



Department of Innovation, Industry and Regional Development

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

Dear Mr Banks,

PRODUCTIVITY COMMISSION INQUIRY INTO THE AUTOMOTIVE INDUSTRY - THE VICTORIAN GOVERNMENT CONTRIBUTION

The Victorian Government is pleased to make an initial contribution to the Productivity Commission's Inquiry into the post 2005 assistance arrangements for the automotive industry. This initial view aims to highlight the key issues facing the automotive industry and the areas in which we believe the Productivity Commission Inquiry's efforts would be most effective. The Victorian Government's detailed policy position will be made known over the next few months. We are pleased that the timing for the Inquiry has been accelerated and that the terms of reference for the Inquiry provide a broad framework for exploring the scope and effects the industry has on the broader economy.

At the outset the Victorian Government would like to express its strong support for the automotive industry, in this State as well as nationally.

This initial contribution acknowledges the strategic position the industry plays in the Australian economy, but notes that its future performance and continued sustainability are not guaranteed. As a general proposition, the Victorian Government believes that the Productivity Commission must consider the best possible business and investment environment for the automotive sector, to enable it to plan for the longer term with confidence and certainty.

The Automotive Industry in Victoria – its size and significance

Victoria is the home of the Australian automotive industry. The design, manufacture and assembly of motor vehicles and components, as well as parts and accessories, is Victoria's largest manufacturing industry, comprising of about 2% of Victorian Gross State Product (GSP) in 1999/00. This represents a total value added of almost \$2.29 billion in 1999/00 from the industry's national total of approximately \$3.88 billion. The Victorian automotive industry directly employs more than 27,000 people, which is more than 50% of the industry's total national employment.

Performance of the industry

The automotive industry has sustained commendable levels of performance in recent years during which time nominal tariff levels have been reduced from 22.5% in 1997 to 15% in 2000, and substantial changes made to assistance schemes. Under the current industry support regime, sales of passenger vehicles, light and heavy trucks increased 64 458 units since 1997. Exports have continued to increase from \$2.72 billion in 1997 to \$4.249 billion in 2001 and are rapidly approaching the 2006 target of \$6 billion the industry set itself in 1997. Export vehicle production figures have doubled since 1997, with export sales of component manufacturers increasing by 63% over the same period, although it should be borne in mind that this export success has in part been assisted by favourable exchange rate movements since 1997 (between March 1997 and March 2002, the Australian Dollar declined in value from 97 to 69 Yen and US\$0.79 to US\$0.51).

There has also been some success within the domestic market, in spite of a difficult trading environment since 1997. Although the share of total imports has increased by 6% points, sales of locally produced vehicles from the medium vehicle market segment increased by approximately 8% points and also maintained their dominance in the large vehicle segment market.

Quality performance of locally manufactured passenger motor vehicles has increased significantly since 1996. Sample average faults per vehicle for medium vehicles fell from 1.4 in 1996 to 0.8 in 2000. A similar trend also occurred in large car manufacturing with sample average faults falling from 1.8 in 1996 to 1.1 in 2000.

Growth of export markets such as the Middle East and the US indicates an admirable alignment of product mix with consumer demand. Indeed, entry into exports markets considered to be difficult to access has been impressive. For example, exports of automotive vehicles to the US – a market considered to have substantial non-tariff barriers – have more than doubled in the six years to 2001: from \$210 million to \$605 million. Similarly, exports of automotive components increased from \$181 million in 1996 to \$486 million in 2001.

Similarly, exports to Indonesia – which has an infant automotive manufacturing industry to protect – have grown six-fold over the same period to \$98 million in 2001.

Strategic Significance

In December 2001, the Minister for Manufacturing Industry, Rob Hulls MP, launched the Strategic Plan for the Victorian Automotive Manufacturing Industry (attached). The plan broadly defined the automotive industry as incorporating vehicle producers, tier 1, 2, 3 component suppliers, service providers such as toolmakers and education providers, and aftermarket manufacturers. The automotive retail, repair and service sector, while not included in this definition, is an important extension of the industry and should not be overlooked. The broader industry definition attempts to reflect a whole-of-industry approach and is inclusive of the other segments contributing to the automotive industry's success. This definition helps us understand why the industry is truly strategic and has a pervasive effect across the national economy.

