2011-12 Federal Budget Priorities

Pre-Budget Submission 28 January 2011

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NSW Business Chamber

Executive Summary

The NSW Business Chamber welcomes this opportunity to contribute to the formulation of the 2011-2012 Federal Budget. The NSW Business Chamber represents the interests of around 30,000 companies across NSW and the ACT, ranging from owner-operators to corporations, and from manufacturers to service providers.

The Government came to office in 2007 with grand plans for reform, and while the early signs were promising, and the Government's response to the global financial crisis was sound, in many ways 2010 was a year of lost opportunity. While the formation of a minority government following the 2010 election has presented the government with additional challenges, this should not be used as an excuse when leadership is required. The Government has talked the talk of "walking the reform road," and now is the time to deliver.

Australia is currently going through an extended period of low productivity growth, averaging less than 1 per cent over the last six financial years; the slowest rate of productivity growth since the late 1980s. The delivery of reform is needed to help drive productivity growth through the Australian economy.

There are many significant challenges confronting Australia; challenges made more acute by the fiscal constraints currently faced by all levels of Government. Fiscal sustainability, tax reform, small business access to finance, skills and infrastructure are all areas where the Government can take bold actions and make significant improvements.

Fiscal Sustainability

The Government's Budget position, while still relatively weak, is in far better shape than it was this time last year. The significant positive revisions to revenue outlined in the 2010-11 Budget – and subsequently confirmed in the November MYEFO – have placed the Budget on a path which will return it to surplus by 2012-13.

However, the Government must not use this as an excuse to avoid taking the difficult decisions which are necessary to contain underlying growth in expenses. It will be necessary to identify significant long-term savings; simply unwinding stimulus measures and making changes at the margin will not be sufficient. Balancing the books through the introduction of new taxes or increases to existing ones must be avoided as this would have a detrimental impact on productivity, efficiency and growth.

It may be timely for the Government to undertake a more comprehensive review of expenditure, and look to identify further structural savings. The Government's latest Intergenerational Report recognises that Australia's ageing population, increasing health care costs and climate change will all place pressures on Government finances over the longer term. Significant structural reforms are needed to address these longer-term challenges and ensure that government finances return to – and remain in – a sound position in the decades ahead.

Recommendation 1:
The Government should outline a medium-term plan for achieving structural savings, expenditure restraint and fiscal consolidation following the return to surplus. Such a plan should include a comprehensive review of expenditure.

The Government currently estimates that the direct costs of the floods to the Budget will be around $5.6 billion over the forward estimates. We strongly support the priority the Government has given to flood recovery efforts. The floods have damaged billions of dollars of essential infrastructure, and it is important that this is rebuilt in a timely fashion to prevent the floods from having an ongoing detrimental impact on economic growth. We also support the Government's commitment to deliver a Budget surplus in 2012-13.

However, we have concerns about the merits of a flood levy. Retailers are already struggling in the two-speed economy, and imposing an additional levy at this time will further undermine the already sluggish recovery in consumer spending. Furthermore, the levy will have only a minor impact on the Government's capacity to deliver a surplus in 2012-13, particularly as the Government will collect the bulk of this revenue in 2011-12.

Recommendation 2:
The Government should not introduce a flood levy, and should instead look to introduce additional savings measures should further expenditure restraint be necessary to return the Budget to surplus.

Tax Reform

While the Government's initial response to the Henry Review was disappointing, the tax summit scheduled for later in the year provides the Government with an opportunity to develop a more ambitious tax reform agenda.

Many different groups have called for various aspects of the tax system to be added to the summit, and we support a broad-reaching agenda. Including issues like the GST, while politically difficult, is nonetheless necessary if the Government is to develop a comprehensive picture of how tax reform can drive further improvements in the nation's productivity and international competitiveness.

Recommendation 3:
The agenda of the tax summit should be broadened to include consideration of the appropriate rate and base for the GST.

The NSW Business Chamber has been a long time advocate for reform of State taxes. Given that State taxation raises less than one-fifth of national tax revenue and only two-fifths of total State revenue, it is difficult to justify the existence of 160 separate State taxes. The Henry Review agreed with this position, and recommended the abolition of payroll taxes, insurance taxes and conveyance duties, and the reform of land tax, motor vehicle taxes, gambling taxes and resource royalties.

Without reform of the current Federal-State financial arrangements, the abolition of inefficient State taxes will increase reliance on Federal grants and exacerbate the existing vertical fiscal imbalance. The Henry Review acknowledges the importance of providing States with better revenue sources to replace their current taxes.

The Government should play a more active role in encouraging the States to undertake these reforms. Without leadership at the Federal level there will be little incentive for the States to act unilaterally to improve the efficiency of their respective tax bases.

Recommendation 4:
The Federal Government, in consultation with the States, should develop a medium-term strategic plan for the implementation of the State tax reforms outlined in the Henry Review.

Small Business Access to Finance

The reduction in competition in the banking sector has both reduced the accessibility of small business finance and increased the price at which finance is available. Spreads on small business loans have blown out from around 200 basis points to more than 400 basis points, and business credit has now fallen for 21 months. Tightening credit requirements and an apparent overreaction towards risk aversion by the major banks continue to constrain the availability of credit.

