2024-25 Federal Budget

Ai Group Pre-Budget Submission

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About Australian Industry Group

The Australian Industry Group (Ai Group) is a peak employer organisation representing traditional, innovative and emerging industry sectors. We are a truly national organisation, and in 2023 we celebrated our 150th year supporting Australian businesses.

Our vision is for *thriving industries and a prosperous community*. We offer our membership strong advocacy and an effective voice at all levels of government underpinned by our respected position of policy leadership and political non-partisanship.

With more than 250 staff and networks of relationships that extend beyond borders, we have the resources and the expertise to meet the changing needs of our membership. We provide the practical information, advice and assistance members need to run their businesses. Our deep experience of industrial relations and workplace law, positions Ai Group as Australia's leading industrial advocate.

We listen and we support our members in facing their challenges by remaining at the cutting edge of policy debate and legislative change. We provide solution-driven advice to address business opportunities and risks.

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Introduction

Australian industry enters 2024 feeling anxious and pessimistic about the immediate future of the national economy. While the Australian economy continues to slow, global uncertainty is growing, and inflation and labour shortage pressures appear to be persisting longer than expected.

Despite these concerns, businesses overall feel optimistic about their own ability to navigate the challenges ahead but are clear on what must be done to assist them. If the mood could be summed up in one sentence, it is this: Improving productivity is the key for industry success and future improvements in living standards in an uncertain, supply-constrained and slowing economy.

Changes to personal income tax scales the Government announced on 25 January present an opportunity to reduce inflationary pressures. The Government should put the case that the Fair Work Commission should take full account of the income tax changes when it considers this year's increase in minimum wages. An employee on the National Minimum Wage (NMW) will receive an increase in after-tax income from the tax cuts of around 2 per cent. Moderating the NMW increase that would otherwise be applied will substantially reduce the inflationary pressures stemming from wages growth.

Australian industry expects mediocre business conditions this year. The economic momentum driven by government support and pent-up consumer demand that lifted us out of the pandemic is clearly over. Australia's economy has been in a per capita recession since the start of 2023 and is forecast to continue to slow through 2024. Conditions akin to a recession are facing some key industries which have already experienced the effects of this slowdown.

Three factors are of immediate concern for Australian industry in 2023:

1. *Heightened uncertainty driven by our geopolitical environment*. Wars have created chaos in both global energy markets and shipping routes in the last year. Broader political risks such as trade disputes and economic nationalism also pose a threat to exports, supply chains and investment competitiveness.
2. *Ongoing supply side constraints*. While inflation has been slowing for a year it remains highly elevated, and CPI is forecast to remain over 3% until late 2025[1]. Australia's labour market also remains extremely tight, with elevated job vacancies, skills shortages and rapid wage rises affecting many industries.
3. *A weakening demand outlook.* Locally, this is driven by households reducing their spending, as inflation and high housing costs (either interest rates or rents) see their real disposable income shrink. Internationally, it reflects slowing growth in our major trade partners and a downturn in some resource and energy markets.

The Federal Government's current industrial relations measures, and further legislative proposals, magnify these challenges facing industry. By increasing workplace rigidity, these IR measures reduce industry's capability to respond dynamically to uncertainty, supply constraints and weakening demand.

[1] Reserve Bank of Australia, *Statement on Monetary Policy*, November 2023.

When you are in choppy waters, you batten down the hatches to ride it out. That's what a lot of Australian businesses will be doing this year, hoping to prepare for brighter and different times ahead.

However, Australian industry is also grappling with many broader transformational challenges. These can be summarised as the "Three Ds": *decarbonisation*, *diversification* and *digitalisation*. Unlike the immediate economic challenges of 2024, these have a long-term time horizon measured in decades, not years. But they cannot be ignored, as getting them right will be key to Australia's future prosperity.

Decarbonisation refers to the systems-change that will be required across Australia's economy and society as we transition our energy systems towards net zero carbon use. It is more than just plugging renewables into the grid. Decarbonisation requires fundamental transformations in our industrial processes, transport systems, business models, international trade relationships, policy frameworks and tax system. Australia's industrial sectors – which account for over half of national energy consumption – are at the leading edge of these transitions.

