could be brought forward. This would involve raising the Low Income Tax Offset to $1,500; lifting the threshold at which the 30 per cent rate took effect to $37,000 and reducing the marginal tax rate applying to incomes between $80,001 and $180,000 to 37 per cent. This would have a cost in 2009-10 of about $3.5 billion.

Alternatively the Government might consider confining the reduction in the tax rate applying to the $80,001 to $180,000 income range to the level currently scheduled for introduction from 1 July 2009 (38 per cent) with the bring-forward of measures targeted to the change in the 30 per cent bracket and the Low Income Tax Offset. This more limited bring-forward of tax cuts would have a cost in 2009-10 of around $2.75 billion.

One argument in favour of confining the bring-forward to the changes to the lower end of the scale is that it is more targeted and will generate a bigger bang for each dollar of tax cut (largely because a larger proportion of the additional reduction in the $80,001 - $180,000 rate is likely to be saved).

The impacts of the more limited bring-forward of the 2010 scale are summarised in the following charts. They are based on the adoption of the following income tax scale.

**Possible 2009 Scale**

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<td>180,001</td>
<td>and above</td>
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Low income tax offset $1,500
Chart 5: Proportional Impacts of Currently Scheduled and Possible Tax Cuts

Chart 6: Cash in Hand Impacts of Currently Scheduled and Possible Tax Cuts
Fiscal Stimulus: Business Measures

**Tax Refunds for Businesses in Loss in 2008-09 and 2009-10**

In Australia, tax relief in relation to losses can only be realised against future tax liabilities. This means that businesses making losses are not able to claim a deduction in respect of these losses until they return to profit.

This asymmetrical treatment of losses is an anomaly in Australia’s tax arrangements. It is an anomaly that in many other countries is addressed by a variety of provisions including the ability to “carry-back” losses and secure current-year refunds against tax paid by the company in earlier years.

In the context of the sudden downturn many companies are confronting losses in the current and 2009-10 financial years. As our tax arrangements currently stand a company making a loss in 2008-09 and 2009-10 would effectively chalk up an unpaid tax credit in relation to these losses. The credit would become refundable out of tax paid on 2010-11, or later-year profits. In reality the tax credit may not be realised until the second half of 2011.

Allowing businesses a tax refund in relation to losses would provide relief from adverse cash constraints. It is a measure that would give businesses critical leeway - including for the purpose of retaining employees that might otherwise be retrenched.

Ai Group proposes that this measure could be limited, for example, to the first $1 million of a business’s losses in each of 2008-09 and 2009-10 and only be available to businesses with average annual turnover over the years 2005-6 to 2007-08 below a specified threshold (for example $100 million).

In general, the proposal would impact on the timing of tax payments and cash flows and not on their level. This would see the aggregate impacts of the measures having a very small impact over the period of the forward estimates.

**Illustration of Tax Loss Refund Proposal**

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<tr>
<td><strong>Taxable Profit (+)/Loss (-)</strong></td>
<td>-100,000</td>
<td>-50,000</td>
<td>200,000</td>
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<tr>
<td><strong>Current year tax liability (+)/Credit (-)</strong> (30% tax rate)</td>
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<td>-15,000</td>
<td>60,000</td>
<td>15,000</td>
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<tr>
<td><strong>Tax Paid (existing arrangements)</strong></td>
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<td>15,000</td>
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<tr>
<td><strong>Proposed Tax Paid (+)/Refund (-)</strong></td>
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<td>-15,000</td>
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<tr>
<td><strong>Proposal’s impact on cash flow</strong></td>
<td>+30,000</td>
<td>+15,000</td>
<td>-45,000</td>
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**Incentives for Business Expenditure in Key “At Risk” Areas**

In December the Government announced a temporary capital allowance to encourage business investment. The investment allowance provides an additional tax deduction of 10 per cent on capital expenditure.

Ai Group welcomes this measure and proposes that the Government:

- Extend these capital allowance measures a further year (so they apply to contracts to purchase or build assets entered into between 1 July 2009 and 30 June 2010); and,

- Extend eligibility for the additional deduction to business expenditure undertaken in 2009-10 in the following key areas:
  - Training;
  - Research and Development; and
  - Export Market Development.

The extra tax deductions in relation to expenditure in 2009-10 would not be limited to businesses making a profit in 2009-10 but would also be available to businesses that recorded a tax loss in that year as a result of the proposed tax loss refund measure.

