AUSTRALIAN INDUSTRY GROUP

31 July 2002

Mr Gary Banks
Chairman
Productivity Commission
PO Box 80
Belconnen ACT 2616

Dear Gary,

Review of Automotive Assistance

Thank you for the opportunity to respond to the Productivity Commission's Position Paper regarding the Review of Automotive Assistance, which we will be discussing at our meeting on 31 July.

Let me compliment you and Assistant Commissioner, Philip Weickhardt on the conduct of the review. I believe the automotive industry has welcomed the open consultative style conducted by the Commission, particularly given the tight time lines for the review.

The Australian Industry Group is pleased that the Commission has recognised the importance of the automotive industry to the manufacturing sector and the economy more generally, and that there are good prospects for achieving a viable industry in Australia. The industry record in lifting exports, both in completed cars and component manufactures, is testimony to its increasing global focus and competitiveness.

We wish to focus our comments on four issues:

1. What constitutes a "viable" automotive industry?
2. The basis for lowering automotive tariffs after 2005.
3. The basis for continuing or lowering ACIS.
4. The future direction of workplace relations in the automotive industry.

This is not to imply that we do not agree with many of the broader points raised by the Commission, particularly in regard to microeconomic reform, taxation, research and development, training and safety arrangements. In this regard, we welcome the Commission's restating that the Tariff Concession System should be abolished as it imposes unnecessary costs on Australian manufacturers and their customers.

However, like the Commission, we believe that the future policy solutions for the automotive industry centre around the four issues identified above.

A Viable Automotive Industry

The Commission has acknowledged that the "Government has expressed its desire for a viable, internationally competitive and globally integrated automotive manufacturing sector" (p.xv).

But what does it mean to be "viable"?

In this regard, we believe that the Commission has taken a view that "genuine 'viability' implies a capacity to compete successfully in global markets without industry-specific government support" (p.xv). This view appears to have underwritten the Commission's consideration of policy options throughout the remainder of the report.

In an open, global competitive market characterised by the elements of pure competition we would tend to agree with the Commission. Industry assistance would not be needed because there would be competition on an equal footing with automotive production being driven by the price mechanism based on global demand and supply at the most efficient level.

However, this is not the environment the automotive industry operates in now, or is likely to in the immediate future. Automotive production globally is supported in different countries by differing levels of tariff and non-tariff protection, government industry support and other market arrangements.

While it is acknowledged that global competition is moving towards a more open and less protected system, as symbolised by our commitment to free trade under APEC and the WTO, Ai Group believes that "viable" must nevertheless be seen within the context the market actually operates under globally.

Consequently, we believe that a viable, internationally competitive automotive industry should be seen within the context of where governments in competing countries offer varying levels of industry support. We have no basis of knowing whether such assistance will or will not continue to be present in 2010 or 2015.

Automotive Tariff after 2005

The Commission has argued that a tariff of 5% should be the target after 2005. After considering three options, it has expressed a view that Option 2 – a pause at 10% with a reduction to 5% in 2010, but with no further reduction before 2015 – would prove the best balance between the competing considerations.

In favouring the tariff reduction, the Commission noted that the 'allocative' gains from further assistance reductions would be small. Indeed, it argued that quantitative modelling undertaken for the inquiry suggests that these gains could be outweighed by small, but adverse, shifts in the terms of trade. Nevertheless, it felt that 'dynamic' considerations not encapsulated in the modelling were far more important in formulating future assistance policy (p.111). In particular, the Commission stated "there would be 'dynamic' benefits from further assistance reductions – most notably in keeping the pressure on the industry and its workforce to address current impediments to greater productivity" (p.117).

Ai Group accepts that the automotive industry, like all manufacturing, needs to strive for enhanced productivity and efficiency. However, while the Commission puts substantial weight on lower assistance achieving this outcome, Ai Group believes that even with the current tariff regime, these pressures are already entrenched within the global marketplace. The manufacturing market has changed, and the Commission appears not to have given sufficient consideration to its implications for the automotive industry.

Both the Australian and Federal US Reserve Governors have recently commented on the changed dynamics of global competition for manufactures. The Australian

Reserve Governor, Ian Macfarlane in a speech on “Relative Advance or Relative Decline” on 22 June 2002 stated:

> *“… import prices, predominately manufactures, have been weaker. This should come as no surprise since the nature of the world’s manufacturing sector has undergone an enormous transformation over the past two decades. In 1980, only 25 per cent of the world’s manufactured exports came from developing countries; by 2000, 80 per cent did so. There has been a role reversal, and this has been accompanied by the loss of pricing power by exporters of manufactures that has effectively shifted real income to importing countries. It is hard to see how this process could not continue, with China and India still having so much capacity for further expansion”* (p.6).

In this regard, it is disappointing that the Commission has not given sufficient consideration to the implications of the likely emergence, for example, of China and Thailand as future major automotive manufacturers, to the Australian automotive industry and global competition.