In this environment, it is important that the Government is proactive in fostering the ability of these small businesses to operate and grow.

The NSW Business Chamber proposes that the Government consider the implementation of a temporary guarantee of small business loans in Australia. Governments in many other countries, including the US, UK and Canada already offer loan guarantees to small businesses, recognising the important role that this can play in supporting small businesses and the jobs that they create.

By charging a price for the guarantee and not guaranteeing 100 per cent of each loan, the Government can reduce moral hazard risks and ensure that the overall program is revenue neutral.

Recommendation 5:
Consideration should be given to the implementation of a guarantee of small business loans in Australia.

Skills

Australian industry needs a skilled, flexible and motivated workforce that contributes to productivity gains and drives economic growth. Ensuring that the available workforce has the skills and knowledge required to meet the needs of industry and employers is a significant issue for Australia.

There are four main areas of policy concern within the education and training portfolio which are critical to increased employment participation and therefore, to improved productivity outcomes. These are addressing emerging skills shortages, additional improvements to the apprenticeship system, reform to vocational education and providing ongoing training to existing workers.

Recommendation 6:
In a climate of re-emerging skills and labour shortages, it is imperative that the skilled component of the migration program contain sufficient flexibility to meet the immediate needs of industry as well as the longer term needs of the economy.

Recommendation 7:
The level of incentives introduced via the Kickstart initiative should be maintained to ensure adequate levels of apprentice recruitment by employers and as a means of improving labour market participation, especially for young people.

Recommendation 8:
The Government should not impose competency based progression requirements on industry, rather each industry sector should be encouraged to introduce competency based arrangements that align with the needs and requirements of the particular industry.

Recommendation 9:
The VET reform process should be informed by industry with the objective of creating a demand driven VET system that links skills attainment with industry need. Training outcomes should be competency based not driven by institutional imperatives.

Recommendation 10:
Improved administration to the Productivity Places Program (PPP) is needed to provide a national rollout of existing worker PPP through Industry Skills Councils, Industry Training Advisory Boards and industry associations along similar lines to the Enterprise Based PPP.

Infrastructure Expenditure

We have been strongly supportive of the Government's Nation-Building Funds and the role played by Infrastructure Australia, with the significant capital and strong governance framework combining to ensure that a considerable amount of critical national infrastructure could be financed over the medium term.

More recently, we have been concerned that the Government appears to be moving away from its earlier commitment to these funds. As part of its mining tax package, the Government announced the establishment of a $6 billion Regional Infrastructure Fund. It is unclear why a new fund is needed, given that the mandate of the Building Australia Fund is already broad enough to cover infrastructure to support the mining sector.

The governance arrangements around this new fund are also weaker - while Infrastructure Australia will be consulted on individual projects, it appears that they will not play the gatekeeper role of evaluating and prioritising expenditure that they currently do in the case of the nation-building funds. This perception has been compounded by the announcement that $573 million will be set aside from this fund at the request of the Independents for special projects. While we support the development of regional communities, it appears that this decision further undermines the oversight role played by Infrastructure Australia. With the bulk of the funding already earmarked for Queensland and Western Australia, the likelihood of NSW getting its fair share from the fund also appears bleak. Such developments are concerning and we would strongly recommend that, should the Government pursue this fund, Infrastructure Australia ensure that all projects financed from it meet rigorous evaluation criteria.

Since its establishment in 2008, Infrastructure Australia has played an important role in helping to take the politics out of infrastructure investment. We would urge the Government to continue to support the activities of Infrastructure Australia, and ensure that it continues to evaluate, scrutinise and prioritise the Government's infrastructure spending.

Recommendation 11:
The Government should not establish the Regional Infrastructure Fund, and instead redirect this money to the Building Australia Fund, where expenditure can be subject to scrutiny from Infrastructure Australia.

The Need to Embrace Reform

The last twelve months have been a challenging time for the Federal Government. The Government came to office in 2007 with grand plans for reform, and while the early signs were promising, and the Government's response to the global financial crisis was sound, in many ways 2010 was a year of lost opportunity.

Infrastructure in NSW and across the rest of Australia continues to languish. The Government established Infrastructure Australia to advise it of nationally significant infrastructure priorities. It was hoped that the new approach would lead to greater transparency around infrastructure investment, and ensure that the most meritorious projects were the ones which received funding. In its June 2010 update, Infrastructure Australia identified an infrastructure priority pipeline of almost $83 billion.[1] Having identified the priorities, the challenge now is to see these deserving projects funded.

The election campaign saw a disappointing approach to population policies and skilled migration, with both parties appearing to support "small Australia" policies. With skills shortages already appearing in many sectors of the Australian economy, skilled migration will be essential to both boost Australia's rate of economic growth and to reduce pressures on inflation.

On tax, the Henry Review presented the Government with a real opportunity to implement substantive reform of the tax system. Unfortunately, very few of the recommendations put forward were adopted, with the Government appearing to prefer recommendations for new taxes rather than those that simplified or streamlined the existing system. Despite this, the "tax summit" announced by the Government for the first half of this year does provide a second chance for the Government to use the Henry Review as the platform for meaningful tax reform.