**Fiscal Stimulus: Drive to Renew Public Infrastructure**

Significant elements of Australia’s public infrastructure are run down and poorly maintained. The under-allocation of resources for maintenance is apparent across a wide range of areas including main and local government roads, bridges, parks, hospitals, schools and libraries, public housing, train stations and rail rolling stock.

The downturn presents an opportunity to make inroads into the maintenance backlog and Ai Group proposes a drive to renew public infrastructure over the 2009-10 and 2010-11 years to accelerate repairs and upgrades on national, state and local government infrastructure.
Boosting Capabilities in the Downturn

Ai Group proposes targeted measures to boost key areas of training and business capability development during the downturn.

Ai Group proposes measures to:

- Increase training opportunities for unemployed people and to assist the upskilling of existing employees;
- Retain the strength of the apprenticeship system;
- Increase the emphasis on young people at risk of not completing base levels of education and training; and,
- Increase the resources and the reach of the Enterprise Connect program for the 2009-10 and 2010-11 years.

Boosting Capabilities in the Downturn: Skilling Unemployed and Existing Workers

Ai Group proposes fast-tracking the existing momentum to improve training programs to ensure that people made unemployed and existing employees are able to upgrade their skills and improve their subsequent employment opportunities and earnings potential during the downturn.

Boosting Capabilities in the Downturn: Apprentices

Historically, apprenticeship numbers drop in an economic downturn and, as a consequence, skill shortages are exacerbated in economic good times. The mistakes of the past should not be repeated and measures should be introduced to stem this tide. Such measures could include targeted and increased sign-up bonuses for employers; realignment of Commonwealth employer incentive arrangements; and expanded pre-vocational, especially pre-apprenticeship programs.

A concerted effort should be made to better inform employers about the options for securing the future of an apprentice who may be at risk of losing employment. These options include: utilisation of group training companies to assist in the transfer of contracts of training; increased employment rotation and acceleration of training components on a needs basis.

Measures should also be adopted to provide better options for out-of-trade apprentices. These include creation of a national database for employers and out-of-trade apprentices and provision of funding to appropriate organisations – for example group training companies to case manage apprentices through to ‘completion’; and greater eligibility of ‘out-of-trade’ apprentices for the full Youth Allowance.

Group Training Companies (GTCs) have a vital role in maintaining the momentum of the apprenticeship system. This is all the more apparent in a period of downturn when host companies can hand back apprentices to GTCs. The measures proposed above may assist GTCs to secure placements for existing apprentices who cannot be retained by their host company. At a time when GTCs are also experiencing a drop in revenue
and an increase in administrative costs associated with the successes of Competency Based Training, the Government can assist by encouraging an ongoing stream of first year apprentices with direct assistance that recognises the public benefit stemming from the important role played by the GTCs.

Ai Group proposes:

- Doubling the commencement incentive from $1,500 to $3,000 in traditional trade areas.
- Reintroducing 12 month progress payments with a further $1,500 to encourage continuation of apprenticeships into next stage.
- Funding Group Training Companies to take up all eligible ‘out-of trade’ traditional apprentices; to support and case manage job rotation accelerated training and work placement.
- Extending access to Youth Allowance to all out-of-trade traditional apprentices as an income support arrangement allowing training completion.

**Boosting Capabilities in the Downturn: Young People at Risk**

Ai Group is concerned about the impact of the economic downturn on the prospects of young people not fully engaged in education and training. In times of an economic slump it is even more important to support those young people at risk identified in Ai Group’s recent *It’s Crunch Time* report. This is also the case for those young people only marginally connected to the workforce as they are often the first casualties of a slump. Ai Group encourages the development of measures designed to support young people at risk of not being engaged in education and training and of only being marginally attached to employment.

**Boosting Capabilities in the Downturn: Expanding Enterprise Connect**

Enterprise Connect provides Australia's small and medium-sized enterprises with access to advice, technology and research, and links firms to capability-expanding business and management advisory services in their immediate region and around the country.

