Air International Group Limited

Response to the Productivity Commission Position Paper on Post 2005 Automotive Assistance

25th July 2002

Air International

1. Introduction

Since the late 1970s Air International has gone from having an annual turnover of under five million dollars to having more than five hundred million in turnover per annum, employing and training around 1,500 people and indirectly generating around the same number of jobs in supplier firms.

We are expanding both in Australia and offshore to maintain the growth of our income for our Australian shareholders, and to build businesses offshore which sell the services in which lie our greatest competitive advantage – design and engineering services provided by Australians from our Australian base.

Supporting our industry association FAPM, we are leading participants in the Productivity Commission inquiry because we believe government policy must 'go the distance' with the Australian industry, to ensure it completes the transition to global competitiveness.

We commend the Commission for its Position Paper which acknowledges the difficult transition the industry is embarked upon and proposes worthwhile options for further consideration.

2. Tariffs

Government Policy envisages tariffs falling from the current 15% to 10% in 2005. The Commission has endorsed a further five year tariff pause from then until 2010. We agree that if tariffs are to fall, this is a sensible way of managing the process at the same time as giving the industry time to adjust.

On the matter of tariffs however, we draw attention to our request in our first submission for the Commission to independently examine the economic case for cutting tariffs from their current level – from the perspective of the Australian economy, not the automotive industry.

To some extent such a study emerges implicitly from the modelling work, though it does not attempt to pin-point an 'optimal tariff'. However that the modelling does show that in a variety of plausible scenarios reducing assistance involves losses to the national economy and that in the other scenarios the gains involved are – in the Commission's words – "generally very small" (p. 165).

Given this finding it is a mystery to us why we would lower assistance, either from the level the industry enjoys today, or from the 10% level envisaged in existing government policy.

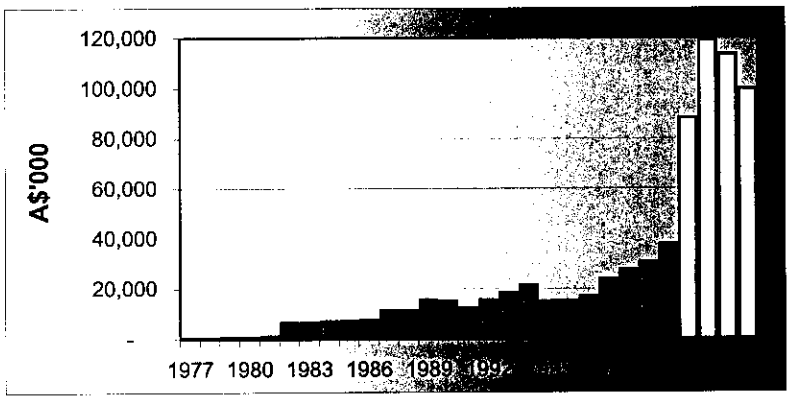
If we confine ourselves to the options foreshadowed in the Position Paper, we think these arguments suggest that the reduction in assistance take place slowly. This is consistent with the Commission's Option 3 on tariffs and FAPM's preference on the Position Paper – the reduction of tariffs by 1% point increments from 2010. (However we would again re-iterate our view that the desirability of such reductions has not been demonstrated in the Position Paper – if anything the Paper's modelling does the reverse).

ACIS

The Commission's modelling also suggested that ACIS could also generate gains for the economy because of its capacity to increase self reliance and so to improve our terms of trade.

In its original submission, Air International drew attention to the huge drain on our limited resources being imposed by our customers.

Air International operating assets



In these circumstances, and in the context of major vehicle upgrades for all or most of our customers in the five years from 2005, we feel – along with the FAPM – that Option 1 is the most sensible one. Though it delivers the same net present value of assistance to the industry as the other two options, it focuses assistance earlier in the program when it can be of greatest use in managing the transition to global competitiveness.

We appreciate the Commission's arguments that the scheme is a transitional one and that accordingly it should not be 'tinkered' with. However we respectfully point out that the foreshadowed scheme will cost of the order of $3 billion and that, with the current scheme, it will be current for at least the next eight years. In these circumstances it seems that it would be responsible to explore whether the scheme can be fine-tuned to deliver its outcomes more efficiently.

