MITSUBISHI MOTORS

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Spirited Cars for Spirited People

SUPPLEMENTARY SUBMISSION

TO THE

PRODUCTIVITY COMMISSION INQUIRY

INTO POST-2005 ASSISTANCE ARRANGEMENTS FOR THE AUTOMOTIVE MANUFACTURING SECTOR

AUGUST 2002

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1. INTRODUCTION

MMAL welcomes the Commission's Position Paper as a thoughtful and constructive analysis of those policy issues that will form the key influences on whether the Australian automotive industry completes a successful transition over the next decade to global integration and competitiveness. On the question of future assistance arrangements we are particularly encouraged by the Commission's recognition that *'…reducing remaining assistance too quickly after 2005 could put at risk production that might become internationally competitive in the longer term under a more gradual transition process.'*

2. GENERAL RESPONSE

MMAL supports the Commission's proposals to:

- establish a ten year assistance policy path;
- establish separate ACIS funding pools for vehicle producers and their suppliers;
- exclude broader goals – such as environmental or industrial relations outcomes – as criteria for the receipt of ACIS benefits;
- continue present eligibility criteria for participation in the scheme.
- maintain the specific tariff on second hand vehicles;
- maintain present tariff levels on 4WDs and LCVs; and
- leave present government fleet purchasing policy undisturbed;

In relation to the following issues MMAL acknowledges the cogency of some elements of the Commission's observations but does not support its proposals without qualification:

- the objective of ultimately aligning assistance to the automotive industry with that applying to other manufacturing industries;
- the timing of any reductions to the 10% tariff;
- the funding of ACIS after 2005;
- limiting design changes to ACIS

MMAL opposes the following proposals of the Commission:

- the capping of all ACIS benefits; and
- a 65:35 split of <u>total</u> ACIS benefits between vehicle producers and suppliers respectively;

MMAL draws attention to the following issues not addressed in the Commission's report:

- the differential impact on budget outcomes of ACIS support for vehicle production for the domestic market compared to support for other qualifying ACIS activities; and
- the significance of the exclusion of vehicle producers from the Tariff Concession Scheme.

3. MMAL'S ASSISTANCE PROPOSALS

On the central issues of Post 2005 assistance arrangements MMAL proposes:

Tariffs

- The currently legislated 10% should be maintained until assistance policy environments in relevant automotive producing nations are more closely aligned with that prevailing in Australia;
- However, if unilateral action is taken to reduce the tariff, any such reduction to 5% should not commence before 2011 and it should be implemented in graduated steps;
- Existing tariff arrangements for, and definitions of, 4WD vehicles should be maintained

ACIS

- The scheme should be maintained until 2015;
- ACIS benefits for production for the Australian market should not be capped;
- Production benefits should continue at 2005 rates until 2010 and then reduce in equal steps to half that rate in 2015;
- Investment benefits for MVPs should be maintained at existing rates until 2010 and be reduced to 50% of that level for the five years to 2015;
- Separate funding pools for MVPs and other participants should be established

- Funding of the MVP capped pool for the period 2005 – 2010 should be the NPV of $1.3 billion less an adjustment to allow for the reduction in capped production benefits linked to the tariff and should be not less than 65% of the total funding of capped benefits.
- Funding of the capped pool for the period 2011 – 2015 should be 50% of that set for the preceding period.

4. POST 2005 ASSISTANCE

PMV Tariffs

While MMAL accepts the proposition that assistance to the automotive industry cannot be maintained indefinitely at higher levels than that applying to manufacturing industry generally, it does not accept that a timetable to achieve that objective should be set without regard to the levels of assistance available in overseas automotive manufacturing locations.

The terms of reference for this Inquiry set out the Government's desire:

- *for an internationally competitive and globally integrated automotive manufacturing sector; and*
- *to improve the overall economic performance of the Australian economy.*

The Commission's analysis, and the various quantitative evaluations undertaken for the Commission and other participants, do not indicate any discernible negative impact on the economy while the automotive tariff remains at 10%. Achievement of the Government's first objective, however, is dependent on Australia continuing to attract investment from major global companies, each with a range of manufacturing locations from which to choose. Clearly, automotive investment will not continue to flow to Australia unless the policy environment is judged to be sufficiently competitive.

