National Reconstruction Fund

CCIWA submission

February 2022

Introduction

The Chamber of Commerce and Industry of Western Australia is the peak body advancing trade and commerce in Western Australia. We are fundamentally committed to using our insights to develop and advocate for public policies that will help realise our vision to make WA the best place to live and do business. As our membership base is diverse in size, across all sectors of the economy, we seek to advocate for the interests of all sectors.

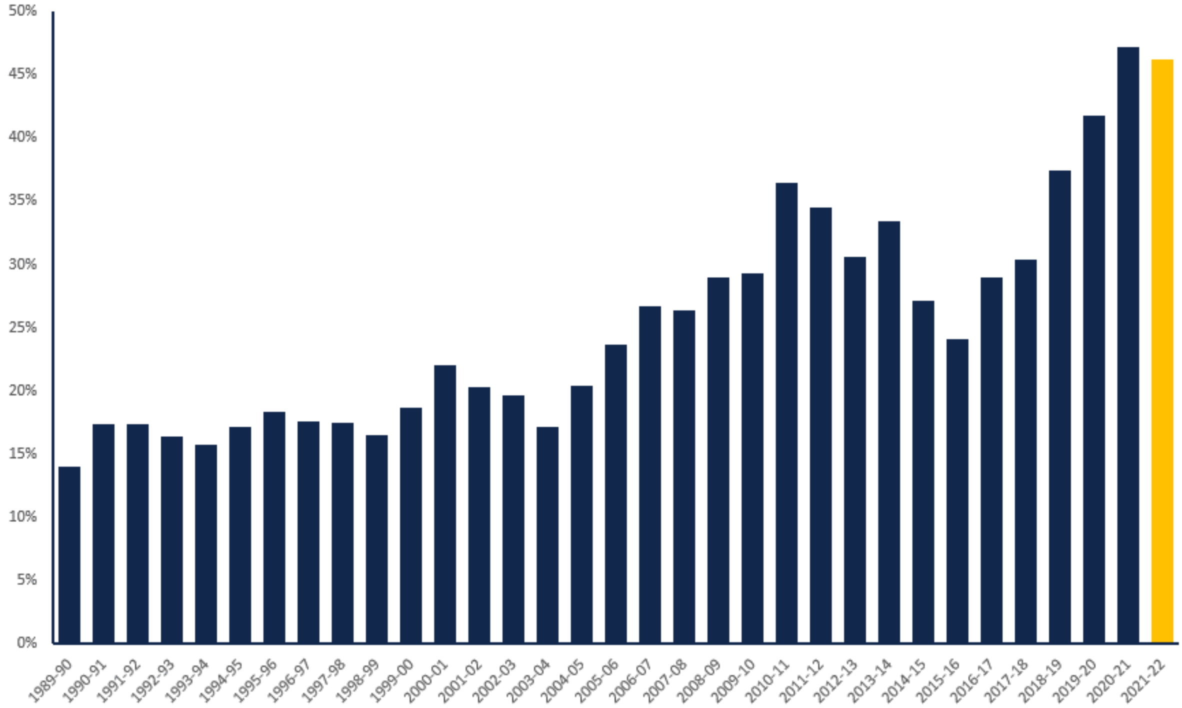
We understand that the aim of the $15 billion National Reconstruction Fund (NRF) is to support, diversify and transform Australia's industry and economy by providing finance to drive investments that add value and develop capability in seven priority areas. This submission provides our feedback on the following areas of the consultation paper:

- Priority areas and target investment levels; and
- The investment mandate.

More broadly, the imperative to diversify is a challenge the WA business community knows well. The mining sector still comprises almost half of our economy as shown in Figure 1. The next largest sector in any State is the health sector in Tasmania, which is just 12 per cent. While the outlook for WA's economy remains largely positive over the next 12 months, commodity markets will inevitably turn, making the diversification challenge ever more pressing.