Diversification reflects the need to build a broader economic base for national prosperity. As the disruptions of the pandemic showed, Australia is at greatest economic risk when we are overly dependent on single relationships – whether for a product, a technology, a supply chain or an export market. In a year of uncertainty, building greater economic diversity will help Australia mitigate economic risks.

Digitalisation – the process of adapting institutional practices and business models to fully utilise new digital technologies – is the enabler behind all of Australia's economic ambitions. Digital technologies can help improve productivity, enable faster decarbonisation, and support the development of diversified industries. But it also poses new risks – particularly in terms of cyber security – that need to be carefully managed and resourced.

This is the context which confronts Australian industry in 2024. In the short-term it faces growing difficulties in the form of uncertainty, costs pressures and weakening demand. But for the longer-run, industry also needs to be readying itself for the transformations that decarbonisation, diversification and digitalisation will require.

An effective and successful 2024-25 Federal budget will help industry manage this tension between short-term challenges and long-term investment needs. The budget should provide industry the support it needs to continue to invest and innovate for long-term transformations, even while business conditions are difficult in the short-term.

This submission identifies a range of initiatives the forthcoming budget should take to support Australia's industrial transformation. Ai Group's proposals cover a very wide spread of policy areas, including industry, workplace, energy, skills and training, regulation, technology, trade and taxation. However, they are united in a focus on aiding Australian transformation to a decarbonised, diversified and digitalised economy.

Overarching these proposals is the pressing need for reform of Australia's taxation system – a policy domain which structures all others. The Government should commit to laying the foundations of a more wide-ranging recasting of Australia's taxation system by building support among Australia's governments and the broader population. These reforms need to produce a system that delivers tax simplification, minimises 'bracket creep' and other unplanned fiscal changes, unlocks opportunities for productivity-enhancing changes to our economy, and supports the aspirations of people wanting to work harder and earn more.

Summary of recommendations

Decarbonisation

- Support to level the playing field for energy transition investments in priority industries.
- Accelerate implementation of innovation support for decarbonisation in industry
- Federal package to reform regulatory barriers to energy transition investments.
- Provide resources to assist business to meet obligations created by new regulatory reforms.
- Resourcing new regulatory regimes that support circular economy practices in industry.
- Support development of a clean economy workforce.

Diversification

- Funding support for high-growth potential businesses in industry
- Cyber, innovation and supply chain upgrades for Australia's defence industry
- Build a migration pipeline for diversification-relevant skills
- Ensure the investment competitiveness of our critical minerals industries
- Diversify Australia's trade promotion efforts for investment in value chains

Digitalisation

- Drive greater uptake of Industry 4.0 practices
- Promote the responsible use of Artificial Intelligence in Australian industry
- Upgrade the cyber-security capabilities of business
- Ensure digital skills are core to Australia's skills and training system
- Digitalise Australia's supply chains through data and free trade agreements
- Promote data stewardship for successful digitalisation

Decarbonisation

The decarbonisation of the Australian economy is not only a challenge for energy-intensive industries but will affect every business and household in Australia. It is also more than simply substituting renewables for hydrocarbons, as it will involve a fundamental rethink of how we measure and manage flows of energy and materials through our economy. Over the next three decades, decarbonisation will be a major driver of the restructuring of the Australian economy, creating many new industries, skills and jobs as older ones are made obsolete.

As a generational undertaking, advancing decarbonisation will be a core theme in many federal budgets to come. The key question for the 2024-25 budget is which efforts are required today to ensure a logical stepping-out of Australia's energy transition.

In recent budgets the *Rewiring the Nation* and *Driving the Nation* initiatives put significant resources into the transition of two of our largest emitting sectors. Households and SMEs have also seen modest energy efficiency funding, though larger investment, coordinated with regulation, will be needed to transform our built environment.

However, the decarbonisation of Australia's industrial sectors equally demands policy attention. Four industrial sectors – mining, manufacturing, utilities and construction – accounted for 46% of Australia's net energy use in 2021-22. Together, this group of industrials account for twice as much net energy consumption as households, and nearly four times more than the transport sector[2]. This makes industrial sectors a leading target for national decarbonisation efforts. They are also major direct users of hydrocarbons (rather than electricity), making them some of the most challenging parts of the Australian economy to decarbonise.