All Governments commit to reducing red tape, but few deliver, and in 2010 the Government's performance in this area went backwards. The OBPR found that in 2009-10, 12 proposals proceeded without the support of a RIS, up from 8 in 2008-09 and 4 in 2007-08. In addition, overall compliance with the RIA requirements fell, from around 90 per cent in 2007-08 to around 80 per cent in 2009-10.[2] It is a worrying sign that the Government's level of compliance with its own best practice requirements is slipping.

Fiscally, Government expenditure continues to increase at an alarming rate. While the "2 per cent rule" will place some constraints on Government expenditure, this rule was imposed at the height of the stimulus payments, and in many respects simply structurally entrenches a higher level of Government expenditure. With limited appetite for expenditure restraint, any downwards revisions to revenue forecasts will jeopardise the Government's capacity to return the Budget to surplus in 2012-13.

The formation of a minority government following the 2010 election has presented the government with additional challenges to manage. However, a hung parliament should not be used as an excuse when leadership is required. The Government has talked the talk of "walking the reform road," and now is the time to deliver.

Reform is needed to help drive productivity growth through the Australian economy. In its latest Intergenerational Report, the Government has recognised the important role that productivity needs to play in helping Australia address medium-term and long-term challenges.

Australia is currently going through an extended period of low productivity growth, averaging less than 1 per cent over the last six financial years.[3] This is the slowest rate of productivity growth since the late 1980s, and is well below the longer run trend for productivity growth of around 1.6 per cent per annum.

While the resources boom will be able to mask the negative effects of low productivity growth in the short to medium term, the boom will not last forever and it is no substitute for real reform.

The Government must embrace a timetable of meaningful reform across fiscal and economic policies. It will be equally important that the Government resist knee-jerk and populist responses to policy issues, many of which are advocated by the minor parties.

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1 Infrastructure Australia, *Getting the fundamentals rights for Australia's infrastructure priorities,* June 2010, p. 51.

2 Office of Best Practice Regulation, *Best Practice Regulation Report: 2009-10,* December 2010, p. 15.

3 Australian Bureau of Statistics, *5206.0 Australian National Accounts,* [DATE]

Reforms of this kind do not occur organically; they require a driven and motivated Government that is willing to make the difficult decisions today in order to secure better outcomes for tomorrow.

Such reforms are not easy to achieve, nor are they necessarily popular. As the Prime Minister rightly recognises "long-term reform is difficult work. It's hard to get right. It's also hard to convince people of its worth because it involves uncertainty, disruption and upfront investment."[4]

There are many significant challenges confronting Australia; challenges made more acute by the fiscal constraints currently faced by all levels of Government.

This submission does not attempt to canvass all the issues, however, it does present some of the most pressing concerns faced by the business community where the Federal Government can make a positive and lasting difference. Fiscal sustainability, tax reform, small business access to finance, skills, and the provision of infrastructure are all areas where the Government can take bold actions and make significant improvements.

[4] Julia Gillard, *Address to the 4th Annual Australian National Schools Network Forum,* 17 November 2009

Fiscal Sustainability

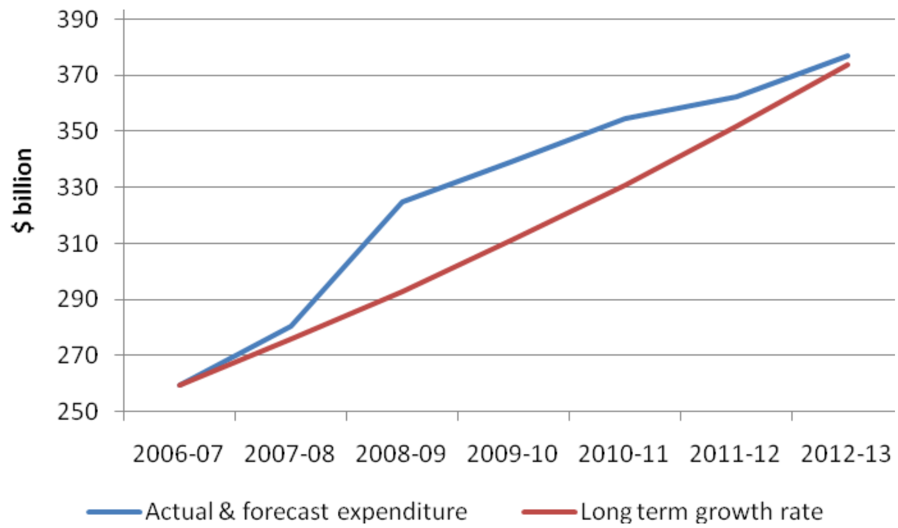
The Government's Budget position, while still relatively weak, is in far better shape than it was this time last year. The significant positive revisions to revenue outlined in the 2010-11 Budget – and subsequently confirmed in the November MYEFO – have placed the Budget on a path which will return it to surplus by 2012-13.

