Supplementary Submission by

HOLDEN

to the

Productivity Commission

August 2002

Inquiry into Post 2005 Assistance Arrangements for the Automotive Manufacturing Sector

For media comment on this submission:

Jason Laird
National Manager Corporate Communications
Tel: 03 9647 5278
Fax: 03 9647 1997

For questions regarding the content of this submission:

Alison Terry
Executive Director Corporate Affairs
Tel: 03 9647 1485
Fax: 03 9647 1997

Samantha Read
National Manager Government Relations and Public Policy
Tel: 03 9647 2017
Fax: 03 9647 1997

Geoff Chamberlain
Chief Economist and Treasurer
Tel: 03 9647 1717
Fax: 03 9647 1747

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Overview

Holden has publicly welcomed the release of the Productivity Commission Report and its coverage of the key issues faced by the Australian automotive industry over the coming years. In particular the Commission's examination of the alternative scenarios that could apply to tariff assistance and direct assistance through the Automotive Competitiveness and Investment Scheme (ACIS) has provided an excellent basis for future consideration of these issues for the industry.

Holden's submission to the Commission provided a clear outline of our future business strategy and the form of Government support that we believe will be required to support this strategic direction.

Most importantly, Holden's ability to maximise its opportunities as a global niche player will be critical to our future success. As outlined in our submission, Holden's strategic direction for growth requires both an expanded share of the Australian domestic market through broadening of the product range as well as expanded export volume. The key to achieving success in all of these areas lies in our ability to capitalise on the niche that we have carved out for Holden within the GM organisation, as a manufacturer and supplier to global markets of large, rear wheel drive passenger motor vehicles.

Holden's strategy for increasing scale of production and maximising its niche opportunities is to build on both domestic and export market opportunities. This cannot be achieved simply by building more of the same products that we produce today. Inherent in Holden's strategy is the need to develop new and innovative products that will allow this growth to occur. Lead times must be reduced and it is critical that support be redirected to the research and development that will be required to develop these products to meet emerging market needs.

Tariff Arrangements

Holden recognises and acknowledges the need to achieve an adjustment process which will ultimately result in a negligible tariff level of 5%. However this can only be achieved in the context of critical trade decisions to be made on both bilateral and multilateral bases. Many submissions to the Commission have emphasised the lack of progress made by Australia's trading partners towards achievement of relatively free external automotive trade. Ideally, it is Holden's view that an end date be nominated for the tariff transition. However, we do not believe that Australia is yet in a position to nominate when this date may occur.

Holden therefore proposes that the automotive tariff level be held at 10% until adequate market access can be ensured for Australian automotive exports. Most importantly in this regard, Holden firmly believes that Australia should not unilaterally disarm itself in world trade negotiations. We do not believe that it is in Australia's best long-term interest to give up our remaining negotiating coin in the absence of appropriate concessions by our trading partners.

An additional issue which remains of great concern to Holden is the tariff on 4WD and light commercial vehicles.

If Holden is to make the required investment in innovative new products, including products that will compete in the expanding sport utility vehicle segment, the disparity in tariff rates between passenger vehicles and those vehicles in the 4WD segment that compete with passenger vehicles presents a significant impediment.

Form of Future Auto Assistance

The Productivity Commission's paper has reviewed in some detail a range of forms of assistance for ACIS post-2005. It is pleasing that the Commission's report has recognised the important role for ACIS in supporting the industry's transition post-2005.

Holden fully supports the Commission's position that the scheme should provide greater certainty for participants by provision of two separate pools, one for the motor vehicle producers and one for the suppliers.

Our business model supports the Commission's first option, that is extension of an ACIS scheme for a five year period from 2006 to 2010.

One area in which Holden is disappointed is the Commission's conclusion that there should be no significant change in the basis for earning credits under an extended ACIS scheme. Holden strongly believes that the key to success for the industry will be its ability to make the transition to a truly globally competitive industry, which is not reliant on ongoing sector specific support. This requires that the drivers that will allow this to happen must first be identified and then strongly promoted in this final transition phase. As outlined in some detail in our original submission, support for research and development and associated investment will provide the strongest impetus for the industry to make this transition. It is quite clear that the scheme must support a high degree of research and development if the necessary product innovation to regain both domestic share and new export market opportunities is to be achieved.

In addition, the operating environment for the industry after completion of the ACIS transition phase will be critical. Holden welcomes the Commission's recognition of the need to review the existing support for research and development across all industries, which is currently provided through the 125% tax concession for R&D. While we have consistently supported the need for a transition to an environment where sector specific assistance is no longer required, more general forms of support, such as that provided by R&D concessions and investment attraction schemes must be sustained at internationally competitive levels. Developed countries are increasingly sophisticated in the support provided for research and development and Australia should be part of this trend if the policy environment is to support a more knowledge intensive economy.

The Way Forward: Other Issues to be Addressed

Holden's original submission and response to the Productivity Commission also covers a number of additional issues, which will be crucial to the industry's future.

In the lead up to the release of the Commission's report, workplace relations has been the subject of considerable debate in the context of continued assistance for the automotive industry. Holden welcomes the acknowledgment that it is neither appropriate nor practical to link future assistance arrangements with industrial relations performance and outcomes.

Having said this, the need for improvements in the sector's workplace relations is without doubt. The environment in which the industry now operates which requires cost competitiveness through reduced inventories and higher reliance on 'just in time' practices has made the industry increasingly vulnerable to stoppages at component suppliers. In addition the industry's increased export profile has introduced a new standard for delivery and timeliness not previously demanded by domestic customers.

A common theme running through Holden's submission to the Commission's Inquiry has been our desire to clearly outline our future business strategy and the specific demands that will place on Holden as an organisation, as well as on the policy and external environment in which we operate. This is equally the case for the workplace relations reforms that we believe are required. Our business strategy requires speed, flexibility and innovation in both products and processes, the ability to work towards ambitious goals and to adapt to the requirements of changing customers in the markets. Most importantly this is required of our workforce and the unions that represent them.

Holden's submission to the last Inquiry emphasised the trend at that time towards a more generally constructive partnership approach and recognition of common interest on a number of topics, less animosity, growing mutual respect and mechanisms to support an ongoing dialogue. There have certainly been some setbacks to this objective over recent years and Holden's specific recommendations in the area of workplace relations are directed towards addressing these areas. In particular, our recommendations require:

- Joint commitment and shared vision with workforce and unions, understanding of shared goals and mutual recognition of growth and global market imperatives.
- A union structure more able to support this shared approach.
- A legislative framework to allow issues to be addressed swiftly and fairly with transparency of process and practices.
- Most importantly no tolerance for illegal action and;
- Flexibility in relation to demarcation issues to support capacity increases and growth initiatives.

Finally, Holden welcomes the Commission's considered views on a range of other topics that are highly relevant to the ability to make the transition that will be required over the next decade. Recommendations relating to the duty on imported second hand vehicles, the luxury car tax fleet arrangements and standards harmonisation all provide a supportive framework for consideration of these issues going forward. Further discussion is clearly warranted in the area of environment and specifically the National Average Fuel Consumption target. Holden's submission deals with this issue in some detail.

In closing Holden reiterates its support for the Commission's recognition of the need for a decade of policy certainty. We also recognise that the transition must now be made to a regime of non-sector specific support if the industry is itself to make the transition required to meet the requirements of global markets.

Post-2005 Tariff Arrangements

Tariff Arrangements for Passenger Motor Vehicles

Holden notes the Commission’s three alternatives for post-2005 tariff arrangements. We consider that the objectives for post-2005 tariff policy should be:

- To recognise the likely impact on Australia of critical trade decisions to be taken in the next several years, in the context of APEC, the new multilateral round, AFTA, and possible bilateral agreements involving Australia. In this context we consider it important to retain “negotiating coin” for both bilateral and multilateral trade negotiation.
- To achieve an appropriate adjustment cadence with the objective of moving to a negligible tariff level (which we interpret as 5%) as soon as this can be made consistent with Australia’s overall interests.