Trade negotiations over the next few years in the WTO and APEC, as well as bilateral initiatives being pursued by Australia, will produce a clearer picture of the state of the 'playing field'. In the lead up to those events, any unilateral announcement by

Australia of a further reduction in automotive tariffs would be a gratuitous exercise in self-abuse.
Consequently MMAL maintains its view that the 10% tariff on PMV imports should continue until assistance levels in other relevant automotive markets reach broadly comparable levels. We believe that the assessment process on this issue will be relatively straightforward and well within the capability of an internal government review. If, however, transparency were seen as a major concern, Mitsubishi would have no objection to an external review by the Commission at the appropriate time.

On the other hand, if the current proposal by the Commission to proceed unilaterally with further assistance reductions is adopted, MMAL believes that the stepped reduction program set out in Option 3 from 10% in 2010 to 5% in 2015 is less inconsistent with the Government's objective of sustaining a viable industry than the alternative options.

4WD Tariffs

MMAL strongly believes that existing tariff arrangements for, and tariff definitions of, 4WD vehicles should be maintained. Those arrangements have been settled for some years and all vehicle producers have been aware that any proposal for production in Australia of 4WD vehicles had to be assessed in the context of those arrangements and supporting criteria. Any changes to those arrangements to accommodate changes in individual perceptions of self interest would undermine the industry's confidence in the commitment of successive Australian governments to the provision of predictability and certainty in automotive industry policy.

ACIS Arrangements

(To facilitate exposition the following terms will be used in relation to the three categories of ACIS support for vehicle production:

- *'DFA' – 15% of a MVP's value of production for Australia & New Zealand.*
- *'DFAplus' - 10% of a MVP's value of production for Australia & New Zealand.*
- *'DFAex' – 25% of a MVP's value of production for export markets).*

MMAL welcomes the Commission's recognition of the critical role of ACIS in the transitional arrangements for the industry and the need to continue the scheme after

2005. We also strongly support the Commission's recommendation that separate funding pools be established for MVPs and other ACIS participants.
However, while acknowledging that the Commission's proposals for the quantum of, and delivery timetable for, funding provide a useful basis for analysis and further discussion, MMAL submits that the calculation of the level of funding requires modification and that the Commission's proposals on capping and relative levels of funding for separate pools are seriously flawed.

Capping of Benefits

When advising the industry by letter dated 22 April 1998 of details of his Government's decision on ACIS arrangements, the Prime Minister explained that a $2 billion global cap on the new entitlements arising under ACIS would be introduced *'in the interests of prudent fiscal management'.* This rationale for capping part of ACIS accords with the Commission's observations relating to the *'open-ended funding commitment'* (p.xxii) and the *'uncertainty for the government and the community'* (p.125) that would allegedly flow from an uncapped scheme.

It is one thing, however, to conclude at a general level that the perceived public interest outweighs the chronic uncertainty and distortion flowing from the modulation of ACIS benefits. It is quite another to impose that conclusion on those elements of ACIS that do not give rise to issues of fiscal responsibility.

The funding of the *DFA* and *DFAplus*, excluding the minimal component attributable to production for New Zealand, is not open-ended. So long as the average level of imported content required by the vehicle producers reaches or exceeds 25% there is no negative impact on budget outcomes. Content figures published by the Industry Department until 2000 and recent estimates by vehicle producers indicate that the industry average imported content figure has exceeded 25% over the past decade. (The published figures require adjustment as they are based on a 16QMA currency adjustment factor provided under the previous Car Plan.)

In these circumstances each ACIS credit earned on production for the domestic market is matched by a collateral duty liability on imported components. The net effect on the federal budget is zero, <u>irrespective of the level of domestic production activity</u>. No public uncertainty flows from either continuing the current uncapped status of the *DFA* or extending that status to the *DFAplus*.

By contrast, the uncertainty and distortion that would be created by adoption of the Commission's proposal to cap all credits for domestic production is illustrated in Table 1, which is based on the data set out in p.93 of the Commission's Position Paper, together with recent estimates by vehicle producers of imported content and production for New Zealand.