The forthcoming and future budgets will need to afford industrial decarbonisation similar attention to that already extended to transport and grid decarbonisation. Several existing policy frameworks provide negative incentives (i.e. "sticks") to drive industrial decarbonisation. But fewer measures offer positive incentives ("carrots") to support Australian industry to develop and adopt the technological solutions required. Measures which would contribute to industrial decarbonisation include:

- **Support to level the playing field for energy transition investments in priority industries.** Many governments have announced subsidy schemes to promote investment in various energy transition industries such as renewables generation, transmission, manufacturing and transport. These subsidies have greatly and artificially impaired Australia's investment competitiveness in energy transition industries. Where Australia has credible competitive potential in an industry, and that potential is harmed by foreign subsidies, government should consider support to restore relative investment competitiveness. This support need not be limited to subsidies but may take a range of forms including regulatory reform, permitting, workforce and R&D support, and tax reform.

[2] Australian Bureau of Statistics, Energy Account, Australia, 2021-22, https://www.abs.gov.au/statistics/industry/energy/energy-account-australia/latest-release

- **Accelerate implementation of innovation support for decarbonisation in industry**. The Commonwealth supports industrial innovation through a diverse range of programs, most prominently via the National Reconstruction Fund (NRF) and the Industry Growth Program (IGP), established in recent budgets. While these programs include “renewables and low-emission technologies” as a priority area, neither has yet matured to the point where they are offering support to businesses for industrial decarbonisation. Given the urgency of the energy transition task, it is imperative that the NRF, and IGP and related programs rapidly accelerate their support for decarbonisation.

- **Federal package to reform regulatory barriers to energy transition investments.** Australia requires significant private sector investment – across the energy generation, transmission, transport, manufacturing, construction, agriculture and mining sectors – to meet our industrialisation decarbonisation objective. Legacy regulatory regimes that were designed for different purposes frequently constrain these investments by adding costs and/or delays to the approvals process. The Federal Government should work with the states to develop a national package of reforms to relevant regulatory regimes. While energy generation and transmission are the immediate priorities, these reforms should not limit their ambitions to the grid but look across the entire industrial ecosystem.

- **Provide resources to assist business to meet obligations created by new regulatory reforms.** Many government regulations impose rules which require industry to meet various decarbonisation, waste and/or circular economy objectives. Some of these reforms will be directly regulated by the government, or a regulator set up for this purpose. Where such regulation occurs, funding needs to be allocated to complementary programs that build business capacity to comply.

- **Resourcing new regulatory regimes that support circular economy practices in industry.** Improved planning processes for managing material flows and waste need adequately resourced regulatory systems to produce timely, credible decisions. It is imperative that these regimes are provided appropriate resourcing, and the market conditions to enable industry to innovate to meet local and global demand. As a critical piece of regulatory infrastructure for national decarbonisation, these regulatory regimes should not rely solely upon industry payments.

- **Support development of a clean economy workforce**. Many occupations currently in demand for energy transition projects are affected by significant skills shortages; while training pipelines have yet to be established to meet our future transition skills needs. Jobs and Skills Australia’s ‘Clean Energy Workforce’ report of October 2023 provides directions to ensure the nation develops the workforce required to achieve net zero emissions by 2050. Implementing its recommendations will ensure that the workforce is adequately prepared for the demands of a clean energy future.

Diversification

In recent years, Australia's economy has contended with a wide range of 'shocks'. Pandemic restrictions, disruptions to international supply chains, global inflationary pressures, surging energy prices and geopolitical difficulties for trade have all afflicted our economy in the last five years. Very sudden technological changes – such as the rapid uptake of work-from-home practices in 2020, or Artificial Intelligence in 2023 – are equally important shocks which disrupt how our economy functions.

For the most part, Australia is unable to prevent or predict these kinds of economic shocks. But we are able to develop our social and economic resilience for when they occur. Economic diversification – the process of developing a broader industrial foundation for our national wealth – is a key tool for shock-proofing the Australian economy.