Specifically, we support a movement to a 5% tariff when, for example:

- the US is clearly committed to putting aside the 25% tariff on light commercial vehicles which currently keeps us from exporting the Holden Ute to their market; and
- ASEAN either enters into free trade arrangements with Australia, or commits in a convincing and unequivocal way to relatively free external automotive trade in 2020 or before.

Realistically, if a decision on the final stage of the car industry’s transition to negligible special assistance must be made in 2002, it must be made before the outlook for these matters can be forecast. In this situation it is essential to avoid haste in any unilateral reduction in tariff level.

Of at least equal importance is the question of cadence. Holden considers that the timing of an eventual reduction in tariff level to 5% must be considered in association with other transitions the industry must make. Perhaps the largest of these is the eventual expiry of ACIS and its successor schemes. The Commission has proposed that the current ACIS be replaced by a scheme with similar value, disbursed over either a five or ten year period commencing in 2006. For reasons explained elsewhere in this submission, Holden considers the optimum program will involve providing this assistance over five years and not ten. This implies that there will be a substantial decrease in industry assistance occurring in 2010. We believe it would be most unwise to have a major reduction in tariff assistance occur within several years of the expiry of ACIS.

In view of the overall industry assistance picture, in the context of international trade negotiations which are still some way in the future, Holden proposes that the automotive tariff level be held at 10 per cent until there are solid grounds for confidence that relevant prospective markets for Australian automotive exports, are clearly committed to providing us with adequate access. This would enable Australia to participate in both bilateral and multilateral negotiations with some capacity to make concessions if this were in the national interest.

We consider that against a background of an unprecedented opportunity for the Australian industry to enter global markets, it is not a good time to create an additional exposure to market instability at home through a premature and unilateral tariff reduction in 2010. We support the execution of the already-committed reduction from the present 15% to 10% from January 2005, primarily because this change has already been committed – and we would not wish to see Australia's excellent transitional policy record fumbled through a policy U-turn in one of the last stages. However, we believe there is a clear need to complete this transition process in a way that helps to launch the domestic industry onto the world stage.

Tariffs on 4WD and Light Commercial Vehicles (LCV)

The Commission has suggested in its Position Paper that *"no change is warranted for 4WD and LCV tariffs".*[1]

In Holden's first submission we argued the case for a limited application of a higher tariff rate to certain vehicles in this segment. The distinction that we drew was between 4WD vehicles that use Body Frame Integral (BFI) construction as distinct from Body on Frame (BOF) construction. The current "4WD" vehicles that use the BFI construction are arguably designed as passenger vehicles and are not designed for serious off-road use.

As stated in our first submission, Holden supports the concept that "special purpose off-road vehicles and LCVs for use in activities such as agriculture, mining and transport of goods should not be burdened with the passenger car rate of tariff".[2] Government considered this subject more than twenty years ago and the result was the Customs rule we now have, which sets criteria for vehicles that receive the concessional low rate of tariff. However, it can be argued that in the context of the Government's intent in providing this concessional rate, the BFI four-wheel drive vehicles which are simply used as passenger car substitutes should be treated as passenger cars and be subject to the same tariff rate.

The argument put forward in Holden's first submission is as follows:

"Holden would support a limited application of a higher tariff for imported 4WD vehicles that do not use Body on Frame construction, at a rate comparable to that used for passenger vehicles. The Body on Frame 4WD vehicles perform a true off-road function, while it can be argued that Monocoque vehicles are not usually purchased for serious off-road use. The imported 4WD vehicles utilising Body Frame Integral construction design are direct substitutes for passenger vehicles and the 4WD features of these vehicles are incidental to the consumers' use of the vehicles."[3]

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[1] Review of Automotive Assistance Position Paper", p 130, Productivity Commission, June 2002

[2] Holden's Submission to the June 2002 Review of Automotive Assistance (sub. 72) page 70

[3] Holden's Submission to the June 2002 Review of Automotive Assistance (sub. 72) page 70

The Commission recognises in their Position Paper that the different tariff treatment between PMVs and 4WDs "may have unintended effects". [4]

In Holden's first submission we noted that in terms of demand, the light 4WD wagon is one of the segments that has enjoyed significant growth in the past 5 years. However, the growth of the light 4WD wagon can be partially attributed to the attractive pricing that these vehicles have enjoyed due to the lower tariff rate, creating significant challenges for local manufacturers wanting to enter this segment whilst also eroding market share of the locally manufactured passenger vehicles.

Contrary to the assertion made by the Commission in the Position Paper that,

"Moreover, local vehicle producers are not amongst those requesting a change to the tariff on 4WD vehicles"[5],

as one of the producers planning to introduce locally designed and manufactured vehicles into the Australian 4WD market segment, we believe that there is a need to reclassify the BFI vehicles as passenger vehicles, thereby equalising the rate of tariff between these vehicles. This would then provide an environment that will allow the local manufacturers to successfully introduce new products into the segment and provide the consumer with greater choice. It should be noted that tariff arrangements in Australia are such that all the imported components of locally made 4WD vehicles will be subject to duty at the passenger car rate. It is grossly unfair that the finished product should then have to compete with fully assembled vehicles imported at half the passenger car duty rate.

Whilst the Commission argues that the best way to achieve uniformity is through the ultimate reduction of the PMV tariff rate, Holden believes that there is justification for the classification of 4WD vehicles to be re-examined. For example, one alternative may be to eliminate the "4WD" classification and classify vehicles simply as either LCV or PMV. This would then focus on the underlying character (basic construction) rather than what are basically appearance characteristics (e.g. ground clearance, approach and departure angles).

[4] "Review of Automotive Assistance Position Paper", p 130, Productivity Commission, June 2002

[5] "Review of Automotive Assistance Position Paper", p 131, Productivity Commission, June 2002

Adjustment Issues

Holden considers that the car industry is in the latter stages of making a difficult adjustment from local and uncompetitive, to globally focused and, within its niche, globally competitive. While this transition is not complete, it is so far advanced that it is appropriate to assert that it can be completed. We believe the focus of post-2005 should be quite intently on facilitating this completion. In asserting that the adjustment process is largely behind us, we do not claim that there are no remaining risks, or that there will be no more pain. On both an employee-profile and geographic-profile basis, there are vulnerable people and districts, and it is important to recognise a major objective of minimising adjustment costs (both personal and financial).

The primary reason for anticipating that the final transition can be made at affordable cost, is that the industry has now found its niche and broadly is moving in a direction that can ultimately be successful. However situations differ between industry participants. If we assess the situation realistically, there are firms that do not yet have a clear path to their goals. The national interest is likely to be best served by ensuring that these firms are provided with a reasonable amount of time to overcome their challenges. In Holden's view there is no basis at present for writing off any significant industry participant as lacking the potential to succeed. It should therefore be an objective of industry policy to provide a clear, stable, and challenging but supportive environment while leaving it to individual firms to succeed or fail in establishing viable strategies.