<u>Table 1</u>

PC Position Paper – p.93
ACIS Benefits: 2001-2005
A$ billion

	MVPs			ACPs		Other		Totals	
Production Credits	Unmod	Mod	Duty	Unmod	Mod	Unmod	Mod	Unmod	Mod
Uncapped (1).	0.800	0.800	0.838					0.800	0.800
Capped									
Domestic (1).	0.532	0.402	0.558					0.532	0.402
Export (2).	0.457	0.345						0.457	0.345
Subtotal	1.789	1.547	1.396					1.789	1.547
Investment Credits									
P&E				0.488	0.369	0.017	0.013	0.505	0.382
R&D				0.766	0.579	0.050	0.038	0.816	0.617
Subtotal	0.371	0.280		1.255	0.948	0.066	0.050	1.692	1.278
Total Credits	2.159	1.827		1.255	0.948	0.066	0.050	3.480	2.825
Total Duty			1.396						

Note: (1) Excludes Production for NZ
(2) Includes Production for NZ

The table demonstrates that in the current five-year period, modulation will deprive vehicle producers of self-funded ACIS benefits of $130 million as a result of capping the *DFAplus* element of the scheme. Modulation of the DFA element during the same period would have resulted in a further reduction in benefits of almost $200 million. In addition to providing windfall gains to Government revenue, these reductions in benefits also materially and unpredictably increase the effective rate of assistance to component producers. Legislated component tariffs no longer provide a secure basis for a vehicle producer's long term component sourcing decisions.
On this ground alone MMAL submits that there is no justification for applying any global cap to either the *DFA* or *DFAplus* (excluding production for New Zealand) in future ACIS arrangements.

This position is reinforced by consideration of the origins of the *DFA*. The original introduction by the Government of an automatic by law for 15% of a vehicle producer's value of production arose out of the recognition that a proportion of original equipment components were not available from local component producers; and that reliance on the operation of the tariff concession system would create significant uncertainty and additional costs. The key condition of this initiative was that automotive components were excluded from the tariff concession system.

(The fact that this arrangement reduced the disparity in effective assistance rates between vehicle and component producers was an outcome of the policy but it was not, as has been suggested to the Commission, the rationale for its introduction. If reduction in effective rates of assistance on component production had been the primary objective it could have been achieved simply, and in the same manner as virtually all other automotive producing countries, by reducing or eliminating the tariff on components. Such an approach would have had the additional benefit of avoiding the current application of the specific subsidy provisions of the SCM Agreement to the *DFA* and *DFAplus* and removed any existing vulnerability of the *DFAex* to characterisation as an export subsidy.)

In the intervening years all reviews of the industry by the Commission and the Government have endorsed the compensatory arrangement embodied in the automatic by law.

What has changed in that period, however, is that cars have become increasingly complex from a technology standpoint and the proportion of components that cannot be sourced locally has steadily increased. Based on its own estimates, MMAL believes that if the industry had access to the tariff concession system it would cover components to a value of over 20% of the value of production of vehicle producers.

As the tariff concession system is uncapped and accessible to most other industries this represents a further ground for not capping the *DFA* and *DFAplus* in future ACIS arrangements.

ACIS Funding Principles

Sectoral Funding

MMAL strongly supports the Commission's proposal for separate funding pools. We are equally strongly opposed, however, to the Commission's proposal to establish separate levels of funding by reference to projected modulated sectoral shares of ACIS benefits over the current five-year period.

The Commission observes that there is no 'scientific' basis for the distribution of funding under the current arrangements. Whether that basis was or was not scientific is academic. What is unquestionable is that there was a rationale to the arrangements proposed by government and agreed to by the industry. The proposal was that, while a particular level of ACIS benefits to individual participants could not be guaranteed, the scheme would deliver overall benefits comparable to those projected for the hypothetical continuation of the EFS in the period 2001 to 2005. This principle was expressed by the then Secretary of the Industry Department, Mr Russell Higgins, in a letter of 2 September 1998 to the then Managing Director of MMAL, Mr Mike Quinn as follows:

> *'It is essential that we maintain the incentive for ACIS at the rates which were derived from data contributed by the industry to deliver the best available equivalence with benefits which would have been earned under the Export Facilitation Scheme had it continued.'*

Government estimates, based on that industry input, indicated that the capped portion of the scheme would cost around $1.5 billion and *that in the interests of prudent fiscal management* a $2 billion cap would be imposed. Based again on that input the government further estimated that the two sub-schemes to be developed would be funded with $1.3 billion to the vehicle producers and $0.7 billion to other sectors of the industry – the original 65:35 ratio.

Those caps then formed the basis for calculating the rates at which benefits could be earned on the various qualifying activities to be established under ACIS.