The above definition clearly illustrates that the automotive industry cannot be considered simply as a manufacturer of vehicle products. Rather, it occupies a broad contextual position within the Australian economy encompassing a significant part of the overall manufacturing and services industry in Australia. It is for this reason that the Productivity Commission

Inquiry must consider the ripple effects on all elements of the industry in its investigations and recommendations.

The significance of the industry therefore extends well beyond its immediate and direct contribution to the Victorian economy. It is a large-scale purchaser of core inputs right across the manufacturing and increasingly service sectors contributing to the strength of the Australian engineering, moulding, plastic, rubber and textile based manufacturers. These manufacturers are heavily reliant on the automotive industry, which provides many companies with a critical mass of sales.

It is therefore essential for the Productivity Commission to recognise that the automotive industry extends beyond the companies directly involved in automotive production. For example, the motor vehicle industry is the single largest purchaser of products from the rubber and the furniture and mattresses sectors industries, the second largest purchaser of basic iron and steel products and the third largest purchaser of paints. The automotive industry is also a leading user of advanced technologies that are associated with design and engineering, production, material handling, inspection and testing processes and communications.

Bearing these industry linkages in mind, the employment effect of the automotive industry is felt widely through both direct and indirect employment. The direct employment is in the form of the manufacture of vehicles, parts and components, while indirect employment can be viewed as a backward linkage from vehicle and parts manufacture to raw material suppliers, fuels, services of all sorts (e.g. financial, transport, energy) and capital goods which supply them. It is the linkages between automotive production and the manufacturing and service sectors that clearly illustrate why the automotive industry is crucial to long term growth in Australia.

In studies undertaken in the USA,¹ Canada² and the UK³ the employment multiplier effect estimated for the automotive industry is approximately 3.0. Therefore, when extrapolated using the 2001 direct employment figures for the automotive industry of 27,551 in Victoria and 54,487 in Australia and a multiplier of 3.0, the effect on employment is 82,653 for Victoria and 163,461 for Australia. It is vital to note that these figures represent significant benefits for the manufacturing and services sectors in metropolitan and regional areas.

Moreover, discussions with senior officials from vehicle manufacturers in Victoria have revealed that many local vehicle producing companies employ policies to maximise local content in sourcing and production. These local sourcing policies contribute additional strength to the manufacturers in the location in which they produce.

¹ *The Contribution of the International Automotive Sector to the U.S. Economy*. A study prepared for the Association of International Automobile Manufacturers, Inc. The University of Michigan Transportation Research Institute, The Office for the Study of Automotive Transportation and The Institute of Labor and Industrial Relations, March, 1998.

² *Final Report Greenhouse Gas Options, Policy and Measures for the Canadian Transportation Equipment Manufacturing Industry* Prepared by: The Transportation Equipment Manufacturing Sector Working Group National Climate Change Industry Table, February 2000.

³ *Report on the Economic Prospects for the Automotive Industry in the UK and Europe and its Impact on Ford of Dagenham*, Professor Garel Rhys Director, Centre for Automotive Industry Research Cardiff University Business School, October 2000.

Further evidence of the strategic significance of the automotive industry exists across the Australian States. We understand from our discussions with NSW and South Australia that they are strongly supportive of the industry and the role it plays within their individual State economies. NSW, although not home to a vehicle producer, cites the importance of the industry to component and service sectors and emphasises the benefits the industry has for regional employment.

Beyond the purchasing and multiplier effects, the automotive industry is highly significant and strategic because of the magnitude and extent of spillover, which are felt across the economy.

The automotive industry embodies leading edge knowledge management, product design, production techniques and engineering capability that other sectors and firms benefit from.

