

Victorian manufacturing: Meeting the challenges

**Inquiry into a more competitive
Victorian manufacturing industry**

**Summary Report
September 2011**



Victorian
Competition & Efficiency
Commission

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About the Victorian Competition and Efficiency Commission

The Victorian Competition and Efficiency Commission, which is supported by a secretariat, provides the Victorian Government with independent advice on business regulation reform and opportunities for improving Victoria's competitive position.

VCEC has three core functions:

- reviewing regulatory impact statements, measurements of the administrative burden of regulation and business impact assessments of significant new legislation
- undertaking inquiries referred to it by the Treasurer
- operating Victoria's Competitive Neutrality Unit.

For more information on the Victorian Competition and Efficiency Commission, visit our website at: www.vcec.vic.gov.au

Disclosure of interest

The Commissioners have declared to the Victorian Government all personal interests that could have a bearing on current and future work. The Commissioners confirm their belief that they have no personal conflicts of interest in regard to this inquiry.

Terms of reference

Inquiry into A More Competitive Victorian Manufacturing Industry

I, Kim Wells MP, Treasurer, pursuant to section 4 of the *State Owned Enterprises (State Body — Victorian Competition and Efficiency Commission) Order* (“the Order”), in conjunction with the Minister for Manufacturing, Exports and Trade, hereby direct the Victorian Competition and Efficiency Commission (“the Commission”) to conduct an inquiry into A More Competitive Victorian Manufacturing Industry.

Background

Manufacturing plays an important role in the Victorian economy, contributing to economic growth, jobs, productivity, exports, investment, research and development, and innovation.

Over the past five decades, Victorian manufacturing has evolved from a concentration of industries protected by high import tariff barriers to manufacturers producing goods and services in an open global economy, for domestic and overseas markets, with critical links to international supply chains. The evolution of manufacturing has occurred in parallel with ongoing growth in the size and importance of the services sector. While manufacturing was once the dominant industry in Victoria, now services dominate.

The Victorian Government has committed to review and apply a range of policy levers at its disposal to support the growth of an internationally competitive Victorian manufacturing industry. Infrastructure development, reviews of industry assistance and strategic use of Government procurement policy are among the actions to be taken. In addition, the Government will also establish an Industry Roundtable to gather industry input on infrastructure planning and government procurement initiatives.

The Government’s rationale for developing a new approach to manufacturing is based on getting the basics right, backing local innovation and creating more local jobs.

Scope of the inquiry

The Commission is to inquire into and report on:

- the changing nature of Victorian manufacturing, including its composition, location, employment size and structure, and linkages with service industries and international supply chains;
- the costs to the Victorian economy of the manufacturing sector continuing to decline relative to the growth of other sectors, including services;
- the key drivers of future growth in Victorian manufacturing, noting that these may vary across sub-sectors, firm size and export intensity, and the opportunities and challenges facing the sector;
- the challenges and opportunities for building a competitive manufacturing sector in rural and regional Victoria, and whether a differentiated approach to supporting manufacturing is warranted in rural and regional locations;
- principles to support the development of policy for the manufacturing sector and the Government's ongoing review of current programs of financial assistance to industry;
- actions to improve competitiveness, productivity, investment, jobs and export growth in the manufacturing sector that the Victorian Government can take consistent with these principles;
- potential strategies to strengthen Victorian manufacturing, with recommendations on the best strategy, mission and objectives for Government policy;
- unnecessary regulatory burdens imposed on manufacturing activity and investment beyond those under review by the Council of Australian Governments or those already identified in past VCEC reviews; and
- the impact of the Victorian Government's procurement policy on the development of the manufacturing sector, and the extent to which local content requirements can stimulate growth and innovation.

In undertaking the inquiry, VCEC should take into account the report in 2010 of the Inquiry into Manufacturing in Victoria by Economic Development and Infrastructure Committee, a joint investigatory committee of the Parliament of Victoria.

In terms of focus, and having regard to the resources at the Commission's disposal, the Government expects the Commission to focus on outlining a forward looking strategy for the future development of an internationally competitive and productive manufacturing sector in Victoria, noting the diversity and complexity of manufacturing operations. The Government recognises that

infrastructure planning strategies are central to competitiveness of the manufacturing industry, but these strategies will be the subject of work by the proposed Industry Roundtable.

Inquiry process

In undertaking this inquiry, the Commission is to have regard to the objectives and operating principles of the Commission, as set out in section 3 of the Order. The Commission must also conduct the inquiry in accordance with section 4 of the Order.

The Commission is to consult with large and small manufacturers, key interest groups and affected parties, and may hold public hearings. In particular, the Commission should consult closely with the Victorian Industry Manufacturing Council and maintain this engagement throughout the inquiry.

The Commission should also draw on the knowledge and expertise of the Department of Business and Innovation and other relevant Victorian Government departments and agencies.

The Commission is expected to produce the following documents:

- a draft report containing analysis and draft recommendations after the receipt of public submissions; and
- a final report to be provided to me as soon as possible, but not later than six months after receipt of these terms of reference.

KIM WELLS MP

Treasurer

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Contents

Terms of reference	v
Contents	ix
Key messages	1
Summary report	3
A forward looking strategy for Victorian manufacturing	4
Manufacturing in Victoria	7
Programs for manufacturing	9
Conclusion	18
Recommendations	19
References	31

Key messages

- Manufacturing is and will remain an important part of the Victorian economy. The total value of manufacturing output has been stable over the past 10 years, but its share of the economy has fallen and its composition is changing.
- Manufacturing is important to regional Victoria. There are positive and negative aspects to a regional location, with access to skills and training being a key challenge.
- To date, the relative decline in manufacturing has not led to an overall decline in output and employment in the Victorian economy. However, it is clear that the high exchange rate, compounded by continuing adjustments in global supply chains, the risk of further policy disruptions in global financial markets and the effects of measures to shift to a low carbon economy are causing further, potentially large adjustments in parts of manufacturing.
- The objective of a forward looking state-based strategy for Victoria's manufacturing sector should be to improve the wellbeing of Victorians by having more high performing manufacturing enterprises operating in a dynamic and internationally competitive Victoria.
- In pursuing this objective, the Victorian Government needs to support the operation of markets, intervene only where there is an identified problem, and transparently evaluate the effectiveness and efficiency of interventions. Government action should be consistent with the principles of good policy.
- Three strong themes emerge from the Commission's review of experience of recent policies:
 - policy should focus on the challenges facing individual businesses and move away from targeting specific industries
 - innovation is crucial to the productivity and competitiveness of manufacturing businesses
 - the depth and strength of the networks within which businesses are embedded is critical to their awareness of the means and need to innovate and improve productivity.
- The Commission has identified ways to increase the number of high performing enterprises and made specific recommendations in the areas of:
 - innovation and enhancing business networks
 - skill formation
 - investment facilitation
 - regulation and taxation
 - government procurement.
- The future strategy for Victorian manufacturing should enhance the opportunities for creating and growing innovative businesses in any industry. The Commission envisages that this strategy would lead to a dynamic business environment which focuses on activity between businesses and supporting infrastructure rather than direct state assistance.