While this is welcome news for the Australian economy, it is important that the Government does not use this as an excuse to avoid taking the difficult decisions which are necessary to contain underlying growth in expenses. It will be necessary to identify significant long-term savings; simply unwinding stimulus measures and making changes at the margin will not be sufficient. Balancing the books through the introduction of new taxes or increases to existing ones must be avoided as this would have a detrimental impact on productivity, efficiency and growth.[5] It would also be inconsistent with Government commitments to keep taxes as a share of GDP below 2007-08 levels.

At present, the Government's "deficit exit strategy" is largely dependent on a strengthening economy to restore revenues, with limited reliance on expenditure restraint. Government revenue is forecast to increase by 9.2 per cent in 2010-11, 11.2 per cent in 2011-12, and a further 7 per cent in 2012-13. While the introduction of the two per cent rule has placed some constraints on increases in government expenditure going forward, the rule is applied to the already very high post-stimulus spending base. Given this higher base, the natural unwinding of the stimulus spending will largely deliver the expenditure restraint necessary to achieve the 2 per cent target.

The chart below clearly illustrates the ease with which the 2 per cent target should be achieved. The blue line illustrates the Government's expected and actual expenditure since coming into government and projected over the forward estimates. In contrast, the red line shows what government expenditure would have been had the government simply continued to increase real expenditure at the long-term rate of 3.7 per cent.[6]

Chart 1 – Government expenditure under the 2 per cent rule



It is clear from the chart above that, even with the fiscal discipline of the government's 2 per cent rule, it will still be spending more in 2012-13 than it would have had it simply increased expenditure in line with the long-run average throughout its time in office.

Most economic forecasters suggest that the Australian economy will experience a period of above trend growth in coming years, particularly if the renewal in the mining sector continues in the medium term. Certainly, the Reserve

[5] ACCI, *Submission to Australia's Future Tax System Review,* October 2008, p. 8-9.

[6] Commonwealth Treasury, *2010-11 Budget,* Budget Paper 1, Chap. 3, p. 6.

Bank[7] and Treasury[8] both expect growth to be above trend until the end of their respective forecasting periods. While continuing weakness in some sectors suggests the presence of a two-speed economy, other areas are approaching supply constraints, particularly as the unemployment rate continues to approach the NAIRU. In such an environment, it is important that the Government carefully considers the macroeconomic impact of its expenditure, as excessive spending in such an environment risks placing upwards pressure on inflation and interest rates, and diverts resources away from more productive areas of the economy, with possible detrimental impacts on economic growth and productivity.

Looking forward, it may be timely for the Government to undertake a more comprehensive review of expenditure, and look to identify further structural savings. The Government's latest Intergenerational Report recognises that Australia's ageing population, increasing health care costs and climate change will all place pressures on Government finances over the longer term. Based on the Government's current revenue and expenditure profiles, the Budget is projected to be in a deficit of 3¾ per cent of GDP by the mid-point of the century.[9] Significant structural reforms are needed to address these longer-term challenges and ensure that government finances return to – and remain in – a sound position in the decades ahead.

Recommendation 1:
The Government should outline a medium-term plan for achieving structural savings, expenditure restraint and fiscal consolidation following the return to surplus. Such a plan should include a comprehensive review of expenditure.

Financing the flood recovery

We strongly support the priority the Government has given to flood recovery efforts. The floods have damaged billions of dollars of essential infrastructure, and it is important that this is rebuilt in a timely fashion to prevent the floods from having an ongoing detrimental impact on economic growth.

We also support the Government's commitment to deliver a Budget surplus in 2012-13. This is entirely appropriate, as the costs of the flooding announced to date would not drive the Budget into deficit, even if the Government did not announce any offsetting savings.

Of the total $5.6 billion costs, the Government has announced that it will incur at least $2.6 billion in the 2010-11 financial year (a $2 billion advance payment to Queensland and around $600 million in payments through the Australian Government Disaster Recovery Payment).[10] This leaves $3 billion in costs to be absorbed over the forward estimates. Even if the full $3 billion was incurred in the 2012-13 financial year, the Government would still realise a surplus in that year, based on currently published forecasts.

While not needed to return the Budget to surplus, we also believe that it would be prudent to offset the increased costs through expenditure reallocation, and we are supportive of the $3.8 billion in spending cuts and infrastructure project delays announced on 27 January. Delaying these infrastructure projects will help to ease the skills shortages that the construction sector will face during the spike in demand brought on by the rebuilding effort.

We also welcome the announcement to fast-track processing of employer-sponsored temporary visas (subclass 457 visas) for employers involved in flood reconstruction work that are unable to source skilled labour locally. This measure will go some way towards alleviating the skill shortage pressures that other states will experience as a result of skilled trades people relocating to assist with reconstruction. The Government should consider wider application of fast-tracked visa processing, and other improvements to the skilled migration program, in recognition of the pressures that will inevitably flow on to industries in other states.