The underlying assumptions behind these decisions have now of course been overwhelmed by the blow out in eligible activities undertaken and projected by the component sector, resulting in an increasing discrepancy in relative rates of assistance between the two sectors.

While MMAL takes the view that it is the job of the various sectors of the industry to make their own case for future ACIS funding, we also submit that if cross sectoral equity is to be restored not less than 65% of future total capped benefits should be reserved for vehicle producers.

MVP Funding Principles

The Commission's basic theme for Post 2005 assistance arrangements is that the tariff should reduce to 10%, either immediately or in stages, from 2010. While that principle has been questioned by MMAL and most other participants in terms of the undesirability of mandating a specific date for the reduction, it does provide a basis for formulating ACIS funding and delivery options for vehicle producers for the full decade that the Commission has identified as desirable for establishing the future assistance regime.

The Commission's funding options, however, do not advance any principle in justification of the proposition that having determined a quantum of funding by reference to the current five year period, that amount should be exhausted in either the first five year period or stretched at a 50% rate over the decade of assistance arrangements. MMAL submits that the principles governing both the funding and time frame for delivery of ACIS benefits cannot reasonably be separated from the tariff elements of the future assistance regime.

Firstly, in a transitional environment in which, in MMAL's view, the ACIS arrangements are at least as important as the tariff, it is incongruous to propose an option under which those arrangements would cease five years before a decade long policy plan is concluded. Secondly, whatever tariff option is implemented, a continuation of the tariff linked *DFA* and *DFAplus* is necessary to avoid further increases in assistance to the component sector and to compensate MVPs for continuing exclusion from generally available tariff concession arrangements. Both the *DFA* and *DFAplus* are self-adjusting in terms of funding as the tariff reduces.

It is those allowances that, in turn, are linked to the WTO compatible tariff linked *DFAex*. In the absence of commensurate export production benefits, as the Commission has pointed out on a number of occasions, there would be a serious discord between relative levels of assistance for the import competing and export sectors of the industry. While the benefits from *DFAex* are not self-funded, due to the operation of the TRADEX and Drawback schemes, the segment is self-adjusting in terms of funding as the tariff declines.

In the context of a ten-year program for the industry involving proposals to reduce or commence to reduce the tariff at the half way point, the Commission has not advanced any reasons for effectively halving production support by either eliminating it after 2010 or spreading a five year budget over ten years. Similarly, the Commission does not justify its proposal to halve funding for investment benefits.

In our view, optimal congruity between tariff option 3 (which MMAL believes is the most likely to realise the Government's objectives for the industry) is best achieved by a fourth option for ACIS funding and delivery for vehicle producers. That option involves calculating funding for MVP capped benefits on the basis of:

- maintaining production benefits linked to the 10% tariff rate until 2010 and then reducing benefits to 50% of that level in equal stages over five years;
- maintaining investment benefits for MVPs at the 2005 level until 2010 and then reducing to 50% of that level for the remaining five years.

If staged tariff reductions from 2010 are legislated in advance then the normal tariff linked formula for production credits can continue to operate. If on the other hand the tariff remains at 10% after 2010 the formula can be converted to a direct value of production percentage series declining from 2.25% in 2011 to 1.25% in 2015.

Calculation of the MVP Cap

Implementation of those funding principles would be relatively straightforward. For example, MMAL proposes that funding of the MVP capped pool for the period 2006 –2010 would be the NPV $1.3 billion less an adjustment to allow for the reduction in the value of capped production credits that commences in January 2005. Funding for the subsequent five year period would be 50% of that calculated amount.

Design Issues

MMAL agrees that introducing design changes to ACIS may create a degree of uncertainty for participants. Nevertheless, some of the unintended consequences arising under the present arrangements demand attention, particularly if separate funding pools are not introduced, or are not introduced on an equitable basis.

There is a strong probability that after 2005 the requirement for modulation at current or even increased levels will continue. In these circumstances it may be preferable to review rates of return on ACIS investment activities rather than rely entirely on the modulation process to ensure that caps are not breached. For individual participants modulation seriously inhibits the medium and long term planning process. Depending on the calculus of funding caps and projected industry activity after 2005, the relative certainty of investment benefits leveraged at a lower rate may be more attractive than the ephemeral promise of more highly leveraged benefits in a modulated environment.

Any such review might usefully begin with anomalies (especially those with the potential to encourage artificial arrangements) such as differential rates of return applying to the same eligible activity undertaken by different classes of participants and the artificial exclusion of some participants from otherwise eligible activities, such as ‘own use’ R&D carried out by or on behalf of vehicle producers.