Summary report

Developments in the manufacturing sector directly and indirectly affect the wellbeing of virtually all Victorians. Even though manufacturing value added has remained largely unchanged over the last decade and has declined as a share of Victoria's economy, the sector is Victoria's second largest. It employs 10.9 per cent of the state's workforce.

The terms of reference indicate that the Victorian Government is seeking a 'new approach to manufacturing' and that it expects the Victorian Competition and Efficiency Commission (the Commission) to outline a 'forward looking strategy for the future development of an internationally competitive and productive manufacturing sector in Victoria'. This inquiry provides an opportunity to review comprehensively the role that the Government can perform in the future of this important part of the state's economy and to provide the foundations, if necessary, for a new approach.

The report outlines a forward looking strategy for government (including principles to guide the detailed design and implementation of that strategy), describes the manufacturing sector in Victoria, and then discusses the implementation of that strategy through instruments such as programs, regulation and procurement policy.

Trends and challenges

The commonly held view that manufacturing is declining is only partly true. The sector's value added has been quite stable over the last 10 years, although employment has fallen as labour productivity has increased. There has also been considerable compositional change within the sector. The distinction between manufacturing and other activities, such as research, product design and services, is becoming less clear. This means that the relationships among businesses, their customers and their suppliers are also changing. Similar trends have been experienced in other states and countries.

The sector faces challenges. First, some manufacturing industries are growing while others are declining. The need to adjust, which has been a strong feature of the industry, will continue. The pressures for change appear relentless, suggesting that government impediments to resource movements are likely to be both costly and, in the long run, ineffective. Second, manufacturing's competitive environment is challenging. Manufacturers have to compete for inputs, such as skilled labour, with growing sectors like services and mining, while facing continuing pressure to reduce their prices from strong overseas competition and the high exchange rate. Third, manufacturers have responded to increased competition by innovating and improving productivity. Workers in some sectors have lost their jobs. In others there is growing demand for higher skilled workers

and skill shortages are evident. Again, this requires adjustment as training systems and labour markets need to respond to new demands.

A forward looking strategy for Victorian manufacturing

In responding to the challenges of the current economic environment the Commission has proposed a manufacturing strategy that consists of three key elements:

- a clear overarching objective for Victorian Government policy for the manufacturing industry ‘to improve the wellbeing of Victorians by having more high performing manufacturing enterprises operating in a dynamic and internationally competitive Victoria’
- key areas where specific actions by the Victorian Government would contribute to achieving the objective
- rigorous principles for the design, development and implementation of policies and programs for manufacturing.

The objective

It is critical, in the Commission’s view, to be clear about what the objective is, and to make this explicit. Indeed the inquiry found that uncertainty about objectives has contributed to some confusion in the previous strategy. Policies appear to have been poorly directed and focused, covering a diverse range of objectives such as employment, investment, innovation and local content levels in the sector.

The Commission’s proposed objective — to improve the wellbeing of Victorians by having more high performing manufacturing enterprises operating in a dynamic and internationally competitive Victoria — would be best pursued through:

- focusing on enterprises and well-functioning markets as the fundamental means for achieving the objective
- ensuring that any intervention by the Victorian Government meets the test that it will achieve net benefits for Victoria, and not only the direct beneficiaries
- ensuring the benefits of any interventions to correct imperfections and failures in markets outweigh the costs.

Adopting this broad approach has implications for the government’s approach to policies and programs. It recognises that selective assistance that lowers the costs of a particular firm or manufacturing industry may improve its competitiveness, but at the expense of the competitiveness of other sectors (or even of other industries within the sector), if it increases their costs or reduces the availability of skilled workers. A Victorian economy-wide (and even more so an Australian

economy-wide) perspective pushes policy makers towards broad-ranging policies, rather than selective options that assist one part of the economy at the expense of another.

The approach proposed by the Commission does not rule out customised assistance to particular industries as such, but it does set tests and principles that require the Victorian community to be made better off. In the Commission's view, where proponents of the strategic industries are seeking customised assistance to their industries the onus should be on them to demonstrate that such assistance is also in Victoria's interests, using the principles and broad strategy outlined in this report.

Actions to achieve the objective

The Commission received many views about the actions that should be taken as part of the strategy for manufacturing. It considers the proposed objective for manufacturing policy would be best pursued by actions in the following areas:

- increasing the capacity of manufacturing enterprises to innovate, building on programs that can demonstrate success, and strengthening business-to-business networking and leadership capability
- improving the quality, quantity and flexibility of skills available to manufacturing including through better careers and training information, attention to remediating basic literacy and numeracy shortfalls, and developing and applying a framework for high performance manufacturing management
- where the case can be made for net benefit to the Victorian community, promote and facilitate selected additional manufacturing activity by reducing information and transactions costs, and encouraging activity with positive net benefits from spillovers
- framing government procurement to achieve both value for money and opportunities for competitive local manufacturers. The means for achieving this include properly defining 'value for money', removing key barriers to the participation of small to medium enterprises (SMEs), strengthening search requirements by tenderers for competitive and efficient local manufacturers, and longer procurement pipelines
- ensuring business regulation is justified and efficient, including by reducing barriers and the complexity of approvals for routes for high productivity vehicles
- ensuring economic infrastructure is efficient, effective and up-to-date, noting this matter was not included in the Commission's terms of reference for this inquiry.

The details of these elements of the strategy are set out, for the most part, in the following sections. The key exception is infrastructure. Infrastructure has been excluded from the Commission's terms of reference, and will be addressed in the

concurrent inquiry into a state-based reform agenda. Taxation policy and economic management more generally are also important, but are out of scope for this inquiry.

The Commission notes that while there are major pressures for adjustment coming from the high exchange rate, global financial volatility and measures to abate greenhouse gases, growth in China and the resources sector provide potential opportunities.

Policy and program principles

A key plank of the proposed strategy is the rigorous application of principles for policy and program design and implementation. These principles are that:

- Intervention should target effectively a clearly identified problem.
- Intervention should induce additional activity.
- Programs should be efficient for government and not impose unnecessary compliance burdens on firms.
- Administration of programs should not be unduly prescriptive.
- Policies, processes and measurement of outcomes should be transparent and public.
- Agencies responsible for programs must have clear and effective channels of communication with the private sector.
- Evaluation should occur regularly and intervention should cease if the evaluation shows that it is not successful.
- Overlaps with other programs, including those of the Commonwealth Government, need to be recognised and managed.
- The intervention should not breach Australia's international obligations.