The US Federal Reserve Governor, Alan Greenspan, stated in his Testimony on monetary policy to the Congress Committee on Banking, Housing, and Urban Affairs on 16 July 2002 that:

> *“…globalisation is intensifying competition in a broad range of markets and dampening pricing power across developed and developing nations alike. Those businesses where heightened competition has engendered a loss of pricing power have sought ways to raise profit margins by employing technology to lower costs and improve efficiency” (p.3).*

This is the reality for the automotive industry. Low pricing power, low margins and global competition are already forcing car companies to look for greater productivity and efficiency. These pressures will intensify when the automotive tariff is reduced from 15% to 10% in 2005.

As Holden pointed out in its submission to the Commission, despite record sales, the net income of the four car manufacturers is down by 72% over the last four years, from 1997 to 2000 (p.30). It adds, “while profitability in parts of the industry has certainly improved from the earlier decades, even in the most successful areas the level of profitability that is being achieved is a long way from world class when current government assistance and the impact of tariffs is removed" (p.12). Similarly, Ford in its submission to the Commission notes "Australian automotive market's prices are among the most competitive in the world", partly due to the effect of "low price entry cars [placing] ... considerable pricing squeeze on medium cars" (p.10). Similarly, Mitsubishi in its submission to the Commission alludes to low pricing power when it states that the "domestic medium/large market has been very competitive in recent years with limited price increases, strong incentives and fleet discounts being offered by all manufacturers in an attempt to maintain their share of a stagnant market segment" (p.12).

Further as Holden adds in its submission to the Commission:

> *"while the reduction in tariff assistance has been an important factor in sharpening the focus of the industries in their drive to become internationally competitive, it has only been one factor. The process of globalisation in the automotive industries has been and continues to be a major driver of their rationalisation, both in Australia and elsewhere"* (p.81).

Consequently, the question that remains unanswered is what additional benefit would the Australian automotive industry gain from being exposed to a set of additional competition forces when they already face severe market pressures? And with this, would these heightened pressures have the potential to threaten the viability of the industry overall? This remains unanswered by the Commission's work, despite the fact that the Commission makes passing reference to "price suppression in the world automotive markets" (p.36), due to "continuing and substantial excess production capacity".

As well, even the Commission has acknowledged in its modelling the damage that lower assistance would cause to the automotive industry and regional economies. At its worst (removing ACIS and tariffs) using the MONASH model, output by 2016 would be lowered by 18% from the base case, employment by 16% and local sales by 1%. At its best (removing ACIS only), output would be lowered by 11%, employment by 8% and local sales by 2% from the base case. As well, regional economies in Adelaide, Melbourne and Geelong where the car industry are concentrated are shown by the Commission modelling to suffer significant employment losses relative to the base case in 2016.

Add to this the spill-over effects on manufacturing overall, and the case for lowering assistance is therefore not overwhelming on economic modelling grounds.

In favouring lower tariffs the Commission has rejected the notion of linking tariff reductions with commensurate action by our trading partners because it would not provide a lever for improving access to overseas markets. We do not agree with this proposition. As we highlighted in our submission to the Commission on General Tariff Arrangements (p.9), our negotiations over an AFTA-CER links have been hampered by the limited scope to secure reciprocal gains in market access.

More fundamentally, our view that further tariff reductions after 2005 should be conditional on further action by other car competing countries is a matter of principle. To put it simply, while we agree that Australia's commitment to free trade implies that we should work towards this goal, this is not to imply we should do this at the expense of Australia's domestic interests, particularly when other countries continue to be well behind the progress already made by Australia.

Nor does this mean, as the Commission implies, that our assistance arrangements would become "hostage to what other countries choose to do" (p.83). Australia would continue to set its own assistance arrangements and change them as it sees appropriate. All that is being said is that one of the factors that should determine Australia's arrangements should be what action has been taken by our trading partners to lower their trade and non-trade barriers.

Consequently, while Ai Group agrees that the automotive tariff should be lowered over time, we believe that it should remain at 10% after 2005 until there is clear and unequivocal evidence of significant progress in lowering tariffs and non-tariff barriers by competing countries.

Continuing or Lowering ACIS

The Commission sees a continuation of ACIS after 2005 “as a means of facilitating a reduction in the tariff to 5 per cent” (p.135). It has presented three options for consideration - continued funding of between $2 billion and $2.8 billion over 5 years; equivalent funding at a uniform rate over 10 years; and equivalent funding over 10 years, with funding for the second-five year period set at half the first five years.

The Commission sees ACIS as “transitional funding” in the context of trade liberalisation, consistent with the ACIS Administration Act 1999. However, equally important, is the role of ACIS in encouraging investment and innovation in the automotive industry.

Ai Group in its first submission highlighted the importance of ACIS in generating new investment. As one of the car manufacturers stated, “(the) elimination of ACIS would significantly slow our expansion/investment plans and would impact on activities related to new product development”. This point appears to have been acknowledged by the Commission when it stated that the withdrawal of ACIS in combination with a renewed round of tariff reductions “could be sufficient to precipitate the exit of firms that might have become internationally competitive under more accommodating arrangements” (p.123).

As well, data collected by Ai Group highlights that the introduction of ACIS appears to have resulted in a significant lift in investment to an expected $1.4 billion in 2002, after almost four years of decline.