Holden proposes that the management of adjustment costs associated with the industry's final transition to global competitiveness, is best approached in the following terms:

- A stable, known, and broadly supportive environment should be created for a limited period
- The structure and specifics of the environment should be designed to facilitate the transition that much of the industry has said it needs to make: that is, to becoming an industry of global niche players, heavily committed to exports and to multiple vehicle variants from a single base platform for each car producer
- The assistance framework should be based on supporting a transition, so the ultimate outcome – no special assistance to the automotive industry – should not be in doubt.
- Broadly the policy framework for industry support should be stated and adhered to, rather than being arbitrarily determined from time to time through ongoing political processes.
- Should any pockets of adverse outcomes become inevitable, the management of them should be based on achieving humane outcomes for people, rather than postponing the inevitable through ongoing support payments to companies.
- Industry and government should adopt the concept of being in partnership to manage this final transition away from specific sectoral assistance. It is a process that neither industry nor government can accomplish alone. The partnership should adopt the principle of having some tactical flexibility, but against the background of shared objectives and a clear strategic framework.

The Tariff Concession System and the Excluded Goods Schedule

In its previous submission to this inquiry, Holden pointed out the existing highly restrictive framework under which car makers have no access to the Tariff Concession System, and there is in addition an Excluded Goods Schedule that further isolates the automotive industry from normal forms of import administration. The Commission made no comment on this issue in its Discussion Paper.

In the context of the Commission's desire to move toward the abolition of sector-specific assistance arrangements for the automotive industry, Holden suggests that it is important to establish a policy framework for the industry's involvement in both the TCS and the EGS. It is unrealistic to make proposals concerning future tariff arrangements and ACIS arrangements, but make no provision for the path toward normalising other policy areas. If the Commission does not deal with these issues, it seems inevitable that some other form of policy review will be required to deal with them at a later date.

Holden reiterates its position that the Tariff Concession System contains provisions to protect the interests of Australian manufacturers against the granting of Tariff Concession Orders in relation to locally manufactured goods. The arbitrary exclusion of the four car makers from applying for TCOs is either an unreasonable discrimination against us, or an expression of lack of confidence in the TCS itself. If the latter is the case, then the TCS should be improved to remedy this situation. It seems clearly unreasonable to exclude, selectively, car makers from the TCS but allow every other sector of industry to participate.

We must emphasise that the argument for our exclusion from the TCS, which has been advanced occasionally in the past – that car makers receive a Duty Free Allowance in lieu of eligibility for TCOs – is plainly spurious. Our understanding is that the DFA came into existence originally simply as a translation of the previous protection arrangement. With the removal of mandatory local content, what had been an "85 per cent local content requirement" became a "15 per cent Duty Free Allowance", and was essentially a different way of expressing the same entitlement. The 85 per cent local content requirement, in turn was the scheme that replaced the earlier 95 per cent local content scheme, when additional parties were invited to join the Car Plan in 1975. The additional parties could not comply with 95 per cent, and argued that the proportion of parts that could not reasonably and economically be sourced in Australia was actually 15 per cent, not 5 per cent. For the existing local manufacturers this was a relaxation in local content requirements. This relaxation was permitted to take effect on a phased basis in subsequent years, with each component that was to be re-sourced from local purchase to overseas purchase, subjected to individual justification through the "non-reversion rule". Hence, the first justification for the 15 per cent DFA was simply that this was the proportion of the car that was not realistically available locally. It is senseless to levy import duty when there is no actual "protection" being provided as a result of the duty.

Subsequent to the introduction of the DFA, a predecessor of the present Commission carried out an analysis of the Effective Rates of Assistance for the car and component sub-sectors of the car industry. The results were contentious, but after subsequent investigations it became apparent that 15 per cent was approximately the appropriate amount of DFA to equalise the Effective Rates for the subsectors. In essence, component makers enjoy the benefit of having a duty rate on their inputs (raw materials, at around 3% duty) which is a fraction of the duty rate on their outputs (automotive components, at 15% duty). Component producers therefore have an Effective Rate of Assistance much higher than their nominal rate of assistance. To achieve both equity and efficient resource allocation between the two sections of the automotive industry, it is appropriate for car manufacturers to receive a DFA, thus increasing their ERA to a level closer to that of component suppliers. Over time, as the component producers' duty rates on inputs and outputs converge, the value of the DFA to car producers also declines, and the necessary equilibrium continues to prevail.

Having established that a 15 per cent DFA is appropriate as an outcome, to give car and component makers equivalent assistance, it might then be argued that giving car producers access to the Tariff Concession System as well as the DFA, might upset this delicate balance of ERAs. To the extent that car makers succeeded in obtaining actual tariff relief through the TCS, their ERA would theoretically increase beyond that applicable to component producers. This argument is, however, fallacious:

- First, there is no clear reason to believe that car producers would benefit substantially from access to the TCS. If 15 per cent is an accurate measure of the proportion of a car that cannot be sourced locally, it follows that all components beyond this level of imported content would have a local supplier. This supplier would oppose the granting of a Tariff Concession Order, which would therefore not be granted.
- Second, if automotive goods were removed from the Excluded Goods Schedule as Holden proposes, then component producers themselves would have precisely the same opportunity as car producers to obtain TCOs for goods that are not locally produced. Under those conditions the effect would be to reduce the average duty rate paid by component producers on their inputs – which would further magnify their ERA. Under these conditions there is no reason to suppose that car makers' ERAs would increase by a greater amount than component makers' ERAs.

At some point not very far into the future, the exclusion of car makers from the TCS, and the further exclusion of a very wide range of automotive components from eligibility for concessional importation through their listing in the EGS, must be eliminated. This will be a necessary part of unwinding the various forms of sector-specific assistance to the automotive industry. Holden suggests that these changes be made now. Not only are the current arrangements unjustified – it is also in the interests of all parties to have the necessary policy changes and adjustments happen while there is still in existence an automotive policy environment and infrastructure which can monitor any transitional issues. If the required changes are delayed until the very end of the transition period, any unexpected adverse effects would be likely to be unmonitored and therefore potentially have a greater effect.

Structure of the Automotive Competitiveness & Investment Scheme

The Productivity Commission's Position on the Form of Auto Assistance

In its June 2002 Review of Automotive Assistance Position Paper, the Productivity Commission discusses the forms of auto assistance in Chapters 9-11.

The Commission's stance is to develop policy options that can ultimately deliver a sustainable and competitive automotive industry without detracting from overall economic performance while meeting its obligations under WTO and APEC. However, in light of the considerations provided by respondents in the position paper, the Commission considers that maintaining assistance at 2005 levels *for an indefinite period* is not a sensible option. In the opinion of the Commission, ACIS type funding beyond 2015 would be difficult to justify. Moreover, the Commission considers that there is a strong case for reduced assistance to be provided via a continuation of transitional arrangements that are transparent, predictable and simple to administer. Along with tariffs, the Commission contends that ACIS without significant changes can continue to play this transitional role after 2005.

While the timing and the quantum of the future ACIS are still under consideration and open for further comment, the Commission has identified the need for separate funding pools for Motor Vehicle Producers and Suppliers. The rationale stems from the Commission seeing no justification for imposing a greater adjustment burden on a particular sector of the industry. One of the options advanced by the Commission is that available industry funding (excluding Duty Free Allowance) be split 65:35 in favour of the Motor Vehicle Producers. Each pool would then be subject to separate modulation factors, providing an increased level of certainty to Motor Vehicle Producers not afforded under the existing scheme.

Holden's Position on the Form of Auto Assistance

As Holden's previous submission to the Productivity Commission has already articulated, the long-term goal of the industry must be to operate without sector specific assistance, but in an environment that supports the elements necessary for ongoing and sustainable growth.

Therefore, Holden largely agrees with the Commission's position that any future assistance schemes be transitional and predictable. To this end, Holden fully supports the Commission's option that the scheme should contain two separate funding pools for the Producers and Suppliers, and that excluding DFA, the funding should be divided in a 65:35 ratio, in line with analysis made prior to the commencement of ACIS. However adjustment should be made for actual changes in circumstances since that time. An example of such changes is recognition that some components previously made in-house by car makers, are now produced by specialist component producers. This would lead to a small increase in the component producers' share above the 35% level. However, as explained in our first submission, Holden considers that the scheme should undergo structural change to maximise the return to the community and to support the industry in taking the next step in its development.