The present downturn creates an opportunity to expand the reach of Enterprise Connect by doubling the number of businesses receiving the benefit of its services and broadening the industries qualifying for selection. There is particularly strong scope to increase the currently restrictive size threshold so that medium-sized businesses can qualify to benefit from services. Ai Group is confident that the demand for the range of services that can be provided by Enterprise Connect is strong and may increase in the current climate as businesses reassess their opportunities and business plans.
Investing in the Drivers of Growth

**Investing in the Drivers of Growth: Innovation Policy**

Whether as part of the 2009-10 Budget or in an earlier Innovation Statement, Ai Group urges the Government to respond comprehensively to *Venturous Australia* the report of the Cutler Review of the National Innovation System. Responding to the Review presents an opportunity for the Government to make decisive advances in the important area of innovation policy.

Ai Group proposes that the Innovation Statement should address the following five strategic objectives:

- **Core Investment:** Australian investment in many of the drivers of innovation has stood still over the last decade and continued investment is required to maintain Australian competitiveness.

- **Knowledge Transfer:** Stronger links between industry and academia are required to maximise the commercial potential of new ideas. Whilst some interaction between the university and private sector is taking place, Australia still lags behind many of its competitors.

- **Gap Finance:** In addition to core investment in the drivers of innovation, targeted funding is required to bring innovative new products and processes to market. A particular focus on seed and ready-for-market funding is required.

- **Private Sector:** The focus of innovation policy and funding is currently skewed towards the public sector. Greater emphasis must be placed on supporting and developing private sector R&D and venture capital activity.

- **Benchmarking Performance:** Despite near-universal agreement that innovation is key to future economic success very little has been done to measure the effectiveness of established innovation programs, or benchmark Australian performance against overseas markets.

To move towards these objectives, Ai Group urges the Government to accept the following measures highlighted by the Cutler Review:

- The current R&D Tax Concession should be changed from a tax deduction measure to a tax credit replacing the 125 per cent R&D Tax Concession, the R&D Tax Offset and the International Premium;

- A 40 per cent Tax Credit should be available to large firms with a refundable Tax Credit of 50 per cent available to smaller firms with turnover under $50 million;

- R&D expenditure undertaken in Australia by foreign-owned firms should be eligible for both the 40 per cent Tax Credit and the refundable Tax Credit;
• A Competitive Innovation Grants Program should be introduced to assist innovative firms with limited access to capital, in high risk, proof-of-concept and development stages. Successful firms would be required to repay grants from the royalties or earning streams accruing from commercial success;

• The COMET program should be extended for another five years, with scope for greater linkages to the Enterprise Connect initiative;

• The Innovation Investment Fund program should be maintained, with a fourth round implemented after 2012;

• A second round of Pre-Seed Funds should be established, with the current absolute $1 million cap per investee firm changed to a maximum $1 million cap on the first tranche of investment. Four new themed funds should be established at a cost of $100 million over 15 years;

• An extension of the Enterprise Connect Program to include services firms and an expanded remit to provide business innovation services;

• The establishment of a new Knowledge Connections program (within the Enterprise Connect Program) to work with Industry Innovation Councils to facilitate new connections and build sustainable clusters;

• The principle of fully funding the costs of university research activities should be applied through adjustments in funding to both block and competitive grants;

• Increasing funding for university research to match the investment levels of leading OECD economies by 2020;

• Reviewing Patent law to ensure that the steps required to qualify for patents are considerable, and that the resulting patents are well defined, in order to minimise litigation and maximise the scope for subsequent innovations; and

• Making information, research and content funded by Australian governments – including national collections – freely available over the internet.

In contrast to the Cutler Review, Ai Group proposes retaining the 175 per cent premium tax concession and sees merit in converting this to a tax credit arrangement in line with the change to the standard tax concession. The premium concession is proving popular with a growing number of companies and over the period of its operation there has been a decisive increase in the pace of business R&D expenditure. While this program should be scrutinised closely, Ai Group is not convinced that the Cutler Review has made a compelling case for its removal.

Ai Group has a number of other proposals for consideration by the Government as it prepares its Innovation Policy. These include the need for:
• Upgrading the education and training systems to enhance innovation skills amongst employees and managers; including a specific program to engage people with low literacy levels.

• A new ‘Into the Market Program’ to fill the void left by the closure of the Commercial Ready program aimed at providing tailored assistance for companies seeking to commercialise their R&D.

• Collaboration Grants to support companies who wish to undertake collaborative innovation with other companies, universities/research institutions, or in regional clusters.