The automotive industry exemplifies the kinds of characteristics and capabilities that increasingly underpin competitive advantage for economies. These characteristics, such as innovation and knowledge, have been identified by both the Victorian and Federal Governments as necessary for future growth in manufacturing. The industry continues to stand out as a leader in the introduction of new products, processes and innovations and continues to demonstrate its commitment to innovation with automotive technologies.

Key examples of the innovative capabilities of the automotive industry include:

- Holden's recent opening of its state of the art \$6 million virtual reality design studio in Melbourne that will help to further reduce the time involved in moving from the design to production stage for new models; and
- Air International, a tier one supplier of automotive interior systems, has announced a \$44 million investment plan for a new Global Engineering and Technical Centre in Melbourne that will support their growing global operations.

The industry is also an active and significant R&D collaborator with public sector researchers. Examples include:

- Holden's longstanding involvement with the Monash University Accident Research Centre;
- The use of the Monash University wind tunnel facilities by both Ford and Holden;
- Ford's strong links with Deakin University in its ferrous and aluminium solidification technology (FAST) and stamping technology for automotive manufacturing processes (STAMP) research centres;
- Mitsubishi's involvement in the CRC for intelligent manufacturing systems & technologies;
- Ford's involvement in the CRC for alloy and solidification technology (CAST);
- Robert Bosch Australia's participation in the CRC for microtechnology; and
- The involvement of 130 components and services suppliers in the aXcessaustralia concept car projects coordinated by the CSIRO's Australian Automotive Technology Centre.

The Victorian Government is strongly committed to the development of a leading edge innovation economy. This is reflected in a number of recent policy statements such as the Victorian Government Budget 2002-03, the Business Statement and The Agenda for New Manufacturing.

The International Outlook and Sustaining Competitive Performance

The Productivity Commission must consider carefully the international context in which the automotive industry operates.

The Victorian Government has held discussions with the automotive industry over the past two years which have confirmed specific plans to grow business and exports including working with parent companies to expand and link into global supply chains. During these discussions, industry has advised of the need to produce at least 350,000 units and to grow exports beyond current levels to maintain the viability of existing plants. These plans however, may be hampered by any tariff decreases, as they are likely to lead to lower domestic sales and therefore increase the need to expand exports. Furthermore, the lowering tariff levels pose a threat to continued growth of the industry. Firstly, a comparably higher competitor tariff induces manufacturers to locate in a protected domestic market taking with them all of the critical mass this implies. Secondly, and of equal importance, our exporters access to those markets is constrained by tariff walls.

Due consideration of our export base must also be incorporated into the scope of the Inquiry. As previously stated, while our export performance has been sound it must be acknowledged that it is narrowly based with 59% of all exports going to the Middle East.

Policy considerations at the Federal level must also take into account the global context in which our automotive companies operate. While the Doha development round of WTO negotiations has commenced, the reality is that the international trading environment is uncertain and that nations around the world have significantly divergent attitudes to free trade. It is the case that many competitor jurisdictions continue to apply high tariff and non-tariff barriers for their automotive industries.

Australia is not alone in recognising the strategic importance of the industry with countries such as the UK, US and Canada providing industry support arrangements. These countries have industry support regimes that are becoming increasingly competitive with our own in the forms of investment incentives, tax concessions, cash incentives, accelerated depreciation allowances, labour cost support, regional aid allowances and loan guarantees at the national and sub-national level.

Despite the APEC Bogor commitment, high tariff walls still exist in South East Asia (up to 300% in Malaysia) and China (up to 61.7%)⁴. This provides greater incentive for companies to invest in those markets and establish a critical mass of suppliers of manufacturing components and service related industries. This protectionism poses a threat to the Australian automotive industry as most of the world's 'big six' producers have indicated their willingness to locate in a strong domestic market to then underpin manufacturing with research and development and further investment.

Essentially Australia is operating in a global strategic game where investments that might be lost by Victoria will not go to other competing Australian States. Rather, due to inappropriate and non-competitive policy settings, overseas options will become more attractive.