Ai Group believes that if the automotive industry is to further improve competitiveness, build its production base and exports, then it is important that ACIS continues as a program that encourages greater investment and innovation. Further, as with tariffs, our policy must be mindful of our competitors where industry assistance continues to be offered to encourage and support the development of the automotive industry.

The Commission has raised the question of whether ACIS facilitates or hinders the necessary process of adjustment. Within the context of a viable internationally competitive sector, Ai Group believes that ACIS through encouraging new investment and innovation is assisting the process of adjustment. If the automotive industry is to remain competitive in a market increasingly characterised by limited pricing power, improved efficiencies need to be delivered through better productivity. New investment is critical to this process. Ai Group believes that ACIS is contributing to this transition and therefore should continue.

Our view is that ACIS should continue under current funding arrangements until at least 2010.

We are unable to indicate to what extent funding should be extended beyond 2010, and indeed express any preferred option under the Commission's three options. Given that the automotive market, both in Australia and globally, is almost impossible to predict with any certainty after 2010, we feel that funding arrangements post-2010 needs to be left open for further consideration at a later date. As well, as the Commission acknowledges, consideration of the future of ACIS is partly dependent on future broader arrangements for R & D and other activities (p.62). These arrangements remain unknown after 2005/6, as the Federal Government has only made forward funding commitments until this date.

Workplace Relations

As the Commission has acknowledged, over the past decade significant improvements have been made in the flexibility and productiveness of automotive industry workplaces.

Ongoing and sustained productivity improvement is essential if the industry is to survive and prosper. Companies in the automotive sector are acutely aware of this imperative and are continuously implementing and refining strategies to improve productivity levels. The maintenance of harmonious and productive workplace relations at the enterprise level is an essential part of any successful continuous improvement strategy.

The legislative amendments which Ai Group proposed in its May 2002 submission would assist in building better workplace relations at the enterprise level. More issues would be resolved before they develop into industrial disputes and disputes which did arise would be resolved more swiftly. As stated in the Productivity Commission's Position Paper, such changes would provide for a better balance between the rights of parties to take industrial action and the rights of other employers and employees in the industry who may suffer significant harm as a result.

Since Ai Group forwarded its submission to the Productivity Commission, we have identified two common sense proposals for legislative amendments which we believe would be particularly helpful in improving the workplace relations environment for employers and employees in the automotive sector (amongst the many worthwhile legislative reform proposals being pursued by various parties). The proposals are:

- To enable the Australian Industrial Relations Commission (AIRC) to order a cooling-off period by suspending protected industrial action to allow for conciliation or mediation of a dispute; and
- Where it is demonstrated that significant harm is likely to be caused to innocent third parties (including employees who may be stood down), enable the AIRC to terminate the right to take industrial action.

A copy of a full page advertisement which Ai Group, in conjunction with the Federal Chamber of Automotive Industries (FCAI) and the Federation of Automotive Products Manufacturers (FAPM), placed in the *Australian Financial Review* on 25 June 2002, setting out the proposals, is attached.

Also attached is a letter sent to the Prime Minister and the leaders of the Opposition and Australian Democrats explaining the proposals in more detail.

In addition to identifying the need for legislative reforms, the Productivity Commission in its Position Paper expressed support for discussions being held at the industry level between peak employer and union bodies to develop initiatives to improve workplace relations. A program of discussions is underway involving Ai Group, the ACTU and key unions in the automotive industry. Two key objectives have been agreed upon and various initiatives are being discussed in pursuit of each objective. The two objectives are:

- To secure a competitive future for the vehicle industry; and
- To secure a stable industrial relations environment in the vehicle industry.

To date, the parties have met on 4 July and 12 July and further meetings are scheduled for 30 July and 6 August 2002

One issue which the Productivity Commission suggested should be on the agenda for discussions is the protection of employees' entitlements. Ai Group is happy to discuss this issue with the unions and intends to do so. However, we believe that measures to protect entitlements are best implemented by Governments across the whole community. Accordingly, Ai Group supports the national initiatives which have recently been introduced by the Federal Government to protect entitlements. These include changes to the Corporations Law and the introduction of the General Employee Entitlements and Redundancy Scheme (GEERS). These initiatives are set out in the attached fact sheet

In relation to redundancy, given the extent of redundancy benefits which exist in the industry, any scheme which endeavoured to fully protect over-award redundancy pay would be extremely costly for employers and would inhibit industry competitiveness. The provision of up to eight weeks redundancy pay under GEERS is consistent with the current community standard. This level of redundancy pay cushions the blow for employees whose employers become insolvent and enables them to search for another job over a reasonable period without experiencing hardship. We note that the ACTU has announced its intention to pursue an improved community standard for redundancy pay via a test case in the Australian Industrial Relations Commission.

In conclusion, we do not believe that it is practicable or desirable for an industry level scheme to be implemented to protect entitlements in the automotive sector. Ai Group favours the Federal Government legislating the terms of GEERS as a safety net scheme generally applicable to all Australians.

Thank you again for the opportunity to comment on the Position Paper.

Yours sincerely,

R N Herbert

Chief Executive