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Executive Summary

The National Farmers' Federation (NFF) views the Productivity Commission's current review of post 2005 assistance arrangements in the automotive industry as an opportunity to highlight the high levels of protection afforded the Passenger Motor Vehicle (PMV) industry and the negative impact of these levels of protection on consumers, the farm sector and other sectors in the economy.

Since the early 1970s the Australian economy has witnessed, in general, reductions in industry assistance, especially in the level of tariffs. The general tariff is now under 5 per cent following significant across the board tariff cuts in 1988 and 1991. These reductions have benefited the Australian economy and Australian consumers as a whole. Some sectors of the economy, however, still have significant levels of tariff protection in place.

NFF supports the unilateral reduction of all tariffs. Tariffs have an inherently negative impact on farmers due to the higher prices they must pay for inputs and the upward pressure tariffs put on the exchange rate (Australian farmers export around 70 per cent of their production).

Essentially, tariffs are a tax on Australian consumers and exporters. They distort resource allocation and make our export sector less competitive. Further, tariffs in the PMV sector lead to higher car prices, meaning Australia's car fleet is older than would otherwise be the case. This has negative consequences on road safety and the environment (through higher gas emissions).

Tariffs have been imposed historically in Australia to increase employment and enable higher wages to be paid in the manufacturing sector than would otherwise be the case. In terms of national benefits, however, they have been constraining.

Regional development arguments for maintaining support focus on employment. While there may be negative effects on employment in a particular region if assistance levels are reduced, there is also a negative impact on employment in other sectors of the economy if protection is maintained. Moreover, it can be argued that any negative effects on employment, as a result of tariff reductions for example, are short-term ramifications which can be smoothed by appropriate, fair and targeted adjustment policies.

NFF understands that tariff cuts may cause adjustment costs which impact directly on some Australians and their families. Reform policy must, therefore, manage this impact in a responsible manner, through the use of targeted and fair adjustment programs.

Some advocates of tariff protection argue that moves towards freer markets and globalisation are destroying political sovereignty. These advocates are often those who fantasise of a fortress Australia. In our view, this approach would be disastrous for economic growth and the farm sector and untenable in today's globalised world.

Recently, a new Round of World Trade Organisation negotiations was launched in Doha, Qatar. Australia, in its own right and through the Cairns Group (which it chairs) is fighting hard to reduce trade barriers around the world. It is important to note agriculture is the most distorted sector in world trade. Domestic tariff protection in Australia, in any industry, hinders our ability to maintain leadership in this important liberalisation endeavour.

Tariffs cannot isolate the Australian PMV industry from global trends of rationalisation and globalisation. High tariff walls do not serve the interests of the Australian economy. They increase costs to Australian consumers and significantly disadvantage the farm sector in particular.

1. The importance of agriculture in the Australian economy

NFF is the peak national lobby group representing the interests of Australian farmers and their families.

Farming is a vital part of Australia's economy. While rural production makes up around 3 percent of Australia's GDP¹, it provides around 21 per cent (\$33bn) of our goods and services exports².

Many rural communities depend upon agriculture for their prosperity. Agriculture contributes more than 30 per cent of employment in 66 per cent of small non-coastal towns³.

Agriculture is one of the largest employers in Australia, providing around 320,000 jobs – a level which has actually increased in the past five years, even with substantial improvements in productivity over this timeframe⁴.

Indeed, it is not often recognised that agriculture has demonstrated significant productivity growth over the past decade – agricultural productivity increased by 3.3 per cent per year between 1988 and 2000, well above the average of 1.2 per cent and the second highest in the market sector (after communications)⁵. This fact in particular should dispel the myth that the agricultural sector is 'old economy'. Farmers have been adopting new technologies and improving practices with fervour.

Agriculture also represents a significant input into many other industries, particularly the food processing industry, which had a turnover of \$51.2 billion and a value added of \$14.2 billion in 1999-2000. Food processing is the largest industry subdivision of total manufacturing, both by value added and by employment. It also provides over \$11 billion of exports⁶.