These principles apply to the whole range of policy levers that the state government can apply as part of its manufacturing strategy. These include its taxes and charges on manufacturing firms; the rules and regulations within which firms operate; the Government's contribution to the training of staff; and the cost and efficiency of transport infrastructure.

Building on experience

The manufacturing strategy needs to be informed by the experience with policies over recent years. The Commission considers this experience emphasises three themes in implementing the proposed strategy.

The first is a move away from focusing on the industries that businesses are in, to the challenges of the business itself, especially in achieving high performance. Past policies have tended to focus on a few industries where it is felt that Victorian businesses enjoy a natural competitive advantage, such as food, or are strategically important, like the automotive industry. The broader focus would

concentrate more on SMEs where the market might fail to provide the best outcome for a number of reasons, including in important areas such as innovation.

A second theme is the central role of innovation and competitiveness to manufacturing businesses, and the importance of improving business capability in this area.

The third related theme is the importance of the depth and strength of the networks within which businesses are embedded to their awareness of the need and means to innovate and improve their productivity. Building more, stronger networks appears to be an effective way of assisting smaller firms to ‘know what they don’t know’, and see new opportunities for their businesses and sources of assistance to capture these opportunities.

Finally, the Commission’s proposed approach would strengthen the Government’s knowledge and understanding of manufacturing businesses but would reduce direct government-to-business intervention in favour of substantially strengthening business-to-business links.

Manufacturing in Victoria

The manufacturing strategy outlined above has been shaped, in part, by an understanding of the drivers of sector growth, the economy wide impacts of recent industry change, and an understanding of the key characteristics of the sector in Melbourne and regional Victoria.

Drivers of growth

While the relative importance of different drivers of growth varies among manufacturing industries and even among businesses, there is consensus that the exchange rate, supply chains, availability of skilled labour, the environment for innovation (including management capability and networking), and regulation and taxation are generally important.

State governments can only influence some of these drivers. Exchange rates and the terms of trade, for example, are determined by the interplay of forces relating to international trade, and indirectly by the interest-rate policy decisions of Australia’s independent Reserve Bank. Governments do not have a primary role in creating supply chains or in identifying specific suppliers for manufacturing businesses. Identifying suppliers and building a supply chain are ‘core business’ for manufacturers — they are fundamental aspects of entrepreneurship and the business case for producing a particular manufactured product. But governments do have a role in skill formation and some aspects of innovation, and a direct role in regulation and taxation. They also play a key role in the provision and cost of economic infrastructure, which directly affects the productivity and

competitiveness of manufacturing businesses, and is outside the terms of reference of this inquiry.

The costs of the relative decline of manufacturing

The terms of reference asked the Commission to review the costs of the relative decline of manufacturing. The reference to ‘relative decline’ is important since, as noted above, production has not declined. Manufacturing has experienced a relative decline during a period of solid growth in the economy as a whole.

In this context, structural unemployment is the most likely cost associated with manufacturing’s relative decline, but the Commission has found very little research into the size of these costs. In fact, the existence of significant skill shortages and limited evidence of widespread unemployment indicate that structural costs are likely to be confined to limited parts of the sector. It appears that the pace of structural change has slowed over the past decade or so, although there is some evidence that this situation may be changing.

Structural change is ever present in the economy, and there will always be costs of adjustment, particularly when unemployment is high. While reducing these costs is a legitimate policy objective, they should be addressed directly rather than by policies that try to hold back change, which can impede growth in productivity and overall living standards.

The challenges for manufacturing in regional Victoria

A significant proportion of manufacturing businesses and employment is in regional Victoria. Food production, primary metal and metal products, transport and machinery equipment products and wood products are significant. Manufacturing is important in Victoria’s major regional centres such as Geelong, Ballarat, Bendigo, Wangaratta and Wodonga. Geelong has strong manufacturing links in primary metal and metal products manufacturing, and transport and machinery equipment, whereas Ballarat and Bendigo have stronger links to food processing.

Several participants in the inquiry identified regional strengths that encouraged manufacturers to locate outside metropolitan Melbourne. Some regional participants, however, said that they have limited access to labour markets and to suitable training and university courses in fields such as engineering. Environmental regulation is also a key factor in the regions, as are rules and processes relating to waste management and land-use planning and development. But broadly speaking, factors such as liveability, access to markets and resources and the scale of production are important for both regional and metropolitan businesses.

The Commission concluded that, from the perspective of developing future government policy, a key success factor for regional manufacturing is the quality and availability of important services such as training and transport. Notwithstanding such differentiation, a future manufacturing strategy should encompass the whole state and create an environment in which all manufacturers have the best chance to compete and grow.

Programs for manufacturing

Over time, a complex array of government policies and programs has evolved in response to the challenges facing manufacturing. State governments have sought to influence areas such as innovation, skills and regulation in a variety of ways. While the Department of Business and Innovation (DBI) is responsible for policies that directly affect the manufacturing sector, broader policies administered by other government departments are also important for the sector. Consider education and skills, for example. Government policy towards primary, secondary and tertiary education affects the whole community, but also influences the quality of the manufacturing workforce. As well as these broad policy areas, there are programs — many of them administered by DBI — designed to meet the specific skills needs of particular sectors, such as manufacturing.

To analyse the broad framework that DBI uses for designing and delivering its programs, the Commission considered seven questions that draw on the principles outlined earlier.

- How many manufacturing programs are there?
- How much is spent on them?
- What is the strategy that links these programs?
- What are they intended to achieve?
- What have they achieved?
- How costly are they to administer?
- What has been learnt from the experience with these programs and how has that experience been applied?

On the basis of its analysis, the Commission concludes that there is considerable scope to improve program design and administration. The Commission, noting the ongoing review of current programs of financial assistance is not yet complete, suggests that for manufacturing programs the review focus on how to achieve:

- a consolidation of programs, with the remaining ones set within a clear strategy
- stronger processes for planning and designing new programs
- improved monitoring, evaluation and transparency

- continued engagement with businesses, particularly through information from the many business networks that exist, to improve understanding about optimising the role of government where it can be justified, and understanding the impacts on manufacturing of key trends.

The effectiveness of the overall spending in this area could be improved to better align with the approach proposed by the Commission. The Commission has recommended improving governance and the consistency of DBI's programs with the proposed design principles.