The State Government has itself forecast slowing growth as we approach 2025, including anaemic growth in business investment. As such, leveraging our strengths in mining and resources, as well as driving our State's diversification agenda is a high priority not just for WA, but it is of national importance. We urge the Government to be cognisant of the risks WA's industrial concentration presents for the national economy and to invest heavily in WA, to help mitigate that risk.

Figure 1: Mining share of the WA economy (Nominal GSP)



We also urge the Government to consider whether and how small and medium organisations will be able to avail themselves of the fund. There is some concern that this financing model is more likely to support larger corporates with large scale projects, leaving SMEs unable to secure low-cost financing options.

We thank you for your open engagement with the WA business community so far, and support your commitment to engage with the State in shaping every level of the program's development.

Priority areas and target investment levels

The consultation paper asks about the types of projects or investments the NRF should focus on, or avoid, within the seven priority areas; and how industry 'transformation', 'diversification', and 'value add' should be defined and measured. It also asks how much detail should be provided on the priority areas, and how this and the need for flexibility should be balanced.

CCIWA's view is that the NRF should only make investments that pass a rigorous cost-benefit analysis. This will ensure that all projects funded are selected on merit, delivering value for money as well as positive social and financial returns for the Australian public. If the same rigorous approach to analysing investment is applied for all projects the best projects across all sectors are funded and the most appropriate use of taxpayer funding is achieved.

By implication, this means that it is best to retain flexibility when it comes to defining the priority areas. If they are defined with too much detail and prescription, this creates a risk that investments that would deliver positive social and financial returns are excluded simply because they do not fit within the definitions.

In terms of defining and measuring diversification, the WA Department of Jobs, Tourism, Science and Innovation has extensive practical experience grappling with these questions, and we encourage the Federal Government to engage with them on this issue.

Investment mandate

Investment needs and opportunities

A major barrier to private sector investment across industries is the risk appetite held by banks, super funds and venture capital investors to invest in innovation and potentially untested technologies. Taking a conservative approach to risk has resulted in investments being traditionally made to large established businesses, infrastructure, and residential/commercial buildings, not in innovative SMEs. Financial lenders also see SMEs as having a much higher risk profile and therefore, any finance is conditional upon high-risk premiums and restricted loan periods.

All these factors have a direct impact on the ability of businesses to access funding to start-up, scale-up and commercialise their innovation. As a result, innovation is taken overseas, and the willingness of SMEs to invest time and resources into the development of innovation is also impacted.

Financing innovative SMEs has been a long-standing challenge[1]. There are several enduring problems: the financial returns from investing in innovation is often skewed and highly uncertain; innovation is often intangible, making monetary valuations difficult to determine; and there is a disconnect between the knowledge and technical insight of the entrepreneurs and the financiers themselves. Other factors such as limited market power, the lack of management skills, and limited assets, also impacts their risk profiles. As a result, investors perceive high-risks and low returns and the ability for SMEs to access finance to grow and diversify becomes an enduring problem.

It is critically important that the challenges that face SMEs are deeply considered in this consultation process, and that pathways to ensure SMEs can benefit from the NRF are clearly identified to ensure they continue to play an important role in the economy.

[1] See: OECD, Financing innovative SMEs in a global economy, 2004.

Returns, financial instruments and working with other investors
The consultation paper asks about the factors that drive or constrain co-investment, the mechanisms / types of finance that would best attract private sector co-investment, and the preferred types of concessional offerings (e.g. lower interest rates).

SMEs want low-cost financing options to activate innovation and grow and diversify their businesses. Our engagement has revealed that anything other than grants is unattractive to SMEs. For example, loans need to be below existing market rates with realistic pay-back periods to be attractive. Diluting control through equity finance lacks support as well. Instead, grant funding has been suggested as the preferred financing option.