1. Source: ABS, *Agriculture (Cat no 7113.0)*, table 1.3.

2. Source: ABS, *International trade in goods and services (Cat no 5368)*, table 2.

3. Agriculture contributes more than half of total employment in 28 per cent of small non-coastal towns. Source: ABARE, *Country Australia*, p38.

4. Source: ABS, *Agriculture (Cat no 7113.0)*, table 1.4, which also shows non-owner employment increased by over 6,000 between 1996 and 2000, or 5.4%.

5. Source: OECD, *Economic Surveys – Australia 2000-01*, p82.

6. Source: ABS, *Manufacturing Industry, Australia, (Cat no 8221.0)*

2. The Australian automotive industry: an overview

There are four car manufacturers in Australia: Ford, Holden, Mitsubishi and Toyota and approximately 200 component, tooling, design and engineering firms (PC 2002: 8).

The industry is largely concentrated in South Australia and Victoria, employing approximately 55,000 people in 1996-97. The industry had a turnover of approximately \$15 billion in 1996-97, and exports of \$2.5 billion in 1998 (Australian Parliament 1998-99). This compares to agriculture, employing 320,000 people with a turnover of \$27.9 billion in 1996-97 and exports of \$23.6 billion in the same year.

The Australian market is “small, mature and diverse” (PC 2002: 11), making the efficient production of motor vehicles based solely on the domestic market difficult.

The international car industry is characterised by significant economies of scale which means that the relatively small scales available in Australia’s manufactures make our car industry necessarily dependent on some export activity to achieve efficiencies.

3. Assistance to the automotive industry

The automotive industry is currently supported by the following:

- ◆ a 15 per cent tariff on Passenger Motor Vehicles (PMVs);
- ◆ a 5 per cent tariff on Light Commercial Vehicles (LCVs) and four wheel drives (4WDs) (and components of these vehicles);
- ◆ a \$12,000 tariff on used PMVs;
- ◆ the Automotive Competitiveness and Investment Scheme (ACIS); and,
- ◆ the Automotive Market Access and Development Strategy.

In all, tariff and budgetary assistance to the PMV industry totalled \$886.5 million for 2000-01 (PC 2001b: 10).

Further, the PMV industry receives indirect support, both from FBT concessions for cars and Government procurement policies.

The ACIS Scheme, as well as the tariff itself, is legislated under the Customs Tariff Act of 1995. Under the Customs Tariff Amendment (ACIS implementation) Bill 1999, the 15 per cent tariff on PMVs will be reduced to 10 per cent in 2005.

The PMV industry remains one of Australia's most highly assisted industries. PMV tariffs were gradually reduced from 35 per cent in 1992 to 15 per cent in January 2000. In 1997, the Government announced that the PMV tariff would remain at 15 per cent until January 2005, when it is scheduled to fall to 10 per cent. The Productivity Commission projects that when this occurs the effective rate of assistance for PMVs will be around 10 per cent (still double the manufacturing average) [PC, 2000-01].

Grants to individual car companies have also been sourced from both Federal and State governments. In August 2001, the Prime Minister announced a \$200 million dollar deal to secure Mitsubishi's future in Australia and was approached for another \$140 million just prior to the federal election (Way 2002: internet). This is on top of assistance by State Governments, including an interest free loan of \$20 million by the South Australian government to Mitsubishi in March 2001. Further, in May 2002 Mitsubishi accepted a joint Federal and South Australian Government investment proposal worth \$85 million. NFF understands that assistance provided from state governments are not included in the PC's figures on industry assistance.

The Export Facilitation Scheme (EFS) was replaced by the Automotive Competitiveness and Investment Scheme (ACIS) in January 2001. This allows firms to utilise "transferable credits to reduce the customs duty payable on eligible imports" (PC 2001b: 12). Credits are earned through the production of motor vehicles, engines and engine components, investment in certain plant and equipment and research and development (R&D) (PC 2002: 12).