• The use of ‘University Compacts’ to build collaborative research across Australia’s universities.

• The implementation of a National Innovation Scorecard to benchmark Australia’s innovative performance and to provide better insight to changes in business practice across key sectors of the economy. The scorecard would build on established research undertaken through the ABS bi-annual Innovation Survey and data compiled through the innovation module of the Business Characteristics Survey (BCS).

• Following on from the recent work undertaken in both the Automotive and TCF sectors, detailed reviews of the ICT, defence and pharmaceutical sectors should be advanced in order to identify similar opportunities for innovation and investment.

• The development of a creative industries strategy to further realise the commercial potential of Australia’s artistic and cultural assets. Particular consideration should be paid to the impact of design and technology as an enabler of innovation across other industrial sectors. It should also consider current intellectual property regimes and seek to address both established weaknesses whilst strengthening protections against threats to Australia’s creative capital (i.e. piracy).

• The establishment of a National Technology Strategy, under the auspices of the National Innovation Council, to identify and develop areas of strategic national importance to the Australian economy. The Strategy should focus on medium to long-term issues and provide a framework for setting relevant policy priorities and improving the effectiveness of business support.
Investing in the Long-Term Drivers of Growth: Infrastructure

Investments in infrastructure will receive a long-awaited impetus in 2009 from recent initiatives of the Commonwealth and State and Territory governments. These initiatives have come at a time when the scope for private sector funding of public infrastructure has all but disappeared as a consequence of the crisis in global credit markets. As a result, the approach required to fund Australia’s infrastructure requirements has altered markedly - with an increased role for public funds needed to make up for the dramatic turnaround in the availability of private financing.

It would be unwise for Australia’s infrastructure plans to be put on hold in these circumstances if, in addition to existing allocations - for example in the Building Australia Fund, further funding for worthwhile projects could be secured with public sector borrowing. Ai Group has consistently supported responsible public borrowing to finance infrastructure where the rates of return on additional investments cover the associated interest expense and other recurrent expenditure.

Notwithstanding the existing allocations for infrastructure commencing in 2009, Ai Group has identified two important gaps in existing plans. These gaps are in the areas of energy and the existing National Broadband Network (NBN) proposal.

Energy

Reforms initiated over recent years to Australia’s energy market have gone some way to creating a truly national market. These reforms have already delivered considerable benefits.

However, as Infrastructure Australia has noted “the reform process is far from complete and there remains considerable scope to improve the efficiency of Australia’s energy sector”. Treasury Secretary Ken Henry, has also stated that despite the progress to date, the Australian energy market remains “a series of regional markets with limited interconnectedness”.

Further, the Productivity Commission has highlighted the benefits that could accrue from additional progress estimating that further energy market reforms could boost Australia’s GDP by 0.43 per cent per annum. Given that many of the outstanding reforms required are related to market design and pricing, a number of investments in aspects of physical infrastructure to assist the process of market efficiency and reform are warranted. These include:

- Interstate Interconnection to help plug critical energy network infrastructure gaps on the eastern seaboard. Such investment would help address existing capacity concerns and future demand, and would also be consistent with the Government’s Climate Change policies which will require significant changes to Australia’s energy transmission and distribution systems over the coming years.

- An Energy Infrastructure Renewal Fund – to accelerate the replacement of generation facilities and the transition to lower carbon generation. Existing research estimates that Australia’s network operators intend to spend between
$4 and $5 billion between 2008 and 2013, and roughly the same amount again by 2020 to meet future demand and to replace ageing assets. However, there are significant concerns that such investment will be insufficient and, as is the case in NSW, that the bare minimum on infrastructure renewal will be invested.

**Broadband**

Ai Group advocates a suite of measures that fit within the Government’s established policy framework. These measures are ‘technology neutral’ and should incorporate support for a wide range of technology platforms (fixed broadband, wireless broadband, satellite broadband and core or backbone transport). Our proposals also seek to target underserved or difficult-to-reach areas and are consistent with the Government’s ambition to establish near-universal digital infrastructure.

Ai Group proposes:

- A Remote & Indigenous Broadband Program to bring high-speed internet access to remote rural and indigenous areas. The grant program would be a technology-neutral opportunity for interested providers to bid for partial subsidies to provide broadband service, at minimum speeds and capabilities consistent with the Government’s NBN policy. This measure would help address existing private sector concerns over the cost cited for the rollout of the NBN and would enable the Government to address public concerns arising from the closure of the Australian Broadband Guarantee.