The scheme must ensure that at the conclusion of the assistance, the auto industry is operating within a sustainable strategic framework and within a macro environment that supports the limited advantages it has over its global competitors. It must achieve this outcome in parallel with ensuring the best return for community investment in the industry.

In contrast to the Commission's view, Holden firmly believes that the needs of both the auto industry and the community are best represented through shifting the links of subsidies from a production emphasis towards R&D and investment initiatives. Based on such a scenario and as reported in our previous submission, independent economic modelling showed significant welfare benefits were obtained from these changes.

The Potential Benefit from Modifying the Form of Delivery

The Commission argued in its position paper that changing the basis for earning credits would create uncertainty. While there may be certain administrative issues to address, Holden sees no justification to indicate that changing the emphasis for credit generation away from production towards R&D and investment would create great uncertainty to the participants. This is because the broad outline of the new scheme would be announced at the end of 2002, three years before the current ACIS expires. It should also be noted that in preparing its previous submission to this Inquiry, Holden commissioned Access Economics to assess the possible national welfare impacts resulting from a change in the method of assistance delivery towards R&D/investment.[6] This investigation indicated that there are substantial economic benefits in the changes Holden proposes. Under these conditions, it seems particularly undesirable to adhere to the current detailed structure of ACIS - a scheme that is demonstrably amenable to improvement - when a major review of that scheme (the Commission's current inquiry) is being undertaken.

We remind the Commission that the study we sponsored found that, with no incremental scheme funding requirement, linking assistance towards innovative R&D/investment activity would deliver significant benefits to welfare:

- Costs to the consumers would be lower
- A generation of $1.2 billion GDP in today's dollars above the baseline would be delivered in 2012
- Around 6,800 employment opportunities would be created within the economy
- At a real discount rate of 5%, the project scenario modelled would deliver an improvement in economic welfare of some $4.0 billion.

The provision of welfare returns of this magnitude necessarily requires a change in the form of support post-2005. Such changes are detailed below.

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[6] See Annexe A of Holden's May 2002 Submission to the Productivity Commission

Holden's Vision for the Form and Function of Automotive Industry Support Post-2005

The form of the required post-2005 assistance must be considered and developed in the context of the problems of the existing ACIS and the new challenges the industry is facing as it prepares to aggressively develop niche products. The scheme should be built around four guiding principles:

1. *The elimination of unexpected outcomes*: The Commission's proposal for separate funds allocations for car and component producers overcomes the primary source of concern on this issue.
2. *A similar conceptual basis in the schemes for MVP and Supplier sectors:* The Commission has acknowledged this need. We note that the current ACIS has almost entirely different provisions for the two sectors, while Holden's proposed changes would create considerable similarity between the two.
3. *The cumulative scheme provides value to each participant:* Given the vast differences between the MVPs and suppliers and even the differences between the four MVPs, no one scheme could possibly be built that will completely satisfy all the stakeholders. However, Holden maintains that its proposed changes to the scheme will provide a means for each participant to receive value across the *cumulative value* of the scheme.
4. *The scheme is developed in alignment with Government intent*. The scheme should provide and deliver benefits even more consistent with Government policy intent than the present ACIS. It should also provide tangible incremental benefits to community welfare.

One of the most conspicuous and intractable strategic needs the industry faces is the requirement to increase the number of vehicles manufactured from a common platform. There are four fundamental business areas that should receive targeted assistance to facilitate this growth: Product Design, Manufacturing Technology, Marketing Innovation and Demand Generation.

Therefore for the Australian automotive industry to remain viable, the existing broad structure of the ACIS scheme should be retained but reshaped somewhat with targeted assistance that improves the four fundamental areas of business.

If no change is made in the assistance arrangements, the average annual cost of the Duty Free Allowance will decrease when the duty rate drops from 15 per cent to 10 per cent in January 2005. The Commission has pointed this out in its Information Paper. In the five year period between 2001 and 2005, the cost to revenue of the DFA is likely to be about $800 million.

Holden proposes that a similar amount - $800 million - should be devoted to Duty Free Allowance over the years 2006-2010. This will considerably exceed the cost of maintaining the DFA for Australian-made cars that are sold in Australia, because of the 2005 duty reduction. Holden proposes that the additional money be spent on applying a benefit equivalent to the DFA to vehicles exported from Australia. There are three reasons to do this:

- First, it is in line with the principle that assistance measures should be applied without regard to the destination of the product. At present we have a domestic subsidy that is not applied to export sales. Since both industry and government are very desirous of increasing exports, and the application of an export subsidy that simply mirrors a domestic subsidy is permitted by WTO rules, this change should be made.
- Second, this overcomes the problem with the current arrangement of applying only an ACIS production subsidy, to export vehicles. With ACIS being a capped scheme, the effect of the cap is to reduce the assistance to export vehicles by a much greater proportion than to domestic vehicles. Applying an identical uncapped DFA to both domestic and export vehicles removes this difficulty.
- Third, providing a production subsidy from outside ACIS, has the effect of allowing ACIS to be focused almost exclusively on investment and R&D support. Holden contends that funds must in future be made available to support “own use” R&D expenditure by car producers to meet the industry’s strategic need (see section on R&D assistance). However this must be done in a way that does not excessively affect the business viability of any car producer who has very little involvement in R&D. The extension of the DFA in the way proposed, not only supports export-oriented car producers – it also gives them better access to an uncapped source of assistance. Holden believes that there is an efficient car producer in Australia which would be unreasonably affected by a switch to an R&D-focused ACIS, if this were not done.

Because the duty rate will by 2006 have fallen to 10%, the $800 million should be approximately sufficient to permit the traditional DFA rate of 15% to be funded over the period 2006-2010, including export production.

We wish to emphasise that the DFA predates the existence of ACIS by many years, and cannot realistically be associated with ACIS in terms of policy intent. The current confusion in some quarters on this point stems from the pragmatic action in 1999 of making the DFA a part of the same legislation as ACIS, seemingly for reasons of pure administrative convenience. The DFA is a policy provision made necessary by another policy provision: the application of the same duty rate to cars and their components. To make this equality of duty rates both viable and equitable, the DFA became a logical necessity and this was demonstrated in evidence to the Commission’s predecessor’s 1990 inquiry. It follows that the removal of DFA, if it were ever to occur, would require that other means had been found to serve the same purpose. Holden understands that ACIS is a special assistance measure for the car industry, and as such, it may expire at a future time. The DFA is not a special assistance measure, it is simply a corollary of other policy provisions, and as such it cannot be allowed to expire without the policy environment having changed and so removed the need for it.

The same basic principles that separate the DFA from ACIS as a policy provision dictate that logically, the DFA cannot be “capped”, or limited in its application. The DFA is essentially a compensation mechanism, and it cannot perform this role while subject to capping, unless the other policy measures which create the need for a compensation mechanism are also capped. In other words, if the DFA were to be capped, the application of import duty to car components would need to be similarly capped, with a lower duty rate being applied to component imports in excess of the capped quantum of assistance to component producers. Such a policy environment would be a poor one, however – it is far more effective and efficient simply to recognise that the DFA must remain an uncapped policy measure.