While supporting much of the Government's package, we do have concerns about the merits of a flood levy. Retailers are already struggling in the two-speed economy, and imposing an additional levy will further undermine the already sluggish recovery in consumer spending. It is unclear why the levy needs to be imposed at this time – if the Government is concerned about returning the Budget to surplus then the levy would be far more effective in

[7] Reserve Bank of Australia, *Statement of Monetary Policy*, November 2010, p. 62.

[8] Commonwealth Treasury, *2010-11 MYEFO*, p. 3.

[9] Commonwealth Treasury, *Intergenerational Report 2010*, January 2010, p. xi.

[10] Prime Minister, *Rebuilding after the floods*, 27 January 2011, p. 1 & Attachment 2.

supporting this outcome if it was imposed in 2012-13. As the levy currently stands, it will only improve the Budget balance in 2012-13 by $235 million.[11]

<u>Recommendation 2:</u>
The Government should not introduce a flood levy, and should instead look to introduce additional savings measures should further expenditure restraint be necessary to return the Budget to surplus.

[11] Prime Minister, *Rebuilding after the floods*, 27 January 2011, Attachment 2.

Tax Reform

The Henry Review, delivered to the Treasurer at the end of 2009, provided the Government with a real opportunity to undertake a significant package of broad reaching tax reform. At more than 1,000 pages, the Review included 138 recommendations covering reforms across the entire spectrum of the tax system.

While the Government's initial response to the Henry Review was disappointing, the tax summit scheduled for later in the year provides the Government with an opportunity to develop a more ambitious tax reform agenda. The Government should be embracing many of the recommendations of the Henry review, improving the efficiency of the tax system and better aligning incentives for businesses and the community as a whole. Continued structural reforms in this area will be necessary to improve Australia's lagging rate of productivity improvement and to sustain long-term economic growth.

Many different groups have called for various aspects of the tax system to be added to the summit, and we support a broad-reaching agenda. It is therefore disappointing that the Government has indicated that the GST will not be within the scope of the tax summit. The GST is acknowledged as one of Australia's more efficient taxes, and reconsidering the appropriate rate and base for this tax could help to facilitate the reform of inefficient and distortionary state taxes.

Broadening the agenda of the tax summit to include issues like the GST, while politically difficult, is nonetheless necessary if the Government is to develop a comprehensive picture of how tax reform can drive further improvements in the nation's productivity and international competitiveness.

Recommendation 3:
The agenda of the tax summit should be broadened to include consideration of the appropriate rate and base for the GST.

It will be important that the tax summit actually deliver outcomes, and doesn't simply become a talkfest where much is said but little is achieved. The 2020 summit, hosted by the Government in 2008, brought together experts from a wide variety of fields to discuss their visions for Australia in 2020. While the summit came up with many welcome recommendations, (such as the Henry Review), now three years on very few of these recommendations have been taken up by the Government.

However, it is equally important that the Government carefully considers the evidence and doesn't make any knee-jerk reactions in response to calls for change. The recent campaign around changing the GST treatment of low value imports is a classic case in point. The NSW Business Chamber supports the Government's approach of referring this issue to the Productivity Commission, as this body will be able to consider in an impartial and arms length fashion whether or not the competitive neutrality benefits of changing the tax arrangements are outweighed by the additional administrative compliance costs which would be borne by the government, businesses and consumers.

The NSW Business Chamber appreciates that tax reform is a politically challenging and complex issue, which has been further complicated by the Government's current Budget position. However, when the system is considered as a whole, productivity improving tax reforms can be achieved in a fiscally responsible manner.

Turning to the recommendations put forward in the Henry Review and the Government's response, we have been supportive of the changes to the company tax rate and the instant assets write-off, but are disappointed that the Government's response in both of these key areas falls well short of the Henry recommendations. While the Government has been quick to point out that the current fiscal environment is constraining its efforts in this space, we believe that there are other reforms to the tax system that could be made to keep the entire package revenue neutral, or alternatively, government savings in other areas of the Budget could be targeted more aggressively to offset these costs.

Another key area where we believe the Government should pay more attention to the recommendations of the Henry Review is in relation to the reform of state taxes. While state taxes are by their nature a state issue, it is equally true that reform of state taxes cannot be achieved without the support of the Federal Government. The taxing powers of the States are limited, and they will find it difficult to give up these inefficient sources of revenue unless they can be replaced with an alternative revenue stream.

In 2008, IPART noted that, "[the Henry] Review provides a timely opportunity to achieve Commonwealth-State tax reform. Such opportunities occur infrequently, and it is important that the potential for coordinated Commonwealth-State reform and reform of the tax-transfer interface at the inter-governmental level is not lost."[12]

The NSW Business Chamber has been a long time advocate for reform of State taxes. Given that State taxation raises less than one-fifth of national tax revenue and only two-fifths of total State revenue, it is difficult to justify the existence of 160 separate State taxes. These collectively entail high costs of administration for government (and therefore taxpayers) and heavy compliance burdens for business. The macroeconomic impact is a diminution of Australia's potential competitiveness, productivity growth and prosperity.