- A set of tax incentives across the main delivery technologies in order to drive high-speed broadband deployment and uptake. Taking into account proposals mooted by the Obama administration in the US, this could differentiate between delivery platforms and provide higher incentives for higher speed networks.

- A Community Broadband Program to enable all Australia’s health, education and community institutions to upgrade to high-speed broadband. This would have particular benefits in rural areas, and would also help drive greater efficiency in the delivery of public services.

- A Broadband Skills Program to increase skills and promote awareness of the commercial opportunities presented by high-speed broadband. This should be tightly targeted at SMEs where, as Ai Group’s research has shown, almost one in three small firms feel they currently lack the skills necessary to seize business opportunities arising from the deployment of high-speed broadband.
Investing in the Drivers of Reform: Education and Training

The future competitiveness of Australia will, in large measure, be determined by the extent to which businesses are able to attract, develop, upskill and reskill both their current and potential workforce. This is an imperative if we are to emerge stronger and more competitive from the current economic downturn.

Ai Group supports ongoing reforms to Australia’s education and training arrangements with a particular emphasis on the following six strategic areas:

- Strong support for the apprenticeships system, particularly Group Training Companies, to ensure adequate levels trade skill development over the next decade;
- Continued development of a demand-led training system with industry at its centre
- Continued rebalancing of the training system to meet both the needs of new entrants and existing workers
- Careful consideration of single tertiary sector ideal in a way that does not compromise or undermine the necessarily different purposes and functions of vocational education and training and higher education;
- Continued reform of the schooling system including the development and implementation of national curriculum and the broadening and deepening of genuine vocational options
- Extending and strengthening industry's role in career and transition arrangements, including the Careers Advice Australia.

Schooling

National Curriculum

The Australian Industry Group supports the development of a national curriculum and the establishment of the National Curriculum Board. This initiative represents an opportunity for some time to establish consistent national standards across the school curriculum. It is important that the Board develops the achievement standards (initially in the areas of English, mathematics, the sciences, and history) collaboratively across Australia with key education stakeholders and the general community.

VET in Schools Reform

A key element to support the engagement of young people is the provision of VET in Schools programs. Notwithstanding the success of these programs it is timely to initiate reform to improve program outcomes. Ai Group supports the following measures:

- Program Expansion: adopt measures to further promote VET in Schools programs consistent with the objective of making vocational opportunities available to all senior secondary students;
• Resourcing: provide sufficient recurrent program funding to ensure that the costs are not passed onto students and their parents so that there are no student tuition costs for participation in the program;

• Industry Coverage: remove the financial barriers to student participation in resource intensive programs such as engineering, building, construction and automotive and to adopt measures to promote these programs to students and their parents;

• Structured Workplace Learning: introduce measures designed to increase opportunities for VET in Schools students to participate in workplace learning in consultation with industry;

• Labour Market Data: implement measures to standardise the provision of labour market data from key central agencies to enable the Career Advice Australia network to have effective access to this critical information to better inform local program decision-making; and,

• Quality Benchmarks: develop a set of quality benchmarks for VET in Schools programs.

The Job Ready Certificate and Employers

Ai Group supports the general thrust of the proposed Job Ready Certificate and recognises that there are issues in relation to rating scales, the award and use of the certificate and student eligibility. Central to the credibility of this initiative is the involvement of employers in the development as well as the assessment phases.

The issue of time and resources to conduct assessments needs careful consideration. Ai Group proposes that the development of the understanding and capabilities of employers be incorporated into the implementation of the proposal.

Careers and Transitions

Career guidance services provide both public and private benefits and support skills development goals, labour market goals and social equity goals. Career guidance services play an important role in economic growth and are also important in managing particular challenges faced by individuals and organisations.

Good quality career development practices in schools contribute significantly to successful transitions of young people from school to work and further education. Anecdotal evidence also highlights the valuable role career development and practical experiences can play in increasing engagement in school education, including previously disengaged young people.