A common focus for economic diversification is Australia's dependence on resource exports, particularly iron ore, coal and natural gas. Resources make an outsized economic contribution in terms of tax receipts, export revenues, private investment levels, and in some locations employment and infrastructure. However, these industries also expose Australia to commodity price cycle volatility; while the long-term future of our hydrocarbon exports is very uncertain. The need to grow alternate industries to lower dependence on these three resources is evident.

However, diversification is about far more than just the resource sector and affects every industry in Australia. Wherever an industry is dependent on a single relationship – be that a source of investment, a technology partner, a type of workforce, a particular product, a customer – that industry becomes highly vulnerable to economic shocks affecting that partnership.

Australia's experience of supply chain disruptions during the pandemic illustrates the general benefits of diversification. When goods shortages started to emerge in mid-2020, it was industries with a wide range of suppliers who were best able to find alternate sources.

Diversification is also important for Australian governments and society. A more diverse economy offers a broader tax base for governments, reducing exposure to fiscal shocks arising from specific industries. It provides a wider range of employment options, establishing a more adaptable skills base that benefits both employees and employers. It also supports a broader range of international partnerships for trade, investment and technology, which augment Australia's security and prosperity.

In this year's federal budget, a number of economic and industry policy domains ought to be guided by the principle of diversification. Some important opportunities which should be immediately pursued include:

- **Funding support for high-growth potential businesses in industry.** High-growth potential businesses (i.e. 'scale-ups') in industrial sectors often struggle to attract funding from conventional or venture-capital sources. Dedicated funding vehicles for scale-up SMEs play a key role in crowding in additional sources of investment capital. The Australian Business Growth Fund provides a recent successful example of this model in Australia; additional applications of this model in priority sectors would help accelerate the growth of a broader industrial base.

- **Cyber, innovation and supply chain upgrades for Australia's defence industry.** The Commonwealth is set to make crucial policy announcements in the coming months, including the Defence Industry Development Strategy (DIDS), the Integrated Investment Program (IIP), and the surface fleet review. These areas all require rapid and transformative growth in Australia's defence industry capabilities. Of immediate importance are efforts to lift the information- and cyber-security resilience, catalyse a broader base of defence industry innovation capabilities, and strengthen 'mid-tier' industrial suppliers within Australia's defence industry supply chains.

- **Build a migration pipeline for diversification-relevant skills:** The creation of new, tech-intensive industries frequently requires skills that are in short supply in Australia. According to the latest Skilled Priority List from Jobs and Skills Australia (JSA), 36% of occupations are currently assessed as in shortage. While skilling our existing workforce remains a medium-term priority, many of these immediate skills gaps must addressed through the migration program. In what are the tightest labour market conditions since the 1970s, Ai Group recommends a planning level for permanent migration in 2024-25 of 190,000. Two thirds of the target should be allocated to skilled migrants.

- **Ensure the investment competitiveness of our critical minerals industries.** Australia has a significant opportunity to develop our critical minerals – lithium, nickel, rare earths and several others – both as a mining and metals processing industry. Their development would help diversify Australia's resource exports away from their current reliance on coal and natural gas. However, very few downstream processing investments have been made in Australia to date; while the established lithium and nickel mining industries have come under considerable competitive pressure. Large subsidies from several foreign governments have undermined Australia's competitive position, and there is a pressing need to level the playing field. Tax treatment, infrastructure, permitting and workforce capabilities are all areas where reform would improve our investment competitiveness in the global critical minerals industries.

- **Diversify Australia's trade promotion efforts for investment in value chains.** Australia's trade promotion efforts – through Austrade, our commercial diplomacy, and our engagement with multilateral organisations like the WTO – has traditionally prioritised industries where we have demonstrated export strength. As we work to diversify our economy, it is also important to diversify our trade promotion efforts beyond traditional export promotion. A stronger focus on investment – for the first time, including supporting Australian investment abroad – will be essential into more deeply embedding our industry into global value chains. A more active approach to international interaction on industrial and technology standards will also be required.

Digitalisation

Digitalisation – the process of adapting institutional practices and business models to fully utilise digital technologies – is a change that sits behind many of the economic challenges Australia faces today.

Digitalisation is typically conceived as a productivity-enhancing measure: that the adoption of digital technologies can help improve business efficiency and competitiveness. With labour productivity in Australia growing at its lowest rate in sixty years, there is a pressing need to support the uptake of digital technologies in government and business to drive stronger performance. In a period of extremely tight labour markets, digital technologies allow industry to better utilise the workforce and skills they currently have.