The Henry Review agreed with this position, and found that "Many of the current State taxes are inherently of poor quality while other State taxes need to be reformed."[13] The Review recommended the abolition of payroll taxes, insurance taxes and conveyance duties, and recommended reform of land tax, motor vehicle taxes, gambling taxes and resource royalties.[14] However, when it comes to outlining the process through which such reforms could be implemented, the Henry Review provided less guidance.

Comprehensive reform of inefficient state taxes will require reworking parts of the current Federal-State financial arrangements. Without such reform, the abolition of inefficient State taxes will increase State reliance on Federal grants and exacerbate existing vertical fiscal imbalance pressures. The Henry Review notes this risk, and acknowledges the importance of providing States with better revenue sources to replace the current suite of inefficient taxes.

Professor Neil Warren has recently completed an analysis of the degree to which current intergovernmental fiscal arrangements act as a constraint to the State tax reforms proposed under Henry.[15] It was found that, given the current arrangement of intergovernmental fiscal transfers, there is presently no incentive for the States to pursue any of the Henry reforms, given the detrimental impact this would have on State tax revenue.

The Federal Government could play a more active role in encouraging the States to undertake these reforms. Financial incentives provided by the Federal Government would encourage the States to progress these reforms, and the net result for the country as a whole would be a more efficient tax system and more effective financial relationships between Federal and State Governments.

Without leadership at the Federal Government level on this issue there will be little incentive for the States to act unilaterally to improve the efficiency of their respective tax bases.

Recommendation 4:
The Federal Government, in consultation with the States, should develop a medium-term strategic plan for the implementation of the State tax reforms outlined in the Henry Review.

[12] IPART, *Review of State Taxation: Final Report to the Treasurer*, October 2008, p. 6.

[13] Commonwealth of Australia, *Australia's Future Tax System – Final Report*, 2010, p680.

[14] ibid.

[15] Warren, *Intergovernmental fiscal arrangements as a constraint on State tax reform under Henry*, June 2010.

Small Business Access to Finance

Access to finance remains an issue of significant concern for many small businesses. The NSW Business Chamber's latest Business Conditions Survey found that 22 per cent of small business respondents said that ease of access to finance had deteriorated over the past three months, while less than 3 per cent expected that conditions would improve over the next three months.[16]

The aftermath of the global financial crisis continues to have a significant impact on conditions in small business financing. As a result of the dramatic and destabilising financial conditions, the major banks have improved their market share and profitability at the expense of smaller banks and financial institutions. The reduction in competition in the banking sector has been partly responsible for the increase in interest margins and has made it easier for the banks to shift greater amounts of risk off their balance sheets through stricter lending requirements, such as higher levels of collateral.

This is not a healthy outcome for the small business sector – the deterioration in competition has both reduced the accessibility of small business finance and increased the price at which finance is available. Spreads on small business loans have blown out from around 200 basis points to more than 400 basis points, and business credit has now fallen for 21 months. Tightening credit requirements, and an apparent overreaction towards risk aversion by the major banks continue to constrain the availability of credit. Given the contribution small businesses make to the national economy, this is an issue of significant concern.

In the absence of comprehensive data on bank lending, anecdotal evidence from small businesses provides an important indicator of current trends in small business access to finance. Such analysis reveals a range of instances of banks tightening lending criteria and undermining the viability of otherwise profitable small businesses.

While recognising that the banks need to run their businesses in a responsible fashion to minimise the risks they are exposed to, the significant tightening of lending criteria has threatened the ongoing viability of many small businesses. In situations where businesses remain profitable and sustainable, changes in lending requirements have undermined the feasibility of existing business plans and required small businesses to alter their strategy, resulting in them curtailing plans for expansion, downsizing, or in some cases exiting the market altogether.

In this environment, it is important that the Government is proactive in fostering the ability of these small businesses to operate and grow.

The NSW Business Chamber proposes that the Government consider the implementation of a temporary guarantee of small business loans in Australia. The implementation of an appropriately priced government guarantee is an effective way of rejuvenating the flow of finance to productive parts of the economy and can be self-funded. Governments in many other countries, including the US, UK and Canada already offer loan guarantees to small businesses, recognising the important role that this can play in supporting small businesses and the jobs that they create.

While some have raised concerns about broadening the range of guarantees provided by Government, any risks to the Government's balance sheet can be addressed and minimised:

- By charging a price for the guarantee, the government can protect its financial position and ensure that it is appropriately compensated for the risk transferred to its balance sheet. Providing a price signal also means that use of the guarantee should naturally wind down over time as market conditions return to more normal levels over the medium-term.
- By not guaranteeing 100 per cent of loans, and leaving banks responsible for loan assessments, the government can avoid the moral hazard issues that a blanket guarantee could have created. Leaving banks with skin in the game in the event of a default will ensure that applications are carefully considered and minimise the risk of default and the guarantee being called on.

Recommendation 5:
Consideration should be given to the implementation of a guarantee of small business loans in Australia.

[16] NSW Business Chamber Business Conditions Survey, *November 2010,* internal analysis of small business data.

Skills

Australian industry needs a skilled, flexible and motivated workforce that contributes to productivity gains and drives economic growth. Ensuring that the available workforce has the skills and knowledge required to meet the needs of industry and employers is a significant issue for Australia.