Innovation

Innovation that strengthens productivity and competitiveness in the manufacturing sector (and any other sector) is fundamentally an activity of enterprises. In the Commission's view, in business, innovation is something done by an enterprise that is new or significantly improved (including the application of existing knowledge in new ways) and creates value for the enterprise or its customers.

The capacity for enterprises to innovate depends on factors including:

- the relevance of innovation to the enterprise's business strategy
- the quality of management and employee relations
- enterprise cultures that support sustained innovation
- the quality and depth of technological skills and capacity to manage innovation
- the capacity of enterprises to capture the full value of innovations.

Consultation with inquiry participants revealed a range of issues that impact on innovation in the manufacturing sector:

- design and administration of government programs (state and Commonwealth)
- the extent of collaboration among businesses and among research institutions and industry
- enterprise skills and management capabilities, including the ability to access new ideas and create the business environment and focus needed to continuously innovate
- access to finance.

Governments can encourage innovation through responsible economic management; encouraging competition; effective regulation; and facilitating the free flow of investment and ideas. They can also support research and innovation infrastructure (knowledge, skills and institutions) needed to identify and exploit new products, processes and organisational changes.

The Commission has recommended that the Government enhance the innovation capacity of manufacturing SMEs by providing early stage funding to encourage manufacturing-focused communities of practice in innovation. This would include expanding existing networks to better integrate with local and international networks and public research organisations. These business driven networks would, among other things, raise awareness of the returns from innovation and lift participants' capacity to undertake innovation. The Commission is also of the view that the capacity for innovation can be enhanced by improving leadership and management skills. This can be assisted through the Government providing early stage funding to institutions, networking groups or private enterprises that deliver innovative leadership and management programs to business. Some desirable attributes of these bodies are that they achieve sustained engagement of participants (as opposed to one-off advice or training) and have a good chance of being viable beyond the initial government funding period.

Training and skills

Victorian manufacturing is changing, requiring more skilled employees; while competition for skilled labour is increasing from faster-growing sectors.

Victorian manufacturers, and their associations, have a direct interest in addressing the skill needs of their workforce, to improve the performance of their business and industry. However, a number of factors taken together, suggests that this can be particularly challenging for some businesses. Government action to complement (or supplement) industry initiatives may improve outcomes.

In this inquiry, the Commission focused on issues where manufacturing businesses are particularly affected, or where options can be considered in isolation from broader system-wide impacts. The Commission identified five areas of opportunity to improve outcomes for manufacturing businesses and workers:

- lifting overall performance management — through an evidence-based framework for high-performing manufacturing businesses that identifies current capabilities and areas where effort is needed to improve performance and specifies, the roles, accountabilities and relationships to give effect to meaningful change
- assisting manufacturing businesses to engage with the skills system — through a manufacturing skills pilot program that helps manufacturing businesses identify skill gaps and navigate the training market; and by providing better information on the quality of registered training organisations

- increasing the emphasis on the delivery of language, literacy and numeracy skills for manufacturing workers — including by providing additional specific emphasis on integrated delivery of language literacy and numeracy skills for manufacturing businesses and workers in the proposed manufacturing skills pilot program
- managing ‘thin markets’ — through an annual risk assessment of potential niche trades and professions in manufacturing that includes information on training courses offered and provided, business skill needs and instances of these not being met
- building capacity of manufacturing businesses to attract and retain skilled labour, particularly young people — in particular by better understanding how government, in conjunction with industry, can improve access to accurate and balanced information about Victoria’s manufacturing sector.

Beyond these, outcomes can be improved by looking at the broader training issues such as how the current training market is working, and the optimal institutional architecture to support the system. The Commission will consider these system-wide issues in its concurrent inquiry into a state-based reform agenda (a draft report is expected in October 2011).

Investment facilitation and assistance

Investment support is an important program administered by DBI. Under this program, the Government offers facilitation services to make it easier for potential investors to do business in Victoria, and sometimes provides financial assistance.

There is a spectrum of facilitation and assistance activities that governments can use to influence firms’ location decisions, ranging from informing potential investors about Victoria, to providing advice — for example, about regulatory arrangements — through to providing financial assistance. The Commission considers that the first two kinds of activities can be thought of as facilitation, and the latter as assistance, while recognising that in practice the boundary between facilitation and assistance may be blurred.

Facilitation

Governments may have at least five reasons for providing facilitation services. First, the private sector has no reason to promote Victoria’s strengths as a business location. Second, new investors, particularly those based overseas, may prefer dealing with a government agency if this increases their confidence that the government welcomes investment. Third, helping businesses to understand regulatory arrangements and required approvals may increase compliance with them. Fourth, governments may believe that they can provide facilitation services at lower cost than would the private sector, given that they have more expertise and authority about their own processes. Fifth, facilitation services may make

Victoria competitive by reducing the time taken to secure development approvals.

Published performance indicators suggest that the primary objectives of investment facilitation and assistance (which are reported together) are to generate additional employment and investment. Consistent with its proposal to focus policies on growing high performance enterprises, the Commission does not consider that jobs and the value of investment are the best measures of the contribution and performance of investment facilitation services.

- The principle that manufacturing policy should be guided by the concern for the wellbeing of the community as a whole suggests that aggregate community welfare, which is usually proxied by changes in aggregate domestic production or consumption, is the relevant objective and performance indicator.
- Focusing investment facilitation on jobs may have little connection with the objective of improving productivity.
- Focusing on the number of jobs or value of investment facilitated does not indicate whether these would have occurred anyway.

In principle, additional economic welfare, as measured by increased gross state product (GSP) is a better indicator of the desired ultimate outcome from facilitation services. This may not, however, be measurable (due to problems of attribution) and the Commission therefore favours a less ambitious approach to measuring performance, based on whether facilitation reduces the costs of firms that use these services. While reducing business costs, facilitation also imposes cost on government — it is important that the overall return on facilitation services is considered. It would also be useful to publish explicit criteria to indicate which projects qualify for investment facilitation.

In the Commission's view, the Government also has a contribution to make in supporting Victorian manufacturing businesses — especially SMEs — in pursuing emerging overseas markets, notably including China and India. There are Victorian Government Business Offices in both countries and trade missions are conducted from time-to-time. Including SMEs among trade delegations and coordinating trade promotion with Austrade would reduce the costs to those small businesses of exporting to these growing markets.

Assistance

The rationale for providing direct financial assistance to companies is that it may encourage them to go ahead with investments that would otherwise not be feasible. The validity of this rationale is hotly contested. Proponents believe investment assistance is an effective way to correct some (often broadly defined) market failures, while opponents believe the potential availability of assistance

encourages rent seeking rather than productivity enhancement, wasting taxpayer funds on projects that would have gone ahead anyway.