The 1997 PC report on the automotive industry advocated the complete abolition of the EFS on the grounds of an increasing international perception of the scheme as a hidden export subsidy, challengeable under the WTO (Industry Commission 1997: 349-351). The inquiry also concluded that the EFS had “served its main purpose” and “contributes to the disparity in assistance between the automotive industry and other Australian industries” (1997: 351). Its replacement, ACIS, was touted as ensuring a “stable transition” for Australian car manufacturers towards a “secure global position” with a non-negotiable cap of \$2 billion (Fischer and Moore 1998: 1).

However, it has since been revealed that assistance under the program may blow out from this \$2 billion cap by \$800 million, adding to what was “already the Government’s most expensive industry assistance scheme”, increasing “the subsidy per manufacturing job in the industry to \$11,000 per year” (Skotnicki 2001: 38).

The Automotive Market Access and Development Scheme was initiated in the 1998/99 budget as a \$20 million project designed to focus on market access issues, development of markets and “the promotion of special activities” such as the “aXcess” Australia concept car (Moore 1998: 1).

4. The NFF's views on PMV assistance

The NFF has learnt from experience the importance of reform in the Australian economy and the negative impacts of protectionism, particularly in the rural sector itself.

NFF vehemently opposes anti-competitive assistance measures and supports the unilateral removal of all tariffs (NFF 2000: 1). The utilisation of tariffs to protect inefficient industries is bad policy that favours import-competing industries at the expense of export-orientated industries, such as agriculture.

In this regard, NFF believes the Howard government should continue with its reform agenda and reduce the tariff on PMVs post 2005 with a view to elimination in 2010, in line with our APEC commitment (Bogor Declaration).

Tariffs protect industries but hurt consumers and the more efficient operation of the economy as a whole. Australian farmers are particularly hurt by domestic tariffs as they not only impose higher input costs on the sector, but the nature of international commodity markets mean that these costs cannot be passed on in the international market. In effect, non-protected industries involuntarily subsidise inefficient and protected industries.

Tariffs are a tax on consumer goods, as the general public is forced to pay higher prices for imports. These consumers, in turn, have a reduced purchasing power. Tariffs are also regressive. Lower income earners are disproportionately affected by the higher prices of protected goods such as cars and textiles, clothing and footwear.

Another negative impact of artificially increasing the cost of automobiles to consumers is that it provides a disincentive for ordinary Australians to upgrade their vehicles, leading to an ageing national fleet. This has important negative consequences, such as; fewer cars in Australia with improved emission reduction standards (i.e. negative environmental impact); and, fewer vehicles on the road with updated safety technology.

Australian industries which utilise inputs affected by the imposition of tariffs suffer competitively. Protection diverts scarce resources from industries such as agriculture to the inefficiencies of protected producers. Protection can also have a negative impact on the propensity of industries to seek new markets and innovate - there is generally less pressure to be an efficient producer.

5. The arguments for support of the PMV industry

The numerous arguments about industry support can cloud the debate. Of course, many industries that decry the eradication of industry protection will champion reform that benefits them.

The interests of some are often more vocal than the disparate voices of the 19 million Australian consumers in Australia. It is easier to argue for the status quo when the losses are more concentrated and quantified, and the net beneficiaries of tariff cuts are dispersed.

In other words, a vocal minority has the ability to cloud the issue and detract from greater societal gains from reform.

5.1. Regional development and employment arguments

Regional development arguments and the fear of job losses are at the real centre of the political argument in Australia over car tariffs. It is in this area where the concentrated interests of manufacturers and their employees have often won over wider community benefits.

It is the issue of the significance of the car industry to the Victorian and South Australian economies which often sways governments to continue to provide assistance. The recent justification of the federal government of a grant of \$35 million to assist Mitsubishi was justified by Prime Minister Howard on the *Today Show* (30 April 2002) as:

“...There’s a lot of companies that when they ask us for money we think the request is unreasonable. But the motor manufacturing industry is crucial to the economy of South Australia. Anybody who understands the South Australian economy will know that without the motor manufacturing industry it would be a different state altogether”.