We acknowledge the risks associated with providing grant funding. In the past, direct financial support has been provided to support feasibility studies into manufacturing particular parts and products that Government wants to see made locally. This has seen billions spent, with no evidence to demonstrate significant improvements in competitiveness, growth or innovation in either the industries involved or the broader economy. In addition, it can make it harder for other industries to grow, if skilled workers are attracted to potentially uncompetitive pursuits: we forgo the opportunity to develop truly competitive industries.

The Government should therefore consider grant funding, but carefully. Grants should only be provided where there are spill over benefits for other industries, those benefits outweigh the cost to the budget, and businesses would not make the investment of their own accord.

Lastly, as noted above, a rigorous cost-benefit analysis will ensure that non-financial considerations are given due consideration as well, for example:

- regional economic development and employment
- enhanced well-being and liveability
- addressing supply chain vulnerabilities

Supporting policy considerations
The consultation paper asks for input about the non-financial barriers to businesses value-adding, growing and diversifying, and whether there are non-financial mechanisms and other levers that could help support the objectives of the NRF.

Over the past three years, CCIWA's quarterly Business Confidence survey has consistently shown that the biggest barriers to WA businesses growing are skills shortages, rising operating costs and supply chain disruptions. Trade tensions have also been a concern, especially for many manufacturers, miners, and transport businesses.

There are a range of complementary areas of reform that would go some way to address some of these issues, and in turn support the success of the NRF. These include:

Australia's Migration System

Reforms arising from the Government's review, *A Migration System for Australia's Future,* must build on changes the Government has already made to the migration system to make it easier for businesses to access skills from overseas when they cannot locally. With respect to an employer sponsored skilled migration program, we have called for:

- temporarily suspending labour market testing requirements while Australia's unemployment rate is below the natural rate of unemployment, to reduce red-tape in the system.
- maintaining just a single occupation list that includes all skilled occupations and allow a pathway to permanency for all skilled migrants.

To meet the need for unskilled, low-skilled and semi-skilled workers, we have called for:

- opening the Pacific Australia Labour Mobility (PALM) scheme to all postcodes in WA (not just regional areas), and all industries / occupations.
- broadening the source countries for the PALM scheme beyond just the Pacific Islands.
- allowing occupations assessed as Skill Level 4 to be included on the skilled occupation list.

Vocation Education and Training Reforms

The Government's vocational education and training reforms, and the establishment of Jobs and Skills Australia, also offer promise that our VET system will ensure we are training locals in the skills needed to deliver on the NRF's objectives. However, the next National Skills Agreement must deliver real funding increases in VET and in turn an increase in the number of funded students. We also urge the Government to continue to retain employer facing incentives to take on apprentices and trainees, to reduce the risk of future skills shortages.

Competitive Tax Framework

In the context of rising operating costs, it is vital that Australia has a competitive tax framework. Extending the threshold at which the 25 per cent corporate tax rate applies to a turnover of $250m would enable more successful SMEs to operate without the burden of higher tax, removing a barrier to their growth and helping to attract international capital.

Supply Chain Disruptions and International Trade

In terms of the barriers created by supply chain disruptions and international trade tensions, WA relies more than other States and Territories on a prosperous trade and investment relationship with China. Damage to that relationship is acutely felt by WA businesses. We welcome the Government's efforts to improve this relationship.

Aligned and coordinated Commonwealth/State policy action to address barriers

Governments need to focus on improving the way they regulate to streamline service delivery and eliminate redundant and archaic rules. This enables businesses to focus on expanding and diversifying their businesses, rather than navigating administrative and regulatory complexity that exist across tiers of government. Climate change is one policy area, where aligned and coordinated Commonwealth and State policy action is needed, particularly in addressing the policies, regulations and investment decision-making processes that currently act as barriers for WA businesses to decarbonise (eg: access to land and infrastructure).

Procurement Opportunities

To support local manufacturing capability, the Government could consider using procurement strategies to support the commercialisation of critical consumables produced locally (eg: 3-plus year purchase orders). The standard due-diligence in the form of a rigorous cost-benefit analysis is needed to ensure appropriate use of taxpayer funds.