In the Commission's view, the case for providing financial assistance to targeted investment projects is very limited. The manufacturing sector faces skill shortages rather than excess inputs. There is, therefore, a significant risk that government grants will simply help those undertaking new investments to compete at the expense of existing firms, thus exacerbating skill shortages and cost pressures. When resources are pulled away from existing businesses, or their costs increase, and their output and capacity to grow are reduced. These effects offset the flow-on benefits, or multipliers, often cited as justification for such subsidies. In addition, the money used to fund subsidies is not costless, as it could be used for other purposes.

The Commission therefore concludes that subsidies can only be justified if the investment is accompanied by additional spillover benefits that improve the productivity of Victorian businesses. Such spillover benefits might involve the introduction of new knowledge or expertise that stimulates innovation in Victorian businesses and would not be otherwise available to them.

In practice, however, care is needed when governments provide financial and other support to such investments. The practical difficulties are substantial. If the assistance required to attract the investment exceeds the value of the spillovers, then Victoria does not benefit. Similarly, if assistance is paid when the investment would have come to Victoria anyway, the money is wasted. The government will always have less information than the investor about whether and how much assistance is needed to influence a location decision, so there is a very real prospect that assistance will be provided when it is not needed or not provided when it might have made a difference.

There will always, however, be pressure on governments to encourage such investment, particularly when subsidies are available in other jurisdictions. While all states are clearly better off if they all stop providing such assistance, this is unlikely to happen, and it will be more difficult for any individual government to act in isolation. The *Interstate Investment Co-operation Agreement* has been used to reduce competitive bidding among the states and territories for new projects. The Commission therefore suggests that the Government should seek to negotiate the continuation of the agreement when it expires later this year, aiming to tighten the constraints on inter-state competition for footloose firms. The Commission also suggests that the Government ultimately seek the cessation of investment assistance, except in situations in which such investment brings with it technological or other spillover benefits that lead to productivity improvements in Victorian businesses that would otherwise not be available to them. For this to occur potential projects would need to meet all of the following.

- The investment would bring to Victoria new technology and innovation that Victorian-based businesses would not access without direct investment in Victoria.
- There is a high probability of take-up by Victorian-based businesses of the new technology.
- The government subsidy is necessary for the business to invest in Victoria.
- The cost of the subsidy is less than the benefits to the Victorian economy of the additional innovation and productivity.
- The actions of the Victorian Government do not contribute to bidding wars across the jurisdictions for such investments.

Situations in which these conditions hold will not be common, reinforcing the Commission’s earlier conclusion that justification for such assistance is limited.

These tests are difficult to quantify and political pressure on governments to attract investment is likely to continue. It is therefore also worthwhile to test the likely impact proposed subsidies would have on the Victorian economy. This should include an assessment of the consequences of any additional cost pressures on existing Victorian businesses.

The Commission understands that a computable general equilibrium model is currently used to assess the economy-wide effects of proposed investment. This kind of model recognises the integrated nature of different economic sectors and tries to model the effects on the economy as a whole. To ensure that the modelling is undertaken from a public interest perspective, it needs to be either undertaken or reviewed by an independent party. This review should include testing for robustness against different assumptions.

Regulation and taxation

Many participants in the inquiry raised regulatory issues. Unnecessary regulatory burdens — for example, if regulation is poorly designed or difficult to comply with — can increase business costs, divert resources from more productive uses, and reduce businesses’ competitiveness. It is also important to consider the cumulative burden of regulation on manufacturing businesses and not just the burden imposed by any individual regulation. The burden of unnecessary regulation may fall unevenly on manufacturing businesses. Smaller businesses may find regulatory and compliance burdens to be particularly difficult to absorb.

The institutional framework within which regulation is made affects its impact on a particular sector. Some regulation is necessary to ensure the smooth functioning of markets and to achieve the government’s policy objectives. The challenge for the regulatory system is to ensure that such regulation achieves its objectives without imposing unnecessary burdens on businesses and the community.

The Commission recently conducted a public inquiry into Victoria's regulatory framework. The Commission's final report is being considered by the Government, but the draft report is available and provides a detailed description of the framework.

Participants in the present inquiry also identified specific regulatory concerns directly affecting their operations:

- planning controls and the planning system more generally
- environmental regulation
- occupational health and safety regulation
- regulatory approval processes for products
- transport regulation
- regulation of the energy sector
- compliance with Australian Design Rules and Australian Standards
- state taxes and levies
- the carbon tax.

The Commission has focused in more detail on two of these issues: transport regulation of heavy vehicles and energy regulation. With respect to transport regulation, there are two main issues:

- different regulations relating to vehicles crossing jurisdictional borders, with the Victorian Freight and Logistics Council (VFLC) arguing that Victoria's requirements are more stringent than other jurisdictions
- regulation of intra-state road transport in Victoria being more restrictive than in other jurisdictions.

In relation to the types of heavy vehicles that can travel on specified roads, the Commission has recommended that VicRoads, while continuing to publish information on the types of trucks which meet the standard for use on particular roads, specify the underlying standards on a performance basis and permit any complying vehicle use of the specified roads.

Multiple permit applications (often involving different levels of government) can impose unnecessary compliance costs and delays on businesses seeking transport services. The Commission recommends a 'one-stop-shop' for transport permits (incorporating state and local government requirements) to reduce compliance costs and delays faced by those requiring transport services.

Energy regulation is a very broad area and a complete examination of the regulatory framework affecting the sector is beyond the scope of this inquiry. However, energy is an important input into many manufacturing processes and so any regulation disproportionately affecting manufacturing industry will have a significant impact on the competitiveness of the sector. The Commission is

expecting to receive a separate terms of reference for an inquiry into low emissions policies following the completion of this inquiry.

The Commission has also recommended that the DBI, through its engagement with business networks, gather data on regulatory burdens affecting the manufacturing sector — focussing on understanding the nature and causes of any unnecessary regulatory burdens — and encourage business organisations to survey their members and publish the results. It has also recommended that DBI outpost a departmental employee with major employer associations to enable:

- improved information on regulatory costs borne by business
- enhanced information from employer associations on key regulatory issues, including the performance of regulators
- improved tracking of performance in reducing unnecessary regulatory burdens.

Government procurement

The relationship between procurement policy and local manufacturing is an important issue that attracts a wide range of views. The Commission has examined those views and sought to set out a position that achieves the greatest net benefits for Victoria. Importantly, the Commission expects that its recommendations are very unlikely to reduce the currently high level of local content in Victorian Government procurement, while giving stronger impetus to improving productivity and competitiveness in local manufacturing enterprises. The recommendations would substantially increase the rigour of information on, and the search for, local manufacturing capability, and reduce barriers to SMEs participating in procurement opportunities.