⁴ Source: DFAT 2002

In order for Australia to retain its competitive position and successful industry performance, the Productivity Commission must examine in detail issues of market access, R&D and the creation of a stable long-term environment for the industry as key elements of this Inquiry.

Structural Adjustment

The motor vehicle industry has been subject to considerable rationalisation and adjustment over the past two decades.

The Productivity Commission research paper, *Structural Adjustment – Key Policy Issues*, concluded that the extent to which structural adjustment options are examined needs to reflect the likely significance of the costs of making a policy change. In other words, the process needs to be pragmatically based and focussed initially on a consideration of the nature of the reform proposal and its likely consequences, the characteristics of those likely to be affected and the general state of the economy and local labour markets.

Policy settings which involve abrupt changes to support arrangements could exacerbate structural adjustment difficulties and have adverse implications for regional employment and the future of a vital industry that is the backbone of manufacturing in Australia. We would expect therefore that the PC Inquiry will thoroughly examine the structural adjustment impacts of any change to the existing arrangements of a 15% tariff and the current Australian Competitiveness and Investment Scheme (ACIS), especially as they may affect regional areas of Australia.

Links to other Economic Policy Levers

It is our understanding that the Federal Government plans to lower tariffs from 15% to 10% on 30 June 2005 parallel to the other reforms such as tax reform having been implemented. The Victorian Government believes it is crucial for the Productivity Commission Inquiry to thoroughly investigate the progress of the reforms and their impact on the automotive industry since 1997 before any reduction in current tariffs is implemented or proposed.

It is also important to understand competitors' tariffs, non-tariff barriers, influences such as trading blocs and investment attraction programs in order to create an assistance regime that reflects the international environment. The Productivity Commission is in a position, through the Inquiry, to complete this type of investigation and to yield information useful for the Federal Government to develop a long-term industry support regime.

Looking Towards A Long Term Competitive Automotive Industry

In our view, this Inquiry offers an opportunity to provide certainty for the future, not only for the automotive industry in Australia, but also as a core component of an international competitive manufacturing and services sector. The Inquiry also offers a chance to ensure that employment in regional Australia is supported and that Australia remains at the forefront of innovation and R&D in key manufacturing and export areas.

While we are not prescribing any particular policy solutions at this stage, the Victorian Government stresses the importance of confidence building within the automotive industry to actively encourage investment.

We are of the firm belief that our policy setting should clearly take into account efforts at trade liberalisation by our competitors. Further, access to overseas markets for our automotive industry on comparable terms to that which competitors obtain in the Australian market must be at the forefront of thinking for policy makers.

In order to provide for a competitive and certain investment climate, we believe that the next phase of a tariff and investment support regime ought to be a period of 8 – 10 years. This would see levels of tariff and investment support that encourages investment, R&D, innovation in design and use of technology consistent with both Commonwealth Government industry and innovation policies as well as the Victorian Innovation Economy agenda.

To reiterate, the Victorian Government remains fundamentally committed to an efficient and innovative automotive industry, as a leader and exemplar of the kind of industry that is fundamental in the innovation and knowledge age.

While recognising the premise that a selective approach to industry development or support for one industry over another can impose costs elsewhere in the economy, the reality is that automotive is a special case due to its size and significance, spillover effects and international outlook. In addition, it is much more than just a single industry. It is a complex of tightly linked manufacturing and service sector and subsectors.

For the reasons advanced in this contribution, the Productivity Commission needs to consider long term strategic issues and challenges in framing its post 2005 assistance recommendations.

The Victorian Government is keen to continue this dialogue with the Productivity Commission. The contact within the Victorian Department of Innovation, Industry and Regional Development is Mr John Dalton, Director of Industry and Regional Policy. He may be contacted via email on John.Dalton@iird.vic.gov.au or telephone on 03 9651 9135.

Yours sincerely

Neil Edwards
Secretary