However, digital technologies are also an under-appreciated enabler for our decarbonisation objectives. They can enhance energy efficiency, facilitate the integration of renewables into the grid, and enable data-driven strategies for carbon measurement, tracking, reporting and ultimately reduction. Without a significant uplift in digitisation levels, it will prove very difficult for industry to meet the decarbonisation targets required for Net Zero.

Digitalisation is also key for the diversification of Australia's economy. Whether in terms of managing efficient supply chains, building new tech industries, or transforming existing industries to be competitive in the 21st century, digital technologies will play a key role. Digitalisation functions as an enabling technology that underpins the broader industrial transformations to which Australia presently aspires.

Australia's trade relationships will also be augmented by digitalisation. It can transform trade in three ways – providing new platforms to sell goods to the world, providing new methods to deliver services to global customers, and creating data flows which have a value in their own right. Success in diversifying Australia's trade will rely on fully utilising the new opportunities which digital trade affords.

Of course, digitalisation comes with risk and reward. Increasing cyber security challenges are especially important, as digitalisation increases the areas in which we are vulnerable to attack. Successful digitalisation also requires strong upgrades to cyber security practice – at the national, enterprise and personal levels – to ensure increasingly valuable data is protected.

Digitalisation is therefore a theme which should underpin many areas of economic and industry policy in this year's Federal budget. Several particularly fruitful areas which should be reflected in this budget include:

- **Driver uptake of Industry 4.0 practices:** Australia lags behind our international competitors in adopting robotics, assistive technologies, and Internet of Things (IoT) in industry. Changing organisational mindsets, exposing gaps in leadership, and effectively using data are the significant issues that need to be addressed for implementation of Industry 4.0. Support for digital technology uptake should be reflected across all domains of industry policy, including those associated with energy and decarbonisation.

- **Promote the responsible use of Artificial Intelligence in Australian industry:** The 2023-24 Federal budget included funding for several AI initiatives, recognising the potential of AI across economic, social, and security domains. As governments around the world attempt to regulate the development and use of AI, Australia needs to focus on supporting both the creators and users of AI. There is an urgent need to develop programs and resources – particularly for SMEs – to ensure Australia does not fall behind the world in AI adoption in industry.

- **Upgrade the cyber-security capabilities of business:** Cyber security has emerged as a significant operational challenge in the industry, with its importance scaling with the size of the business. The announcement of a new Commonwealth cyber security strategy in November 2023 was an important step in addressing this challenge. This strategy will require adequate funding for implementation of aligned programs. Of particular importance are programs to assist businesses to find effective, trusted appropriately-scaled solutions to their specific cyber risks.

- **Ensure digital skills are core to Australia's skills and training system.** The latest OECD Programme for International Student Assessment (PISA) shows a deterioration in Australian students' science, math, and numeracy abilities. Action needs to be taken to arrest this decline and invest in the higher-level STEM abilities needed for a digitally transformed economy. Given the rapid change in digital technologies, it is important that existing workers are given opportunities to build digital skills utilising microcredentials, short courses, accredited and non-accredited, and other types of formal and informal training.

- **Digitalise Australia's supply chains through data and free trade agreements.** Supply chain shocks during the pandemic exposed our vulnerabilities caused by a lack of diversification; whereas digitalised supply chains enable us to predict and prepare for disruptions, instead of simply reacting. With over 80% of Australia's trade now covered by a Free Trade Agreement, further investment is required to upgrade those FTAs to include digital chapters, and equip our supply chains to make use of digital technologies. Recent investments in the Simplified Trade System should also be leveraged to ensure that government held data on trade flows is liberated and can be used to refine and strengthen the digital supply chain strategies of Australian businesses.

- **Promote data stewardship for successful digitalisation.** Successful digitalisation will require data stewardship – to collect data efficiently, deploy it effectively, and protect it responsibly. Relevant regulatory infrastructure, such as national and state privacy regimes, should uplift data stewardship capability in both industry and regulators. Programs to support industry to implement internationally-aligned data stewardship principles should be rolled out alongside proposed reforms to the *Privacy Act.*

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