In 2009, the former Victorian Government introduced a preferential element in procurement policy, whereby Australian and New Zealand content became a consideration in the evaluation of bids in a wide range of procurement tenders. In light of its own analysis, and evidence provided in the 2011 Ernst & Young review of Victoria's current procurement policy commissioned by DBI, the Commission proposes an alternative approach that it considers will be more effective, while reducing the potential costs to the community, and cutting compliance costs for many businesses.

A key factor in achieving the currently high levels of local content is the work of Industry Capability Network Victoria (ICNV) to identify import replacement opportunities, coupled with competitive pressure on tenderers to obtain value for money from their suppliers. The Commission concludes that procurement policy should focus on those activities that have the greatest impact on the ability of local suppliers to compete for government business. The core work of ICNV is therefore important and should continue.

The Commission identified four critical issues to be addressed by a new approach to procurement policy as it relates to Victorian manufacturing:

- *access* — removing impediments to local firms accessing government procurement opportunities, including impediments relating to the structure, size and breadth of projects
- *awareness* — improving the provision of information about the capability of local suppliers (joined with a strict requirement for tenderers to test the actual performance of local suppliers) and the pipeline of government projects
- *value for money* — a focus on whole-of-life value for money, correctly defined, as the sole objective of public procurement
- *capability, compliance and consistency* — improving the capability of procuring agencies, and the extent and consistency of their compliance with procurement rules and policies.

Conclusion

Victoria's manufacturing sector is facing many challenges. The Commission believes that the strategy articulated in this report would enable the Government to increase the effectiveness of its contribution to the sector. It has developed 44 recommendations — outlined below — to give effect to this strategy.

Recommendations

Chapter 6: Towards a forward looking strategy and principles for policy

Recommendation 6.1

That the objective of a forward looking strategy for manufacturing is to improve the wellbeing of Victorians by having more high performing manufacturing enterprises operating in a dynamic and competitive Victorian economy.

That actions in the strategy to achieve this objective:

- focus on enterprises and well-functioning markets as the fundamental means for achieving the objective
- meet the test of achieving net benefits for the Victorian community
- ensure the benefits of any interventions to correct imperfections and failures in markets outweigh the costs.

That the strategy focus on the following action areas:

- increasing the capacity of manufacturing enterprises to innovate
- improving the quality, quantity and flexibility of skills available to manufacturing enterprises
- promoting and facilitating selected additional manufacturing activity, by reducing information and transactions costs and encouraging activity with positive spillover benefits
- framing government procurement to achieve value for money and opportunities for competitive local manufacturers
- ensuring business regulation is justified and efficient
- ensuring economic infrastructure is effective and efficient.

Recommendation 6.2

That policies and programs to give effect to the manufacturing strategy meet design principles for intervention, including:

- intervention should target effectively a clearly identified problem
- intervention should induce additional activity
- programs should be efficient for government and not impose unnecessary compliance burdens on enterprises
- administration of programs should not be unduly prescriptive
- policies, processes and measurement of outcomes should be transparent and public
- agencies responsible for programs must have clear and effective channels of communication with the private sector

- evaluation should occur regularly and intervention should cease if the evaluation shows that it is not successful
- overlaps with other programs need to be recognised and minimised
- intervention should not breach Australia's international obligations.

Chapter 7: Government programs for the manufacturing sector

Recommendation 7.1

That the Department of Business and Innovation within one year develop a strategy that outlines the overall objectives for manufacturing policy and the role of programs in contributing to that strategy. This strategy would establish a consolidated set of programs that focus on identified problems, and are accessible, effective, mutually consistent, non-overlapping, and capable of being evaluated.

Recommendation 7.2

That the Department of Business and Innovation publish immediately its Initiative Design Framework and all analyses of new initiatives prepared using this framework.

Recommendation 7.3

That approval of funding proposals for manufacturing programs be conditional on preparation of a business case identifying options from which the proposal was chosen and why it was chosen.

Recommendation 7.4

That the Department of Business and Innovation arrange for an independent external assessment of the effectiveness and efficiency of its approach to monitoring and evaluation. This assessment should be completed and published within one year.

Recommendation 7.5

That the Victorian Government establish the requirement that all future programs must sunset, and can only be continued after an evaluation of their relevance, effectiveness and efficiency, against their intended purposes and the overarching strategy for manufacturing. This evaluation would have regard to evidence from stakeholders, including participants and industry associations. The results of these evaluations should be published on the Department of Business and Innovation's website within six months of completion.

Recommendation 7.6

That the Department of Business and Innovation in its next annual report or a related document increase public reporting of the allocation of grants, the progress of programs towards achieving their key performance indicators, and the results of evaluations of programs.

Chapter 8: Innovation

Recommendation 8.1

To the extent that innovation programs are not included in the review of financial assistance programs proposed in recommendation 7.1 the Victorian Government evaluate, by September 2012, all current innovation programs available to the manufacturing industry against the principles in this report and the framework of principles for innovation initiatives. The outcome of the evaluation should be made public.

Recommendation 8.2

That the Victorian Government enhance the capacity for innovation by manufacturing small to medium enterprises by, in consultation with industry, providing seed funding (for a maximum of two years) to encourage manufacturing business-focused communities of practice in innovation by:

- expanding existing business networks (to better integrate with local and international networks and public research organisations)
- encouraging or creating new networks with a focus on innovation.

These business driven networks (which include research organisations and other non-government organisations) would, among other things, raise awareness of the returns from innovation and lift participants' capacity to innovate.

Recommendation 8.3

That the Victorian Government enhance the capacity for innovation by manufacturing small to medium enterprises (SMEs) by improving leadership and management skills, focusing in particular on entrepreneurship.

In addressing this objective, the Victorian Government provide early stage (seed) funding to institutions (including Universities), networking groups or private enterprises that deliver innovative programs to enhance the leadership and management capabilities of SMEs in the manufacturing sector. Important eligibility criteria are the extent to which proposed programs and initiatives:

- provide on-going, sustained engagement of participants as opposed to one-off advice or training (though may include components of this)
- participate in exchanges with other program providers on the processes used and outcomes achieved

- are likely to be sustainable beyond the initial funding period.

Recommendation 8.4

That the Victorian Government, through the Department of Education and Early Childhood Development, request each Victorian University to review impediments to greater engagement and collaboration with business in the areas of research, development and commercialisation, initially with particular attention to small to medium enterprises in the manufacturing sector.

That the outcome of the reviews be used to consider what action could be taken by the Victorian Government, or what action it could advocate be addressed by the Commonwealth Government.