There are four main areas of policy concern within the education and training portfolio which are critical to increased employment participation and therefore, to improved productivity outcomes. These are addressing emerging skills shortages, additional improvements to the apprenticeship system, reform to vocational education and providing ongoing training to existing workers.

Skills Shortages

NSW Business Chamber supports the Government's policy of attracting very highly skilled labour to Australia for their potential contribution to economic growth and innovation. However, skilled migration policy needs to be part of an overall policy approach that delivers training and retraining to existing workers and for those re-entering the workplace. Further, migration intakes need to be mindful of the need to provide a complimentary mix of highly skilled, skilled and semi-skilled labour to be of greatest benefit.

NSW Business Chamber is supportive of the skilled migration program, but believes that it should be flexible enough to reflect the changing and elastic short and longer term needs of industry as skill and labour shortages emerge. This is both in support of skills shortages in regional areas, and in specific industry sectors. It is essential that government remains committed to providing strong consultative mechanisms that engage key industry and business stakeholders to ensure a balanced migration intake that meets such needs with the flexibility to ensure timely responses to emerging skills shortages. This is particularly so in regional areas, both in terms of certain visa categories and their application, and market salary rates. Such administrative restrictions do not provide regional businesses with the flexibility they require to address their labour needs.

Recommendation 6:
NSW Business Chamber believes that, in a climate of re-emerging skills and labour shortages, it is imperative that the skilled component of the migration program contain sufficient flexibility to meet the immediate needs of industry as well as the longer term needs of the economy.

Support for Australian Apprenticeships

There is a great risk to Australia's productivity if new Australian Apprentices are not recruited and existing Australian Apprentices are not retained, or do not complete their training. Australian Apprenticeships remain an important vehicle for youth engagement and therefore boosting the skill levels of young people17. Improving the performance of youth in the labour market is a crucial challenge.

Substantial increases to Australian Apprenticeship uptake have always had a strong correlation to financial support provided to employers. NSW Business Chamber was supportive of the Kickstart Apprenticeship initiative which created increased employment opportunities for young people across Australia. In addition, the Government recognised the importance of providing ongoing support for apprentices and employers with the introduction of the Kickstart Mentoring program. The success of the Kickstart initiative clearly reflected the efficiency and responsiveness of the Australian Apprenticeship Centre (AAC) model.

Recommendation 7:
NSW Business Chamber recommends that the level of incentives introduced via the Kickstart initiative should be maintained to ensure adequate levels of apprentice recruitment by employers and as a means of improving labour market participation, especially for young people.

[17] OECD (2009). *Jobs for Youth: Australia*

NSW Business Chamber agrees that competency based progression approaches build the stock of the nation's skills where there is alignment with the needs of industry. The Treasury's 2010 Incoming Government Brief stated that "apprenticeships take too long, with an outdated focus on time served rather than competency"18.

Arrangements for competency based progression in a particular industry sector must be driven by and aligned to the particular needs and requirements of that industry. Broadly speaking, competency should be understood as a proxy for work value, and competency based progression should be on the basis of the acquisition of usable skill sets.

Recommendation 8:
The Government should not impose competency based progression requirements on industry, rather each industry sector should be encouraged to introduce competency based arrangements that align with the needs and requirements of the particular industry.

Vocational Education and Training

NSW Business Chamber supports improvements in the Vocational Education and Training (VET) system, to the extent that reform creates a demand driven VET system that links skills attainment with industry need, based on competency and is regulated at a national level with quality assured outcomes. Overall, reform to the VET system must strengthen the school to work transition and directly engage employers, notably through Australian Apprenticeship Centres.

NSW Business Chamber believes future reforms to the Australian VET system should achieve increases in workforce productivity, higher employment participation through greater skills development and meet wider social inclusion objectives.

Recommendation 9:
The VET reform process should be informed by industry with the objective of creating a demand driven VET system that links skills attainment with industry need. Training outcomes should be competency based not driven by institutional imperatives.

Ongoing training for existing workers

One approach to minimising training costs and maximising return on investment in training is increased commitment to upskilling existing workers to trade level or higher level qualifications where there is enterprise lvel demand for such skills.

NSW Business Chamber acknowledged the Productivity Places Program (PPP) as a major Government commitment to boost Australia's skills capacity, including upskilling existing workers, and therefore the supply of skilled labour.

Some improvement to the administration of the PPP is required to address skills shortages in critical industries and to increase the uptake of traditional trades.

Recommendation 10:
NSW Business Chamber recommends improved administration to the PPP to provide a national rollout of existing worker PPP through Industry Skills Councils, Industry Training Advisory Boards and industry associations along similar lines to the Enterprise Based PPP.

[18] Federal Treasury (2010). *Incoming Government Brief (Red Book)*

Infrastructure Expenditure

In the 2008-09 Budget, the Government announced the establishment of three new "nation-building" funds, the Building Australia Fund (BAF), the Education Investment Fund (EIF) and the Health and Hospitals Fund (HHF). These funds were established to assist in financing the current shortfall in critical national infrastructure. Initial expectations were that around $40 billion would be allocated to these three funds.