There are other design issues arising out of the twelve quarter moving average applied to the calculation of investment benefits that will have to be addressed to avoid discontinuity between 2005 and 2006.

5. WORKPLACE RELATIONS

The Commission's Workplace Relations Proposals

In relation to the Commission' preliminary findings on workplace arrangements and industrial relations issues as set out at pages 49 & 50 of the position paper, MMAL makes the following observations:

Improving Workplace Outcomes: Co-operation, Communication & Understanding

MMAL supports the views expressed by the Commission. The global and domestic competitive environment needs to be understood by all stakeholders to facilitate the competitive and economic outcomes that are essential if their particular enterprise is to improve its competitive position. MMAL's experience is that constant effort, training and development, and the provision of information to employees and Unions about company performance, competitive position, domestic and international benchmarks, are imperative to engage those stakeholders in the process of continuous improvement. Each enterprise needs to tailor that communication/consultation process to its own environment; it takes skill, commitment and persistence, however, to effectively engage the key stakeholders. Clearly, this is a process of ongoing evolution and continuous improvement that requires attention to managing and working with your human resources rather than just having an eye on daily performance and target achievement. It is an area, particularly in some of the smaller component suppliers, where substantial improvement is required.

Changes in Union Coverage

Changes to the nature of union coverage is a difficult subject, particularly within the current framework of the Workplace Relations Act. While MMAL does enjoy effective and professional relations with the Unions, particularly at the local level, there would be advantages in a single industry union structure operating across the automotive sector, complemented by "Enterprise" based structures operating within each specific site. A single union structure would be much better placed to focus on the competitive pressures operating globally within the industry and identify, within each enterprise, the initiatives that need to be implemented to remain competitive and develop within a global perspective.

Regulatory Changes

The impact of the current level of disputation on production operations and customer delivery cannot be sustained. MMAL endorses the Commission's call for appropriate regulatory changes to constrain the scope for protective industrial action and, in particular, to strengthen the requirements to observe dispute resolution procedures within current agreements. On the latter issue the current Workplace Relations Act and other legislative measures are of little assistance in effecting an expeditious return to normal operations which is a matter of concern.

External Pressure for Workplace Outcomes

MMAL does not believe that there is any longer a strong nexus between assistance to the industry and the realisation of better workplace outcomes. The pressure for workplace improvements, efficiency and flexibility are driven primarily by the internal benchmarking and competitive requirements applying within each global group. This pressure extends to our supplier base that must also achieve higher levels of efficiency and performance to remain competitive in a global sourcing framework. The pressures that operate globally within the automotive industry are enough to ensure that every business needs to do whatever it can to remain competitive and attract investment and further market opportunities. In MMAL's case, this is clearly demonstrated through the recent new model approval process wherein we competed internally – particularly with our North American Plant – for the new model investment. In this process we were able to demonstrate, inter alia, that our workplace arrangements provided the necessary flexibility to support the required business case. It is this external pressure that continues to focus and drive our improvement.

Workers' Entitlements

MMAL supports the Commission's conclusions. The protection of workers entitlements is a difficult issue to argue at the enterprise level. MMAL's believes that the subject does require sensible and open discussion at either the industry or national level, taking account of the impact of employer liquidation on employee entitlements. It is also our view that consideration of the issue should not be coupled with campaigns to gain improvement to existing benefits.

The Commission's Proposals on Skills and Training

MMAL makes the following observations on the Commission' preliminary findings on issues set out at page 53 of the position paper:

Available Skills

We acknowledge the Commission's finding that there is no current skills crisis in the Australian automotive industry but MMAL does foresee shortages in some areas, particularly specialist professional roles such as product and production engineering, electronics and, in some cases, tooling design and manufacture.

Training

MMAL agrees that the effectiveness and timeliness of responses by the training system is an important issue. However, equally important in our view, are such issues as:

- formal industry links with learning institutions;
- positive promotion of the opportunities in, and the needs of, the industry;
- strategic planning by the educational system to deliver the skill requirements to meet those needs.

External Review of Training

MMAL supports the Commission's proposal to review the training advisory arrangements. There is no doubt that improved consultation between industry, Government bodies and various educational institutions could enhance the industry's capability as a source of significant skills development both locally and internationally.