Chapter 9: Training and skills

Recommendation 9.1

That the Victorian Government develop an evidence-based framework for high-performing manufacturing businesses that:

- identifies current capabilities and areas where effort is needed to improve performance, including:
 - ‘high performance’ standards relating to management, innovation and skills development — which Victorian manufacturers can use to assess their existing activities and gain insights into the scope to improve existing practices and processes
 - the drivers of, and barriers to, change so that a realistic assessment can be made of the potential to improve — focusing on what needs to be done, how it can be done, who is best placed to make this happen
- specifies, subject to the above, the roles, accountabilities and relationships to give effect to required change
- includes provision for ongoing monitoring, evaluation and review.

Recommendation 9.2

That the Victorian Government make available and encourages the use of the framework for high performing manufacturing businesses through the business networks (Recommendation 8.2).

Recommendation 9.3

That Business Victoria develop a manufacturing skills pilot program to help manufacturing businesses to identify skill gaps and navigate the training market and development programs. As well as responding to issues identified in the current review of the *Skills for Growth* program, the manufacturing skills program should include:

- explicit focus on improving general skills and capability of manufacturing workers including basic literacy and numeracy, and managerial skills
- expanded scope to offer practical advice on workforce development; benchmarking; recruitment, selection and retention; skills utilisation; upskilling; workforce literacy and numeracy; and dealing with registered training organisations
- quality assurance mechanisms to address concerns about the independence of workplace advisors under the program
- a competitive tender to select providers based on their capacity to deliver the expanded scope of services and comply with quality assurance
- monitoring the non-accredited training and non-government funded training that results from the training plans, as well as any referrals to other Victorian and Commonwealth Government programs.

The program should build heavily on the existing *Skills for Growth* program and should be evaluated within twelve months of implementation to consider whether:

- an industry-specific program has any different, beneficial outcomes to the general broader program
- the trialled expanded scope and focus of the program presents worthwhile benefits to the sector.

Recommendation 9.4

That Skills Victoria improve the information publicly available, particularly to manufacturing businesses, on the quality of registered training organisations (RTOs) over the next twelve months.

In particular, by seeking permission from RTOs to publish the outcome-based indicators it already collects, and working with relevant parties to develop a comprehensive information service through the proposed Victorian Public Register and the Commonwealth's proposed MySkills website.

Recommendation 9.5

That the Victorian Government increase emphasis on language, literacy and numeracy skills for manufacturing workers by:

- providing additional emphasis on integrated delivery of language literacy and numeracy skills for manufacturing businesses and workers, including through the proposed manufacturing skills pilot program (recommendation 9.3)
- building on existing Skills Victoria programs that seek to strengthen communication between businesses and registered training organisations to specifically recognise language, literacy and numeracy gaps and opportunities.

Funding for this effort would come from redirecting some resources currently assigned to industry programs.

Recommendation 9.6

That Skills Victoria undertake and publish an annual risk assessment of potential niche trades and professions in manufacturing, with the first risk assessment completed no later than July 2012. The risk assessment should include information on:

- training courses offered and provided by registered training organisations in these trades and professions
- business skill needs and instances of these not being met.

The risk assessment should draw on intelligence from industry training advisory boards, data from registered training organisations, and other information from businesses.

Where significant risks are identified, Skills Victoria should bring the results to the attention of relevant industry groups in the expectation that they will respond.

Recommendation 9.7

That, within six months, the Department of Business and Innovation undertake and publish a review of the effectiveness of the existing manufacturing careers programs to understanding how government, in conjunction with industry, can improve access to accurate and balanced information about Victoria's manufacturing sector.

This would include, but not be limited to, an evaluation of the Careers in Manufacturing program that considers:

- whether it strengthens the provision of balanced information to young people considering career options
- whether it affects decisions by students about courses of work and skills developed
- the appropriate level of government funding versus industry funding
- the desirability to continue, or change the mix of activities in the program, or expand the target age group in the program
- the experience of other initiatives where business has successfully engaged with young people about potential careers.

Subject to the outcome of the review, the Department of Business and Innovation, work with businesses and industry groups to implement identified strategies and report on these yearly.

Chapter 10: Investment facilitation and assistance

Recommendation 10.1

That:

- the Investment Facilitation Team replace its current performance indicators with client-based ratings of the quality of its advice, timeliness with which it was provided, and cost savings to the project resulting from the facilitation services
- these cost savings be benchmarked with the costs of the facilitation services, to give an indication of the rate of return on the services.

Recommendation 10.2

That the Investment Facilitation Team use and publish the following criteria to allocate its resources:

- the complexity of the approval and other government processes involved
- the perceived capacity of the investor to manage these processes
- whether a private provider could provide some or all of the facilitation services
- the cost of providing the facilitation services in relation to the perceived benefits for Victoria if the investment goes ahead
- the importance to the proponent of Victorian Government support.

Recommendation 10.3

That the Victorian Government support the continuation of the Interstate Investment Co-operation Agreement when it expires later in 2011, aiming to tighten the constraints on inter-state competition for footloose businesses and ultimately seeking the cessation of investment assistance. If continuation is not possible, the Government should explore ways of exchanging information with other states to restrain the costs of competitive bidding.

Recommendation 10.4

That if investment assistance continues, its objective be changed to attracting investment that generates technological or innovation spillovers that lead to productivity improvements in Victorian-based businesses that would not otherwise have occurred. The tests for providing assistance to new investment would be changed to:

- the investment would bring to Victoria new technology and innovation that Victorian-based businesses would not access without direct investment in Victoria
- there is a high probability that Victorian-based businesses will adopt, or otherwise capitalise on, the new technology to improve their competitiveness

- the government subsidy is necessary for the business to invest in Victoria
- the cost of the subsidy is less than the benefits to the Victorian economy of the additional innovation and productivity
- the actions of the Victorian Government do not contribute to bidding wars across the jurisdictions for such investments.

Recommendation 10.5

That larger proposals for investment assistance should be evaluated using a computable general equilibrium model, so that decisions are informed by an understanding of the impact on existing businesses and the Victorian economy overall.

Recommendation 10.6

That the Department of Business and Innovation should establish a practice, subject to appropriate safeguards, of publishing information about the outcomes from individual projects that have received assistance.

Recommendation 10.7

That future funding of investment facilitation and assistance should be conditional on satisfactory implementation, as measured by the Department of Treasury and Finance, of all recommendations in this chapter except recommendation 10.3.

Chapter 11: Regulation and taxes

Recommendation 11.1

That the Victorian Government advocate to the Commonwealth that the recommendations made by the Productivity Commission in its 2008 report *Annual Review of Regulations on Business: Manufacturing and Distributive Trades* relating to therapeutic goods regulation be implemented expeditiously.