It must be remembered that there is also a negative impact on employment in other sectors of the economy due to protectionist policy. Generally, the gain to employment economy-wide from removing protection is greater than any loss that may eventuate in the industries that lose protection. In addition, a more innovative PMV industry may actually increase its production and employment in the long run.

Moreover, it can be argued that any negative effects on employment, as a result of tariff reductions for example, are short-term ramifications which can be addressed by appropriate structural adjustment policies, including training assistance.

5.2. Strategic industry arguments

Arguments in favour of protection also utilise strategic industry arguments that focus on the value of maintaining a particular industry in Australia. While such arguments have not been validated by economic research, several are still prominent in protection debates.

Australia is a vocal opponent of the strategic industry argument used in the United States to defend protectionism in agriculture. Since September 11, the argument that “an army marches on its stomach” has gained attention. Australia has no credibility opposing this argument overseas in agriculture policy if we resort to the same argument at home to defend PMV policy.

Specific groups have argued that the PMV industry should be supported because value-added exports are more important to the Australian community than raw commodities. Value-added exports are considered important for several reasons, including associated technological development, self-sufficiency and a more diversified economy. These arguments have been particularly strong during times of uncertainty.

These assertions rely on the misconception that Australian manufacturing would disappear in a liberal trade environment and that without manufacturing Australia would be nothing but mines and farms. Neither of these claims have any supportive evidence.

Moreover, NFF would argue that there is nothing wrong with mines or farms anyway. Many assert that agriculture is old economy. On the contrary, Australian farmers have demonstrated high rates of productivity growth, and utilise leading edge technology to compete in a global market place. We are one of the most efficient agriculture producers in the world.

As paradoxical as it may seem, in the Australian Financial Review recently, the Federal Chamber of Automotive Industries chief executive, Peter Sturrock, uses the argument that with the support the Government has provided since 1997, the industry has “some quite significant runs on the board”. He seems to use the logic that a doubling of exports, a 30 per cent increase in domestic market sales since the last Commission report and a “very positive” outlook are arguments against further reductions (AFR, Koutsoukis 2002: 18). Surely these developments would be an impetus for more tariff cuts, not less? That is, are these developments not due to the productivity improvement that comes with falling tariffs?

One question is relevant: does a reduction in tariffs necessarily spell a significant contraction in the PMV industry in Australia?

The Federal Chamber of Automotive Industries (1991) argued that the PMV industry could have a positive outlook under tariff decreases if the reductions were accompanied by macro- and micro- economic reform; to reduce input costs and avoid further squeezes on profit margins. That is, if the Australian economy could become more competitive in particular areas, the automotive industry had the opportunity to survive and prosper.

This finding was over a decade ago, and many of the issues on needed reform have received attention. Specifically, inflation and interest rates are relatively low; the tax system has been subject to the GST overhaul and waterfront and labour market reform have achieved significant productivity improvements. These reforms may not have been completely finished, but their effect on the international competitiveness of Australian industry is substantial. Indeed, NFF looks forward to the Government pressing forward with their reform agenda to further reduce costs in the transport and infrastructure sectors, as well as in industrial relations.

5.3. Broader arguments against trade liberalisation and microeconomic reform

Organisations such as the Australia Manufacturing Workers' Union, when arguing for "Fair Trade Not Free Trade" are using broad arguments against trade liberalisation. Such arguments prey on a lack of understanding within the general Australian public on the positive effects of trade liberalisation. They focus on insecurity and implicitly endorse the maintenance of barriers to protect the economy from foreigners.

Some groups have argued that unilateral tariff reductions decrease Australia's negotiating power in trade talks.

Other arguments against liberalisation include: decreasing tariffs in Australia would expose Australia to imports; Australia's already aggressive tariff reductions are ahead of our APEC partners and we should give time for other nations to "catch up"; and, that the future of trade liberalisation in the world is bleak and a likely surge in protectionism might catch us unawares. The AiGroup (2000) has utilised all of these arguments in previous PC submissions.