Research and Development Policy

The key change in ACIS that Holden considers necessary is moving the Motor Vehicle Producer aspect of the scheme from having an emphasis on production assistance, to having an emphasis on assisting R&D. As we demonstrated in our previous submission, this change has several important advantages:

- It is considerably more cost-effective in terms of the economic growth that can be stimulated by a given amount of government assistance
- It is timely, in that it would facilitate a strategically crucial change in the profile of expenditures by the vehicle producers, just at the time that this change is needed
- It is equitable and efficient, in that it would make the motor vehicle producers' section of ACIS much more like the component producers' section of ACIS than is currently the case
- It complements and supports the broader policy objective of making Australia's economy more knowledge-intensive
  - Given the strong spillovers from the automotive sector to multiple other sectors of the economy, it is reasonable to suggest that a stronger automotive R&D activity would be a powerful driver of additional technology-creation across the broader economy
- Australia as a whole is in urgent need of an efficient but powerful R&D-enabling program. ACIS can provide an opportunity to pilot such a scheme in a way that has minimal risk of adverse consequences.

In view of these advantages to be gained by making ACIS R&D focused, we believe there is every reason to change the scheme, and no persuasive or powerful argument for leaving it as-is. The current version of the scheme has provided a learning opportunity. It is now appropriate to take this up and make efficient use of it, in a way that creates no additional cost to government compared with extending the duration of the current scheme.

The Commission's discussion document has proposed alternative approaches to the funding and duration of the ACIS replacement scheme. The first of these is to provide a scheme to the value of $2 billion (or $2.8 billion including Duty Free Allowance) over five years from January 2006. The second and third options provide a scheme with the same value (on a Net Present Value basis) over ten years.

Holden strongly supports having the ACIS replacement scheme operate over five years rather than ten. The reason for this is closely tied to our proposal to focus the scheme on supporting highly innovative Research and Development. Holden's strategic business direction identifies a rare opportunity to enter major new export markets in the latter part of this decade, through the provision of products of types not previously manufactured in Australia. In some cases, there does not appear to be an equivalent product concept in production anywhere in the world. To pursue these concepts would require exceptionally "high risk" R&D activity, and at present the business case for carrying out the activity is considered less than viable. However, an appropriately tailored scheme, involving no additional government financial commitment beyond replacing ACIS but directing a part of those funds into R&D, would enable the products to be developed – and would help turn around the business case.

In Holden's specific circumstances, it is clear that a strong flow of R&D support over the five years from 2006 would have substantially more effect than a slower flow over a ten year period, simply because the timing would then match the period of need for this assistance. Equally importantly, when the objective is to foster a transition (in this case, toward even greater R&D intensity), the important stage in making a change program work is to achieve sufficient momentum at the beginning, before there is a widespread commitment to change. We expect that across the industry, five years of strongly focused assistance to highly innovative R&D will have a powerful effect, which should be self-sustaining. The five-year period beginning in 2010 should then see the beginning of a succession of unique, highly innovative Australian products appearing on the world stage.

The automotive industry has access to the R&D Tax Concession scheme. This scheme is an important one, and is delivering benefits to industry. However it is not sufficient to promote and foster the transformation that the motor vehicle industry needs to make in the current decade. The tax concession scheme provides two forms of concession: a tax deduction on relevant expenditure of 125 per cent (versus the normal 100 for most other forms of legitimate business expense); and a tax deduction of 175 per cent on incremental expenditure above a three year moving average. The base concession (the 125 per cent deduction) only provides a subsidy of 25 per cent times the corporate tax rate of 30 per cent, or a net benefit of 7.5 per cent of the eligible expenditure. This rate is not an important driver of decisions to undertake the highly innovative, and highly risky, large projects of the type being discussed.

On the other hand, while the 175 per cent rate provides a more helpful 22.5 per cent, this rate only applies to the incremental expense which typically diminishes due to the 3 year moving average and the expenditure cycle of the program. Accordingly it is not of much relevance to automotive projects. The 175 per cent rate might be of major influence on project decisions in an industry with a low base level of R&D spending, interrupted by intermittent high "spikes" of expenditure.

Holden maintains that post 2005, motor vehicle producers should become eligible to receive a substantial R&D subsidy through the scheme that replaces ACIS, but this should be closely targeted at highly innovative R&D. That is, to qualify for the first assistance rate it should be directed toward a vehicle of a type not previously made in *Australia*. A vehicle not previously made in the *world*, should qualify for an improved assistance rate. These assistance measures should specifically apply to R&D carried out by motor vehicle producers "for their own use". In our view it is especially important to support R&D in cases where Australia gains from the downstream effects (car and component manufacture) as well as accruing the direct gains from the R&D activity itself.

Successful innovation is the only available route by which the local vehicle industry can win back market territory lost to imported vehicles in (for example) the growing “4x4” and “people mover” classes. The intent is for Australian manufacturers to develop highly innovative vehicles that create new segments for the Australian domestic market (with the benefits of import replacement) and highlight strong export opportunities.

Taxation and Microeconomic Reform

The Productivity Commission's Position

In its June 2002 Review of Automotive Assistance Position Paper, the Productivity Commission scoped its position on taxation and microeconomic reform in Chapter 6.

In broad terms, the position of the Productivity Commission is that taxation arrangements are less of a concern than in the past, largely because of the replacement of the wholesale sales tax (WST) system with the consumption based goods and services tax (GST). Holden agrees that this was an important and valuable reform. The Commission also concluded that microeconomic reform in the transport sector has improved the efficiency and reliability of auto supply chains. Unfortunately, continued inefficiencies in electricity supply arrangements are adversely affecting some automotive producers. The Commission decided to pass responsibility for formulating recommendations on improving electricity supply to the current review of electricity markets being undertaken by the Council of Australian Governments.

Holden's Position on Taxation Arrangements

In its position paper, the Productivity Commission considered any recommendations on payroll tax and stamp duty outside the scope of its inquiry because of the broad-based applications of these taxes across a number of activities and industries.

Holden maintains that there is potential for States to effectively review a number of transactional taxes, especially payroll tax and stamp duties. Payroll tax is a very unhelpful impost on any highly trade-exposed activity, and in our view it should be reduced or eliminated as one of the financial reforms made possible by the GST revenue stream to the states. With respect to stamp duty the case for reform is even stronger, because the burden falls largely on two types of transaction (motor vehicle sales and real estate sales). Because of its selective nature the tax is inherently inequitable, and prone to creating economic distortion. While the Commission's need to "stick to its brief" is recognised, in the particular case of stamp duty, the targeting of the automotive industry involved is somewhat egregious and in our view makes it reasonable for the Commission to address the issue.

The collection of a transactional tax in the form of stamp duty discourages consumers from turning over their vehicles periodically and hence contributes to environmental and safety issues as older vehicles remain on the roads. Apart from the flow-on community improvements in environment and safety, the industry would clearly benefit from an increasing turnover and volume of domestic sales. As the Australian market is essentially isolated and finite, with little prospects for growth, any legitimate means to increase domestic sales volumes would be very beneficial to the industry.

Holden's Position on Microeconomic Reform

The Commission's position paper limited its discussion on microeconomic reform to transport/waterfront reform and changes in electricity supply. Holden largely agrees with the findings of the Commission regarding the improvement in transport (although further improvements are still needed to bring transport performance in line with international best) and the need for further improvement in the supply of electricity.

However, Holden would like to reiterate the point it made in its submission to the Commission that microeconomic reforms in other sectors of the economy have only marginally offset the impact of the reductions in assistance to the automotive industries. The Industry Commission acknowledged as much in its 1997 inquiry into the automotive industry. At that time the Commission concluded that:

"*…it is not reasonable to expect these benefits to be large enough to offset the increased competitive pressures associated with the reduction in tariffs.*" [7]

Moreover, Holden would like to extend the breadth of the discussion to those microeconomic reforms that assist with increasing levels of innovation or "cleverness" within Australia. Australia has historically relied on the strength of its education systems (especially Universities) to undertake innovative R&D.