The operation of the nation-building funds was to be supported by Infrastructure Australia, which was established to ensure that expenditure from each of the funds met rigorous evaluation criteria. Such an assessment of infrastructure projects is essential to ensuring that investment is directed to those projects that give the biggest bang for their buck. This is particularly important given the significant constraints that are currently placed on the Government's finances.

We were strongly supportive of the framework around these funds, with the significant capital and strong governance framework combining to ensure that a considerable amount of critical national infrastructure could be financed over the medium term.

However, we believe that there are areas where the governance arrangements could be improved, and in our pre-Budget submission to the Federal Government last year we recommended that the Government publicly release the cost-benefit analyses underpinning recommendations put forward by Infrastructure Australia.

More recently, we have also seen signs of the government moving away from its earlier commitment to these funds.

While these funds initially appeared to have a long-term expenditure profile in mind, their assets have been drawn down rapidly. At the end of March 2010, the Building Australia Fund held $0.7 billion in uncommitted funds, while the Education Investment Fund and the Health and Hospitals Fund held $2.7 billion and $2 billion respectively.[19] These balances stand in stark contrast to initial Government commitments to transfer more than $40 billion to these funds.[20]

We recognise that the global financial crises meant that the projected 2008-09 Budget surplus was never realised, and that this undermined the government's capacity to transfer the full amounts to these funds. However, it is equally true that the current fiscal projections in the latest MYEFO indicate that the Budget surpluses will strengthen in the second half of the decade. While the government may wish to use some of this money to pay down debt, it would be equally prudent to transfer some of this money to the nation building funds.

In their June 2010 report to COAG,[21] Infrastructure Australia identified an infrastructure priority pipeline of more than $82 billion. This is more than four times the total amount of funding committed to the Building Australia Fund by the Government, and suggests that there is a real need for the Government to transfer a proportion of future surpluses to this fund to meet these identified needs.

Instead, the Government appears committed to the establishment of new funds, which may lack the scrutiny which currently applies to expenditure from the nation building funds. As part of its mining tax package, the Government announced the establishment of a $6 billion Regional Infrastructure Fund, to support investment in "infrastructure that supports the ongoing development of the resources industry."[22]

It is unclear why a new fund is needed for this, given that the Government's existing Building Australia Fund was established to finance "the current shortfall in critical economic infrastructure in transport and communications, such as road, rail, and ports facilities, to ease urban congestion and enable growth in trade, and broadband."[23] Surely this fund is broad enough to finance the ongoing infrastructure investment necessary to support the mining industry?

Some may suggest that the establishment of a new fund allows the Government to avoid scrutiny from Infrastructure Australia. Certainly the governance arrangements announced to date suggest this is a possibility –

[19] Commonwealth Treasury, *2010-11 Budget*, Budget Paper 1, Statement 7, page 7

[20] Commonwealth Treasury, *2008-09 Budget*, Budget Paper 1, Statement 7, page 5

[21] Infrastructure Australia, *Getting the fundamentals right for Australia's infrastructure priorities,* June 2010.

[22] Commonwealth Treasury, *2010-11 Budget*, Budget Paper 1, Statement 1, page 21

[23] Commonwealth Treasury, *2008-09 Budget*, Budget Paper 1, Statement 1, page 27

while Infrastructure Australia will be consulted on individual projects,[24] it appears that they will not play the gatekeeper role of evaluating and prioritising expenditure that they currently do in the case of the nation-building funds. This perception has been compounded by the announcement that $573 million will be set aside from this fund at the request of the Independents, for investment "exclusively in projects identified by Regional Development Australia committees that will expand the development and growth of regional communities."[25] While we support the development of regional communities, it appears that this decision further undermines the oversight role played by Infrastructure Australia. We also note that two thirds of the money from this fund has already been earmarked for Queensland and Western Australia, with the rest of Australia left fighting for the remaining third. Given that NSW alone represents around a third of the national economy, the likelihood of NSW getting its fair share of funding appears bleak. Such developments are concerning and we would strongly recommend that, should the Government pursue this fund, Infrastructure Australia ensure that all projects financed from it meet rigorous evaluation criteria, and that appropriate consideration is given to the needs of all states, not just Queensland and Western Australia.

Since its establishment in 2008, Infrastructure Australia has played an important role in helping to take the politics out of infrastructure investment. We would urge the Government to continue to support the activities of Infrastructure Australia, and ensure that it continues to evaluate, scrutinise and prioritise the Government's infrastructure spending.

Recommendation 11:
The Government should not establish the Regional Infrastructure Fund, and instead redirect this money to the Building Australia Fund, where expenditure can be subject to scrutiny from Infrastructure Australia.

Should you require further information or clarification of our submission, then please do not hesitate to contact Mr Micah Green, Economist on 02 9458 7259 or via e-mail at micah.green@nswbc.com.au.

[24] The Hon. Wayne Swan MP, *Media Release - $6 Billion Regional Infrastructure Fund*, 9 June 2010.
[25] Commonwealth Treasury, *2010-11 MYEFO*, p. 200.

invigorating

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