NFF argues against these views. NFF believes that trade is a "win-win situation", not a struggle to preclude foreigners from access to local markets (NFF 2000: 4). NFF advocates that the reform undertaken by Australia in the late 1980s and 1990s has, far from reducing negotiating power, enabled Australia to negotiate internationally with a leadership role and from "a position of strength" (NFF 2000: 4).

The idea that imports are bad and exports good has been around for more than a century. There are many problems with this thinking. Apart from ignoring the basic concept of comparative advantage, Australia needs imports as inputs in order to enable us to export; imports also contributing to higher standards of living. In any case, it is not clear that car protection is beneficial in this regard – tariffs reduce Australia’s ability to export competitively.

The Centre for International Economics (CIE) advocates unilateral tariff reductions on the basis of the national gains from such moves exceeding costs and the limited influence of Australia’s comparatively small share of world output (Pearce and Stoeckel 1996: 23). Technically, the benefits to Australia from unilaterally reducing tariffs in an environment of protectionism are still benefits not otherwise achievable.

Arguments for protection are, therefore, plagued by inaccuracies, countervailing evidence and misleading assertions. It is in the interests of Australian consumers and the Australian economy that debate is broadened.

6. The utilisation of adjustment programs

Although the design and effectiveness of adjustment programs is contentious, they are clearly a tool that could be used to aid adjustment for individuals, companies and regions. There are generally available adjustment programs including a social safety net of varying benefits and labour market programs.

A 2001 PC report into structural adjustment asserted that while programs initiated due to equity or fairness were inherently subjective, “the case was likely to be strongest where a proposed policy change imposes a clear and sizeable burden on a specific group in the community...” (2001: XIX). Regional areas of both Victoria and South Australia may be short-term losers of a reduction in PMV industry assistance. Anderson and Garnaut have suggested the options of an additional share of federal grants to states disadvantaged by liberalisation, allowing investment in the restructuring of their economies (1987: 120).

NFF believes a responsible reform agenda should include targeted and fair adjustment policy.

7. WTO Doha negotiations

As chair of the Cairns Group, Australia is known throughout the world as the strongest advocate for multilateral trade reform. With a new Round now in progress the rest of the world is watching Australia closely. Our international credibility could be totally undermined if we say one thing in Geneva but do the opposite back home.

This is the situation that the United States now finds itself in. Protectionist instincts in Congress that have led to the signing recently of a highly distortional Farm Bill; steel tariffs of 8-30 per cent; 29 per cent duties on Canadian soft-wood lumber; protection of Mississippi catfish producers from Vietnamese imports; and protection of South Carolina textile producers from competition from Pakistan.

These decisions have undermined America's status and authority in the WTO. This is a tragic policy development at a time when American leadership is needed most.

With US leadership in tatters in the WTO, it is up to the Australian-led Cairns group to pick up the baton and save the Round (Corbet, 2002). Protection in the PMV sector hinders Australia's ability to do this to its full potential.

Conclusion

The Government should continue to reduce the tariff on PMVs post 2005, with a view to elimination in 2010 (in line with our APEC commitments).

NFF believes that protective car industry tariffs should be eliminated in 2010. Such policy instruments are to the detriment of Australian exporters, consumers and the economy as a whole.

Specifically, consumers will be the greatest beneficiaries from tariff reductions, paying lower prices for motor vehicles. Increased demand as a result of lower prices also has important environmental and road safety benefits. Further, a reduction in the tariff on PMVs will lessen costs on other areas of the economy; particularly export industries such as agriculture.

NFF believes there is a role for targeted adjustment programs that manage adverse effects on workers and regions reliant on the car industry.

Only by a continuing commitment to trade liberalisation can the Government ensure that Australian industry and farmers can take advantage of the long-term trend towards globalisation. Australia must continue to reduce and eventually eliminate all import barriers if we are to compete effectively with other countries.

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