The predecessor to the Productivity Commission enunciated the benefits of government supporting R&D:

"*…the fundamental rationale for government intervention [to support R&D] remains the 'public good' characteristics of knowledge creation—its lack of appropriability and wide applicability—enabling spillovers to society from private investments in R&D.*" [8]

However, to make the improvements needed to act as a global niche producer of innovative products, in addition to public-funded R&D, Australia will need to build its expertise in private businesses dedicated to developing intellectual property. Sole reliance on Government funded institutions will not meet the long term needs of the Australian automotive industry. Consequently, support of this new emerging industry area should be encouraged to ensure a viable and ongoing automotive environment in Australia.

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[7] Industry Commission, *The Automotive Industry, Vol 1: Report*, Report No 58, 26 May 1997, p. 172.

[8] Industry Commission, *Research and Development, Vol. 1: The Report*, Report No. 44, Australian Government Publishing Service, Canberra, p. 9.

Overseas Assembly Provisions

The Productivity Commission's Position

In its June 2002 Position Paper, the Productivity Commission chose not to include a discussion on the creation of an Overseas Assembly Provision (OAP). The rationale for not considering an OAP in the Position Paper was based on the Commission's attempt to "concentrate on what we see as the major issues relevant to the industry's role and future."[9]

However, it is Holden's position that Australia's policy on OAPs is a poor one.[10] Holden believes that a workable and effective OAP is a significant foundation to ensuring growth and prosperity within an Australian automotive industry increasingly reliant on its place within a global trading environment. On this basis, Holden believes that the creation of an OAP should take on greater significance in the Productivity Commission's deliberations for the reasons outlined in the remainder of this document.

Holden's Position on OAPs

Australia's major trading partners have commonly used OAPs in various forms for many years. The US, EU, Japan and Canada are among those countries to adopt tariff concession policies for the re-import of locally made goods. OAPs are a distinct feature of the tariff systems of most industrialised countries. One fundamental driver behind these governments' support and adoption of such schemes stems from the need for high levels of trade in partially completed goods to develop a growth strong economy and improved export competitiveness.[11] These governments recognise that the installation of tariffs on the trade of such goods essentially also represents a tax on that part of the domestic production.[12]

Trade in partially completed goods allows economies to participate in the proliferation of multi-stage production processes, where several nations add value to the completed good according to their area of strength. In all cases, such "border-nation" production strategies retain high skill or high value-added processes at home, while leveraging the advantages other nations can supply to the value chain in areas where the home country is deficient. Such practices allow home companies to concentrate on building expertise in higher value-adding activities such as design and intellectual property development. When presented with such opportunities, firms are also encouraged to invest in value-adding capital equipment while increasing the knowledge and skill levels of employees. While experience overseas does not always readily translate into Australian conditions, in September 1997, the Productivity Commission reported:

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[9] "Review of Automotive Assistance Position Paper", p VII, Productivity Commission, June 2002

[10] Holden's Submission to the June 2002 Review of Automotive Assistance (sub. 72) page 84

[11] Eichengreen, B. & Kohl, R. "The State and the External Sector in Eastern Europe: Implications for Foreign Investment and Outward-Processing Trade", *Berkeley Roundtable on the international Economy*, Vienna, Austria, June 5-6, 1997.

[12] Lloyd (1994), 'Offshore production and the base of import taxation', *The World Economy*, pp719-735

"…it does not appear logical to levy it [import tariffs] on that part of a product which originated in Australia, as well as that part which originated abroad." [13]

While the Productivity Commission has already identified that it is not logical policy to apply tariffs to Australian re-imported content, an OAP can also be argued on grounds of equity.[14] As far back as 1984, the Industries Assistance Commission was seriously investigating the OAP concept, and reported:

"Given that the purpose of a duty is to protect Australian manufactures from import competition, it may be argued that it is unreasonable to pay a duty on Australian commodities when these are imported as parts of other goods."

This sentiment is especially pertinent as it applies to Australia's automotive industry. For many years, automotive manufacturers have become more global in their approach, building common platforms and major components that are modified to suit local market conditions. The "border-nation" manufacturing methods have been entrenched in the industry for many years, particularly in North America and Europe. Automotive producers have increasingly been sourcing global components for manufacture in low-labour cost locations such as Mexico or Eastern Europe.

Australia is now a net importer of vehicles with a significant proportion imported from our Asia-Pacific regional neighbours. The competitiveness of Australian automotive component manufacturers to participate in overseas multi-stage production processes would be increased through the creation of an OAP that allowed concessional entry for the re-import of Australian components/raw materials in the finished product. Given the desirability of the Australian market to Asia-Pacific auto producers, Australian component makers would be able to obtain a saleable advantage if an OAP for the automotive industry were to be implemented.

While attractive to Australian businesses, the installation of a properly scoped OAP would also be attractive to Australia's regional neighbours as a means of strengthening their economies and providing preferred access to Australian markets. The benefits obtained in Eastern Europe (eg: the former Czechoslovakia) from working with the EU within an OAP scheme should be achievable for similar Asian economies rich in labour resources. Such potential gains would be viewed favourably by Australia's regional neighbours when entering trade negotiations with Australia.

Moreover, in the absence of an OAP, any intermediate goods producers unable to compete on the world-market, would be limited to supplying only the domestic manufacturers' share of the Australian final goods market. With an OAP, this producer can theoretically expand their market up to the size of the total domestic final goods market.[15]

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[13] John Cosgrove – Commissioner, September 1997, 'The Textiles, Clothing and Footwear Industries', *Australian Industry Commission* Volume 1, Report 59, p221

[14] Industries Assistance Commission, 1984, "Overseas Assembly Provisions – Imports of Goods Incorporating Australian Content and Re-Imports", Background Paper

[15] Industries Assistance Commission, 1984, "Overseas Assembly Provisions – Imports of Goods Incorporating Australian Content and Re-Imports", Background Paper

By way of example, in 2001, Holden exported more than 12,000 Australian-made engines that were subsequently re-imported in finished vehicles into the domestic market. While the engine exports provided considerable revenue and a positive benefit to Australia's balance of trade, the full value of the re-imported finished vehicles (predominantly in Daewoo vehicles) attracted the import tariff. The significant duty paid on the re-imported Australian engines constitutes a large burden on export trade. The introduction of an OAP—that allowed concessional entry of Australian components within finished goods—would bolster the export opportunities for Holden's engine production. Likewise, other component manufactures can benefit from the potential of increased exports via the initiation of a well-designed and implemented OAP.

Workplace Relations and Skilling

Workplace Arrangements and Industrial Relations

The key elements of Holden's business strategy are market *insight*, *flexibility* in response to emerging trends and above all a high level of *innovation* in both product development and consumer influence. These underlying elements of business strategy translate into three equivalent fundamental aspects of future workplace relations.

- Just as *insight* is required to form a constructive relationship with our customers, Holden and its Unions must each achieve a deep understanding of the other party.
- *Flexibility* is not only the hallmark of success in developing and marketing products. It is also fundamental to inter-personal relations - especially between employer and employee.
- *Innovation* is regrettably, only rarely a feature of Australian industrial relations. However, if the car industry is to succeed in its current transition to a world-class niche player, some very innovative change will be needed.

Holden considers that the Productivity Commission has identified and broadly addressed the key issues affecting the current and longer-term viability of the industry in regard to workplace arrangements and industrial relations. The following points provide our specific comments on a number of these issues.