Recommendation 11.2

That the Department of Transport seek clarification, as soon as possible, from the Commonwealth Department of Infrastructure and Transport as to the extent to which the requirements of the *Motor Vehicle Standards Act 1989 (Cth)* are being enforced, having regard to the issues raised in this inquiry.

Recommendation 11.3

That the Department of Business and Innovation, through its engagement with business networks, gather data on regulatory burdens affecting the manufacturing sector — focusing on understanding the nature and causes of any unnecessary regulatory burdens — and encourage business organisations to survey their members and publish the results.

That the Department of Business and Innovation outpost a departmental employee with major employer associations to enable:

- improved information on regulatory costs borne by business
- enhanced information from employer associations on key regulatory issues, including the performance of regulators
- improved tracking of performance in reducing unnecessary regulatory burdens.

Recommendation 11.4

That VicRoads, while continuing to publish information on the types of trucks which meet the standard for use on particular roads, specify the underlying standards on a performance basis and permit any complying vehicle use of the specified roads.

Recommendation 11.5

That VicRoads, in consultation with the Municipal Association of Victoria, examine and report to the Victorian Government by September 2012 on the feasibility of establishing a ‘one-stop-shop’ for road transport permits.

Chapter 12: Procurement policy

Recommendation 12.1

That the Victorian Government implement the proposed principles-based procurement policy as soon as possible, to strengthen the policy framework for public procurement, including a renewed focus on value for money, and arrangements to ensure that the complexity of procurement is matched by the capability of procuring agencies.

Recommendation 12.2

That the Victorian Government reform its procurement policies to ensure that the structure, scale and breadth of procurement projects are not unwarranted barriers to the involvement of local businesses. To implement this recommendation as part of the forthcoming procurement reforms, the proposed assessments of complexity and capability, and the market analyses, would explicitly consider the risk that the structure, scale and breadth of projects could deter bids and therefore reduce value for money.

Recommendation 12.3

That the Victorian Government’s proposed procurement reforms include steps to ensure:

- prequalification and project requirements, tendering rules and contractual conditions are not overly risk-averse, prescriptive, onerous or inconsistent

- procuring agencies give adequate weight to capital costs, whole-of-life costs and overseas supply risks in the evaluation of tenders.

To implement this recommendation, the Victorian Government Purchasing Board and Industry Capability Network Victoria should jointly provide good practice guidance and assist departments and agencies to address these potential barriers.

Recommendation 12.4

That the Victorian Government pilot the e-auction approach for an appropriate set of procurement activities, and evaluate the impact on transactions costs, value for money and opportunities for regional suppliers and small to medium enterprises.

Recommendation 12.5

To address information gaps relating to the existence and capabilities of local suppliers, the Victorian Government:

- retain the requirement for shortlisted bidders in applicable tenders to prepare a Victorian Industry Participation Policy (VIPPP) Plan
- establish that Industry Capability Network Victoria (ICNV) will only certify a tenderer's VIPPP Plan if the tenderer is assessed to have thoroughly considered the capabilities and value for money of relevant local suppliers.

ICNV would inform the tendering agency of the grounds for this assessment, and would publish information about the number of and grounds for refused certifications.

Recommendation 12.6

To ensure that successful tenderers consider local suppliers when making post-contractual-award changes to their supplier mix, that the Victorian Government require tendering agencies to add a standard contractual condition that selected tenderers consult Industry Capability Network Victoria post-award.

Recommendation 12.7

To enhance the role of the Industry Capability Network Victoria (ICNV), that the Victorian Government:

- clarify the objectives of ICNV
- establish new performance indicators for ICNV, including with regard to the breadth of industries and product categories in which it seeks to replace imports
- improve how ICNV's performance is measured and reported
- give ICNV explicit flexibility in how to achieve the desired outcomes.

Recommendation 12.8

To better enable local suppliers to plan for and participate in government procurement, that the Victorian Government publish a rolling procurement pipeline with a two-year horizon. This would be achieved by requiring departments and agencies to prepare Procurement Plans, which would be centrally published by the Victorian Government Purchasing Board. The information in the plans would be included in the Regional Industry Link website. Implementation of this recommendation would be subject to a Regulatory Impact Statement or an equivalent assessment.

Recommendation 12.9

To strengthen the focus of public procurement on value for money, that the Victorian Government remove the preferential aspects of the Victorian Industry Participation Policy. This would include removing local content as an evaluation criteria in government procurement, while strengthening the requirement for tenderers to test the relevant capability of local manufacturers. In the event of two or more bids being ranked equal first, a ‘best and final offer’ approach should be used to separate them (that is, give the bidders a further opportunity to enhance their proposal).

Recommendation 12.10

- To encourage innovation in public procurement, that:
- Victoria’s tendering agencies adopt approaches such as outcome-based specifications that do not constrain the ability of businesses to offer innovative solutions with the potential to deliver better value for money
- provided that the current evaluation demonstrates clearly that the program has generated net benefits for Victoria, and provided that the design principles in chapter 6 are applied to the program, the Department of Business and Innovation adopt and strengthen the *Smart SMEs Market Validation Program* or a modified version of that program.

Recommendation 12.11

To remove unnecessary compliance costs, that the Victorian Government limit the compulsory requirement to prepare a Victorian Industry Participation Policy (VIPP) Plan to tenders where there are significant opportunities for import replacement. In other cases, preparation of a VIPP Plan would not be compulsory. To implement this recommendation:

- the Victorian Government Purchasing Board and the Department of Business and Innovation would prepare guidance and criteria for procuring agencies to determine whether a planned tender is likely to have significant opportunities for import replacement
- the criteria would include project size and contestability

- agencies would be required to report the basis for their decisions about whether a VIPP Plan was required.

Recommendation 12.12

That, in light of the proposed procurement reforms and the findings and recommendations of this inquiry, the Victorian Government Purchasing Board, Department of Business and Innovation and Industry Capability Network Victoria work together to identify opportunities to:

- cooperatively provide training to government agency staff about the proposed ‘market analysis and review’ process, and addressing barriers to local businesses participating in procurement
- provide advice and guidance to potential suppliers about how best to participate in government procurement
- establish a ‘community of practice’ among government agencies involved in procurement
- improve the measurement and performance reporting of the Victorian Industry Participation Policy (VIPP), include measuring and reporting the compliance costs associated with the VIPP, and increases in local content attributable to the VIPP.

Recommendation 12.13

To improve the auditing of successful tenderers’ Victorian Industry Participation Policy (VIPP) Plan commitments, that the Victorian Government:

- clarify that the audit role would not be undertaken by the Industry Capability Network Victoria
- assign the audit role to a suitable government body such as the Department of Business and Innovation or the Victorian Government Purchasing Board
- accelerate the conduct of VIPP verification audits.