Ai Group strongly argues for the development and implementation of a National All-Ages Career Development Strategy. Many of our international competitors have already acted to establish services in this area and to be globally competitive Australia should establish high quality services in this area.
The Career Advice Australia (CAA) Network is one important element of an All-Ages Career Development Strategy which has proved its worth over the last three years. The outcomes to date from the Australian Government’s Atelier Evaluation support this view and in particular the valuable role played by industry in delivering CAA Services. All three key networks within the CAA Network, including National Industry Career Specialists, Regional Industry Career Advisers and Local Community Partnerships, should continue to be funded on long-term contracts to further cement the strong foundation this Network has laid for young people and industry in the future.

In addition, career development should be a mandatory element of a national school curriculum and all secondary schools should have at least one professional career guidance teacher with appropriate specialist training.

Skills and Training

There is an ongoing need to re-orient both the training system and the funding mechanisms to better meet the needs of business to skill new entrants and to broaden and deepen existing workers’ skills.

Training system reforms

Ai Group supports the Government’s additional investment, particularly in the productivity places program. This program is a useful step in addressing the need to expand the resource commitment to the VET sector as well and stimulate skill development in difficult times. This program must be rigorously evaluated to ensure timeliness, flexibility and relevance.

Structural reform of the governing arrangements of the national training system is required. The establishment of Skills Australia has been important in the provision of strategic advice to the Deputy Prime Minister.

It remains of concern that industry has no determinative powers in our ‘industry-led’ training system. This needs to be addressed. An ‘industry-only’ voice needs to be established at the strategic governance level.

Important work is also currently being undertaken on ‘VET Products for the 21st Century’ and this will be an essential cornerstone to the next phase of reform of the training system.

Training for the existing workforce

Australian companies are turning to their existing workforce as the source of much needed skills. The traditional boundaries of training are being ignored at the business coalface. Ai Group believes it is necessary to better link the many and varied approaches that enterprises take to skilling their workers and to have this diversity recognised in public policy, including resource allocation. Policy recommendations include:

- Develop a Workforce Skills Development Advisory Network;
• Establish a Workforce Skills Development Fund;
• Establish a National Workforce Literacy Strategy;
• Build understanding and capability in RTOs of Workforce Skills Development;
• Increase priority for investment in workplace and organisational learning programs;
• Develop a comprehensive strategy for the provision of ‘green skills’ for existing workers; and
• Continue the development of flexible, demand and outcomes-based funding.²

Impact of Competency Based Training

A major policy development over recent years has been the displacement of traditional annual progression for apprentices with a greater role for Competency Based Training (CBT). Under existing funding models there are disincentives that deter the full promotion and implementation of CBT by Group Training Companies.

Ai Group proposes an independent assessment of the impact of CBT on the financial and administrative pressures of Group Training Company promotion of CBT and their participation in the broader apprenticeship system.

Higher Education

The Bradley Review into Higher Education contains a broad and comprehensive array of initiatives. Ai Group particularly welcomes the strong focus on quality, a clear desire to address the equity tail in relation to higher education participation, and proposals around the means of student income support.

Ai Group is concerned however that the Review seeks a lower-than-OECD average target of 40% of degree level qualifications compared to the 50% targets adopted in some other countries. The Report acknowledges that Australia will do no more than maintain its relative OECD position if all of the recommendations are implemented. We should reconsider this aspiration as the development of a strong set of public performance indicators for international comparison is a necessary step in this process.

Ai Group retains serious practical concerns over the creation of a single ‘tertiary’ sector. While superficially attractive, the purposes and functions of both the vocational education sector and the higher education sector are necessarily very different. This difference should be valued and preserved but at the same time allowing for closer alignment. Furthermore, the notable omission of the involvement and leadership of industry in the proposed set of reforms for the ‘tertiary’ sector is a major concern. This should also be addressed.

² See Ai Group’s Skilling the Existing Workforce, December 2008.
Investing in the Drivers of Growth: Greenhouse Gas Abatement Investment Incentive

A major challenge facing business over the coming decade is the structural change required by the need to reduce greenhouse gas emissions. Businesses will be required to reduce their direct emissions and to reduce their use emissions-intensive inputs – particularly electricity.

To complement the targeted measures proposed for trade exposed emissions intensive industries and the range of measures to be funded by the Climate Change Action Fund under the Government’s proposed Carbon Pollution Reduction Scheme, Ai Group proposes the introduction of more generally available depreciation arrangements for investments that reduce the emissions intensity of business operations.