Relationship with Unions

Holden firmly agrees with the Commission's overview, that notes,

"A key to resolving current workplace problems is to achieve a greater coincidence of interest between firms and their employees. A range of industry and government initiatives could help in this regard."[16]

Reference is made to Holden's[17] and Toyota's[18] comments that emphasise the importance of a, "mutual interest", or, "partnership", approach to workplace relations with particular focus on the union at the enterprise level.[19] Much work needs to be done between the parties to explore the concept for the mutual benefit of all stakeholders.

One of the characteristics of much of Australian labour relations has been a process of mutual "demonisation" in which each party plays to its own constituency by making abrasive remarks in relation to the other. Whether or not this is tactically sound practice,

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[16] "Review of Automotive Assistance Position Paper", p XVIII, Productivity Commission, June 2002

[17] Holden's Submission to the June 2002 Review of Automotive Assistance (sub. 72) page 61

[18] Toyota's Submission to the June 2002 Review of Automotive Assistance (sub. 39) s.7.1.4

[19] "Review of Automotive Assistance Position Paper", p 45, Productivity Commission, June 2002

it is essential that it should not impede the development of a genuine understanding of the other party's viewpoint and its validity.

In the case of the trade unions, as democratic organisations they exist on multiple levels – plant, state and federal. The smooth integration of these three levels is often not achieved and needs to be a matter of ongoing focus. Holden accepts that at all three levels, the union movement include many skilled professionals. The weaknesses in vertical integration of the three levels would appear to be a structural issue and will ultimately require a structural solution.

Holden supports the conclusion that development of skills and knowledge of the parties at the workplace level is important and in particular the Australian Industry Group's submission, that industrial relations training programs be developed for component suppliers.[20] It is important that these initiatives are focused and tailored to the needs of both management and workplace delegates and that they comprehend the broader requirements of the industry. Such programs to reduce the, "adversarial nature of negotiations"[21], need to address the critical issue of the gap between unions' expectations and what the industry can sustain to maintain its future viability.

Union Structure

Holden's first submission noted that,

"Traditional demarcation based on the origins of craft based unionism still prevails significantly in the workplace and efforts by Holden to change this have been vigorously resisted by the unions, especially in the trades group. Although this is not unique to the automotive industry in Australia, (and in some instances globally), there is a significant opportunity to improve productivity and efficiency in the workplace by diminishing these traditional barriers."[22]

In our view the existence of demarcations between trades, and between trades and non-trades, are issues of an internal and technical nature for the union movement. It is most regrettable that they spill out of that milieu and become contentious issues not only in employee bargaining but also in day to day industrial relations.

The structure of unions should be evaluated from the viewpoint of whether they foster or impede workplace flexibility. It is inevitable that there will be tensions and differences of opinion between employer and employee in some respects, but if either party is arbitrarily divided into sub-groups for historical reasons, this merely imposes an unnecessary burden on all concerned.

The solution to the issue of union structure must ultimately be a matter for unions and their members. Holden merely notes that the time is ripe for an open and innovative approach.

[20] Australian Industry Group's Submission to the June 2002 Review of Automotive Assistance (sub. 43) page 12

[21] Australian Industry Group's Submission to the June 2002 Review of Automotive Assistance (sub. 43) page 46

[22] Holden's Submission to the June 2002 Review of Automotive Assistance (sub. 72) page 61

Changes to the Regulatory Framework

Industrial relations' issues and the vulnerability of Holden to supply chain disruption from industrial action are of growing concern. The TRISTAR dispute in the second half of 2001 resulted in $220 million of lost sales for Holden alone. This year Holden has already suffered an additional $100 million in lost sales as a result of the dispute at Walker Australia with disaster narrowly avoided at BHP (on 2 separate occasions), Socobelle, Suspension Components and most recently at Pilkingtons.

The industrial environment in Australia is creating a negative perception within the parent companies of many local producers related to security of investment and supply and is a significant factor in investment decisions. If not managed, it will place Holden and other local companies at risk of losing potential export opportunities.

The ongoing disruption to our business can not be tolerated in the longer term and as an industry we must make progress towards a more stable industrial relations environment.

The range of legislative initiatives proposed by the Australian Industry Group are supported for further examination and debate with an emphasis on ensuring that there is accountability by the parties involved and processes that enable prompt means of ensuring compliance. Avoiding disruptive industrial action in the industry should be the key objective in this regard. "Giving the AIRC the discretion to determine whether or not a cooling-off period should be established to assist the resolution of a particular dispute"[23], would be particularly useful in consideration of the recent disputes that have threatened the industry.

The achievement of an industrial relationship that provides the potentially contending parties with both a reasonable balance of power, and a bias toward constructive negotiation, must be the yardstick against which the national industrial relations framework is measured. Within such a framework the role of government should be minimal. Despite many experiments, it is arguable that this ideal is not closely approached in Australia. Tactical disputation involving third parties, and disputation relating more to intra and inter union issues than genuine employer – employee rivalries have been and remain endemic. In our view a substantial part of the problem is structural and may only be cured by changes in the industrial framework.

Intolerance for Illegal Action

The conflicting interests of the parties make industrial disputation at some times and in some circumstances, nearly inevitable. However, it is clearly in the economic interests of the parties that the sum of the economic value created by the business enterprise is maximised. The purpose of restrictions on the rights of the parties to exercise power against each other must be to minimise economic losses.

[23] Review of Automotive Assistance Position Paper", p 47, Productivity Commission, June 2002

It is obviously of fundamental importance that the rights of the parties in the sensitive area of Enterprise Bargaining are not merely rational and coherent, but are well supported by public opinion. However, a lack of clarity on the latter point can lead to both brinkmanship and experimentation.

While it is possible to make excuses for illegal actions on grounds of uncertainty about risks and rewards, it is also reasonable to assert that valid laws made in a functioning democracy should be obeyed in the public interest. The use of widely accepted techniques to protest against certain laws is acknowledged and would certainly not be opposed by Holden. However, the flouting of laws, and the unnecessary disruption of economic value creation, is in our view to be condemned.

Flexibility

The thrust of Holden's business strategy is to recognise that our opportunity for growth and the achievement of world competitiveness is dependent on becoming a viable niche producer. This has profound implications for the nature of our business. In current international conditions there is probably no longer such a concept as a "static niche". Niches now appear and disappear on a continual basis. This implies that Holden can only thrive as a global player through acceptance of the need for constant change – change in products, in processes and even in business paradigms.

If the essence of Holden's business is the acceptance of supreme flexibility, this must also become a hallmark of our business processes, including workplace arrangements. An industrial environment established in a time of highly stable business circumstances is no longer a viable setting for our future activities. We emphasise that this is not an issue of the allocation of economic benefits between employer and employee – it is a fundamental driver of our ability to aggressively create and pursue market opportunities.

The industrial environment which is absolutely required by Holden's business model, is one in which employer and employee strive jointly to maximise value creation. They may then experience some lack of consensus regarding dividing of the economic surplus that has been created – but they will not lack agreement that the first priority must be the maximisation of the quantum of economic benefit available for division.

Skilling and Training Issues

Holden has enjoyed a co-operative relationship with the unions in terms of development of industry specific qualifications and training packages. However as the automotive industry in Australia faces the challenges of the global market place, as already mentioned, Holden is concerned about the need for greater flexibility in our workforce to meet our increasing productivity goals.

One of the significant developments over the last decade has been the increasing use of technology, which has driven a change in the required skill sets of employees. The ability to use a computer in the course of one's employment has become a standard skill whereas previously this was considered to be a "higher skill" demanding a premium in the marketplace. The skills within our industry have changed greatly in recent years and the concept of a production worker being considered as "unskilled" labour is no longer the case. However, to continue the development and evolution of the skills required to support a sustainable, globally competitive industry, demarcation of the trade areas must be eliminated.