The Commission quotes Graham Spurling's view that

> assistance should not help firms resist the forces of rationalisation. And where possible it should actively assist the process ahead of other objectives.

We made a similar point in our own submission. However having accepted that "[t]his is an important issue for the composition and quantum of assistance delivered by any future transitional assistance regime (p. 106)," the Commission does not really consider it at all, because it argues that its support for ACIS is transitional.

Given the magnitude of the expenditure involved and the period of time for which it will be committed – a further eight years - we believe that the scheme would deliver its objectives in a substantially more cost effective way if it were targeted at increases in output or investment in plant and equipment and R&D.

3. *Air International's contribution to the Australian economy*

Air International recently commissioned Deloitte Touche Tohmatsu to undertake an economic analysis of ACIS credits received by Air International. The study concluded that the total quantifiable economic contribution from Air International's automotive activities to the national economy in 2001 and 2002 was $1.647 billion. This comprised:

- A direct contribution of $547.6 million; and
- An indirect contribution of $1.1 billion generated by the flow-on consumption-induced and production induced effects.

Of this total contribution, the component attributable to activity resulting from the ACIS credits paid to the company was:

- A direct contribution of $221.8 million; and
- An indirect contribution of $447.1 million.

The total contribution to the economy resulting from ACIS-induced activity was $668.9 million. This meant that across these two years, Air International directly spent $10.04 for every dollar of ACIS credit received, with a total contribution to the economy of $30.27 for every dollar of ACIS credit received.

Additionally, the payment to State and Federal Governments that result from the ACIS-induced activity that the company performed in 2001 was $18.3 million. This means that every dollar in ACIS credits earned by the company generated a payment of $1.56 back to State or Federal governments.

4. *Market Access*

Market access both in our region and the wider world is also critical. Prohibitive barriers to imports are commonplace in our region – for instance in China, Malaysia, Thailand and Korea. Yet we accept strongly growing imports from all these countries. We must redouble our efforts to gain access to these markets. We feel that the dedicated staff recruited to an automotive specific function within Austrade have played an important role in the industry's remarkable export performance and we think something similar should be retained.

It is our view that the funding of A$20 million over four years for Automotive Market Access and Development Strategy ("AMADS") was not substantial enough to make a significant change to market access. In saying this, a number of very successful activities were undertaken under the auspices of AMADS and the industry needs to find a mechanism to replace this program.

Our original submission contained an appendix containing some proposals for a new approach to 'effectively closed' markets for particular industries within the World Trade Organisation. We appreciate the Commission's tight deadline, but we hope that it has had the time to explore these proposals since the publication of the Position Paper. We hope the final report will explore the matter more fully.

We also call on the vehicle manufacturers to assist Australian component suppliers break into foreign markets. We seek no special 'favours' where we are not competitive. Rather it is critical that, where their subsidiaries have had excellent experience of our commitment to innovation, technical sophistication and quality, parent companies are made aware of our strengths. That means we can compete on a more level playing field as newcomers in foreign markets. We would welcome the opportunity to explore the matter further in discussion with the Commission.

5. *Industrial relations*

We currently have a situation in which a few hundred disgruntled workers, or far fewer managers managing badly can cripple the entire industry. Fixed costs are such a large part of the industry and profits are so low already that most firms only make profits in the last few weeks of each working year. Employees have lives to lead and will not come in on weekends to make up for lost production.

This is an exceptionally worrying matter for the industry with no clear solution in sight. We welcome the Commission's discussion of different alternatives to the current union structure. A single union would enable the industry to put demarcation disputes behind it. That having been said there are also obvious risks involved in a single industry union.

We believe that increasing management attention to training and education and to communication and collaboration with their workforce will also assist harmonious industrial relations in the industry. However the fact remains that where people have a veto power over an industry in which thousands of livelihoods are at stake, that power will sometimes be abused.

Even if the industry were a shining light of industrial harmony – and while we are proud of our own record and commitment, it is clear that the industry has some way to go – it would still only take one workplace to bring the industry to its knees. We think this is a grave structural problem for the industry.

We support the ideas being explored by Government for the imposition of 'cooling off periods' and the suspension of bargaining where it is damaging the economy.