Ai Group proposes a regime under which special depreciation schedules are available for qualifying investments directed at improving energy efficiency and reducing emissions intensity. Ai Group proposes that business should be able to claim the entire value of the capital expenditure over the first half of its effective life (compared with the general ability to spread deductions over assets’ entire effective life). “Emissions intensity” should have a broad definition and include direct emissions, emissions related to electricity use and indirect emissions from sources other than electricity.

Investing in the Drivers of Growth: Export Market Development

As an export-oriented economy, Australia is heavily reliant on trade and market access to sustain economic growth and activity.

The Export Market Development Grant scheme provides important support for small and medium-sized companies hoping to expand through the creation and development of international products. In 2007-08, 80 per cent of recipients were small businesses with turnover of less than $5 million. The scheme in 2007-8 had a budget of $156.9 million.

The program was recently examined as part of a broader review for government of Australia’s export policies and programs and was found to be effective and worthy of continuing support. Modelling for the review showed that for each dollar spent, between $13.50 and $27 of export revenue was generated.

Ai Group endorses the review’s overall conclusion that the EMDG scheme should be continued. The current difficult economic climate is certainly not the time to cut the funds available to export-oriented Australian industries looking to diversify their market reach. Without such support, access to the capital needed to push into the international market would be increasingly difficult for many small Australian companies.

While the Government has been advised in the review to lift the threshold required to access and shorten the period of accessibility to EMDG funds, Ai Group believes the fund must remain accessible to smaller exporters. Rather than restricting access, the scheme now requires strengthening. Funding for the scheme has eroded in real terms.
by over 22 per cent over the past ten years while the average grant has declined in real terms by 32 per cent over the past nine years.

The scheme is worthy of increased funding to increase the overall pool available to industry and to support more grants, especially to smaller industry players who should not be locked out.

Export Finance

Ai Group strongly supports the important contribution that the Export Finance and Insurance Corporation is making in the current downturn. EFIC provides valuable advice and commercial services to a wide range of businesses and, at a time when global financial markets are not operating efficiently, this range of services has assumed even greater significance. Ai Group proposes that the need for a greater public contribution to the EFIC should be considered as part of the 2009-10 Budget.

Expand Resources of AusTrade in key Emerging Markets

The strong growth potential in emerging markets is not matched by comparable allocation of AusTrade resources. Ai Group proposes an increase in the commercial focus and representation of AusTrade, with a particular emphasis on improving access for Australian companies in the emerging markets of Africa, South America and South East Asia.
Accelerating Gains in Public Sector Efficiency

Ongoing Program Scrutiny and Reprioritisation

Ai Group proposes the Government maintain momentum of rigorously scrutinising all existing programs as part of an ongoing strategy of removing inefficient programs and reprioritising the allocation of public sector funding into more efficient programs.

Extending the Reach of the Gershon Review

The Government has indicated its intention to implement the recommendations of the Gershon Review into more efficient ICT use at the Commonwealth level. Ai Group supports this important step and advocates extending the directions recommended by Gershon to further enhance public sector efficiency and reform.

This extension is an important element in generating greater efficiency from the Australian public sector and should include:

- The application of the main findings of the Gershon Review across State, as well as Federal, governments;
- The inclusion of participants with expertise from outside of government in the Ministerial Committee and Secretaries’ ICT Governance Board established to drive more efficient ICT use;
- A requirement that all government agencies be required to meet AS 8015-2005 Corporate Governance standards by the end of 2012;
- A comprehensive audit of ICT use across government in order to establish credible metrics against which to benchmark performance;
- Establishing a realistic ‘glide path’ for the reduction of external ICT consultants at a rate that complements the development of in-house public service skills and capabilities;
- Introducing a dedicated program designed to boost the participation and retention of women in ICT roles throughout the public service;
- Using the new National (high-speed) Broadband Network as a mechanism to rationalise public sector data network connections;
- Optimise the location of government ICT data centres and back-office systems throughout Australia to make better use of labour force skills and reduce costs;
- Removal of artificial constraints from the government-ICT marketplace so it is able to operate effectively;
- Use Gateway Reviews as a mechanism in all major ICT procurements and across all government agencies;
- Establish a formal strategy to transition government agencies to environmentally friendly, energy-efficient ICT; and,
- Require all government agencies to report on the energy consumed by ICT use by 2011.
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