The “craft “skills associated with the trades have in some cases evolved but in some cases have also disappeared. Realistic appraisals of future trade positions, which identify the need for multi-skilling needs to occur. To do this, old demarcations need to be removed and a more flexible model adopted.

Holden is also concerned by the lack of skilled workers that are being attracted to production type work. Traditional workforce sources such as new migrants have disappeared. With positions in the industry increasingly requiring higher-skilled workers, school leavers can be reluctant to either seek employment in the first instance or to remain in such a vocation, resulting in a labour shortage that needs to be recognised and addressed.

Skill shortages can be offset by employment of older workers but there are no incentives provided by governments to do so. Under current arrangements there are no subsidies provided to train new employees who may have completed a qualification earlier in their careers. Holden believes that this discrepancy should be addressed and indeed provides opportunities for older workers, who may have been unemployed for a period of time, to successfully re-enter the workforce.

The lack of focus by the education sector on the skill-sets required for a 'knowledgeable Australia" must be addressed. Key skills such as creative thinking, problem solving and mathematics are not being well developed in school leavers. It can be argued that the drive to expand schools’ curriculum to encompass all aspects of learning has come at the cost of time devoted to development of core skills. In addition, of growing concern is the demise of the TAFE system in Australia, which as noted by the Commission, is failing to keep pace with the increasing demands of the industry. This creates an opportunity for the education sector, government and industry to come together to address the gaps in required skills.

In Holden’s first submission, we also raised the following concerns regarding tertiary education:

“Although advances have been made in recent years, there are still further opportunities for improvement, particularly in the area of engineering. To provide the skills needed to succeed in a rapidly changing environment, engineering education in Australia urgently needs creative and innovative approaches to ensure that students gain knowledge of the opportunities presented by new and emerging technologies. Australia needs more than classically trained competent engineers. In order to prosper as an industrial nation, we need creative engineers able to implement innovative, high technology solutions that allow us to compete successfully in the global market.”[24]

[24] Holden’s Submission to the June 2002 Review of Automotive Assistance (sub. 72) page 33

Holden continues to invest in the ongoing development of our employees as a necessary infrastructure cost to ensure that our future goals can be attained. But the responsibility for preparing students, either at a secondary or tertiary level, to enter a manufacturing sector undergoing rapid change and facing increasing international competition, must be taken by both industry and government. The quality of our local labour pool is a key factor in attracting ongoing investment not only in the automotive industry but also in manufacturing as a whole. Holden would support the Commission’s recommendation that an external review be conducted to ensure that training arrangements and packages continue to meet the needs of the industry.

Safety and Environmental Issues

The Commission has provided a balanced analysis of the issues confronting vehicle manufacturers in implementing the technological changes required to achieve the increasing standards for safety and improved environmental performance. Holden supports the statements of the Commission that encourage the setting of standards and regulations that help to facilitate the industry's participation in the global market along with the need to consider the adjustment timeframes required to meet broader environmental targets.

Vehicle and Related Standards

Holden supports the current activity to align the Australian Design Rules with the United Nations Economic Commission for Europe (UNECE). We believe that through harmonisation of standards, opportunities are created for the Australian industry to increase its global competitiveness and to provide the benefits of advanced technologies to the Australian consumer.

The Commission notes that,

"the delayed introduction of more stringent emission standards in Australia will not, of itself, prevent local automotive producers from upgrading their engine technologies to meet emission requirements in global markets"[25].

Although this is true, the significant investment cost and risks associated with the development and implementation of advanced technologies to meet the more stringent requirements in overseas markets are not insignificant. As noted in our submission to the Commission,

"Vehicle regulations that require high investment to achieve compliance are areas where Australia currently lags behind world's best practice……..These areas represent a challenge for Australian designed vehicles. To develop vehicles to comply with regulations that apply in overseas markets but do not apply in Australia requires significant investment."[26]

The associated investment cannot necessarily be recovered in domestic Australian sales, as we noted in our first submission, because the increased piece cost in the vehicles and the additional amortisation of the development costs would impact on the ability to price competitively in the domestic market. The Commission has noted that:

"However, demand by consumers for safer and cleaner vehicles and for improved environmental outcomes more generally, will also be a fundamental driver of change."[27]

[25] Review of Automotive Assistance Position Paper", p 67, Productivity Commission, June 2002

[26] Holden's Submission to the June 2002 Review of Automotive Assistance (sub. 72) page 45

[27] Review of Automotive Assistance Position Paper", p 65, Productivity Commission, June 2002

We support the concept that to the extent possible, consumer preference and market mechanisms should be the basis for setting minimum vehicle specifications. In cases where difficulties arise in, for example, properly pricing externalities[28] in the market price equation, public policy intervention may become necessary.

In the present Australian situation, the lack of widespread low-cost availability of higher quality fuels, particularly high octane fuels and those with lower sulphur contents, can hinder the development and introduction of new engine technologies. Whilst it is true that engines can be de-tuned to operate on Australian fuels, this is often accompanied by increased fuel consumption and green house gas emissions.

Holden is supportive of activities underway to improve fuel standards to assist the industry in meeting the Euro 2 and Euro 3 requirements and we concur with the Commission's view that the adjustment capacity of both the automotive industry and the oil industry is an important consideration in this process.

Fuel Consumption Targets

Holden supports the Commissions' comments that consultation with industry is important in any process designed to set future fuel consumption standards.

In the Commission's Position Paper it is noted that,

"…… current government policy is to pursue a 15 per cent improvement in fuel efficiency over business as usual by 2010, to be achieved through negotiation with automotive companies. This translates to a target of 6.3 litres per 100 kilometres."[29]

Holden would challenge the assertion that this is an appropriate target, and indeed that a 15 per cent improvement over business as usual translates to a target of 6.3 litres per 100 kilometres. Holden believes that 6.3 litres per 100 kilometres is not commercially achievable by 2010. The investment and per-unit costs are unlikely to be recovered in the vehicle price until (or unless) consumer attitudes and preferences regarding fuel economy result in an increased demand for these features.

As noted by the Commission, the industry has proposed two Co-operative targets of 6.8 litres per 100 kilometres by 2010 and 6.3 litres per 100 kilometres by 2015. In our previous submission we provided extensive commentary on this issue and commented that achieving 6.8 litres per 100 kilometres by 2010 was still far more difficult than the previously identified "Achievable Target" of 7.4 litres per 100 kilometres. A number of characteristics in Australia such as fuel quality, lower octane fuels and relatively low fuel prices in world terms create barriers to introducing technologies to reduce fuel consumption. In addition, the absence of significant numbers of vehicles utilising advanced diesel engines is another factor that will impact Australia's ability to achieve the aggressive fuel economy targets. In contrast, Europe which is three to six years ahead of Australia in reducing fuel consumption, benefits from better fuel quality, higher

[28] such as air quality and energy conservation

[29] Review of Automotive Assistance Position Paper", p 70, Productivity Commission, June 2002

octane fuels, significantly higher pricing of fuel when compared with Australia and a high number of vehicles with advanced diesel engines.

Holden supports the observations made by the Commission that,

"Revisions to current fuel consumption targets should only occur after consultation with the industry to determine what improvements in the fuel efficiency of local vehicles can be achieved without compromising commercial viability."[30]

In order to meet the challenge ahead, joint action is required by the industry and Government. This action must involve development and introduction of the appropriate technologies on the industry's part supported by Government efforts to create an environment that facilitates the introduction of the required technologies. This facilitation might be through assistance for R&D, changes to fuel standards, and potentially, changes to fuel pricing, for example. Essentially, it is necessary either to move the demand curve up or the cost curve down, so that improved fuel economy becomes a sufficiently attractive product feature to make customers want to pay for it.

[30] Review of Automotive Assistance Position Paper", p 71, Productivity Commission, June 2002