



**South Australian Government Submission
to the Productivity Commission**

on

**Post 2005 Assistance Arrangements for the
Automotive Manufacturing Sector**

May 2002

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EXECUTIVE SUMMARY

The Government of South Australia is committed to an efficient, globally competitive and sustainable automotive industry which contributes to Australia's economic prosperity through jobs, exports, international integration, innovation in technology and management, and as a driver of associated production and service industries.

The automotive manufacturing sector has experienced continual improvement in the last decade and, in particular, since 1997. Greater efficiency and competitiveness have occurred during a time in which government assistance has been reduced – but is also the result of such assistance. Government assistance, through the maintenance of tariffs on automotive products (albeit at significantly lower levels) and through the Export Facilitation Scheme (EFS) and the Automotive Competitiveness and Investment Scheme (ACIS), must be credited for its contribution to a better performing sector.

Assistance has contributed in a number of key ways.

- It has allowed structural adjustment within the industry to take place at a realistic and measured pace within a secure policy environment, which has promoted investment, long-term planning, and the development of technology and new management practices.
- It has provided important signals (including through the retention of tariffs) to the automotive industry, which is globally driven by the major ten vehicle-building firms (none of which are owned by Australians), that Australia continues to be committed to a domestic automotive industry.
- It has ensured that the Australian automotive industry has enjoyed some parity in attracting investment with its global competitors which continue to receive government support through a variety of mechanisms, both overt and hidden and often on a much broader scale. Automotive assistance acts to increase the attractiveness of investing in Australia by reducing the opportunity costs when compared to investing in a global competitor's market, where often much greater levels of assistance are on offer.
- It has encouraged further integration of the sector into the global economy.

The South Australian Government recommends that the Commonwealth Government maintain current levels of assistance to the automotive manufacturing industry for at least five years from 2005, when tariffs on passenger motor vehicles (PMVs) and components fall to 10%.

To this end, the South Australian Government makes the following specific recommendations:

Recommendation 1

The South Australian Government does not oppose the reduction of PMV and components tariffs in 2005 from the current level of 15% to 10%. Beyond 2005,

however, South Australia recommends the retention of these tariffs at 10% at least until 2010 and until real market access outcomes are achieved that result in increased access to markets throughout the world and particularly in Asia.

Maintenance of a 10% PMV and components tariff beyond 2005 is supported by the following arguments:

- Automotive tariffs should not be reduced until real market access gains have been made for Australian exporters – reciprocity should be sought before any decision is made to further reduce Australian tariffs.
- The existence of a tariff helps to attract foreign investment from global automotive companies – even at low levels it is an important signal to the industry that the sector has national support.
- Tariff reductions should be made incrementally to allow the automotive industry time to adjust.
- For reductions below 10%, any welfare gains through improvements in allocative efficiency will be trivial and will be outweighed by adjustment costs.

South Australia recommends the retention of tariffs on light commercial vehicles (LCVs) and four wheel drives (4WDs) and components for these vehicles at the current level of 5% after 2005 and at least until 2010.

Recommendation 2

The South Australian Government recommends that the Commonwealth Government continue for at least five years from 2005 an assistance scheme which promotes investment, R&D and production within the industry, such as has been provided under the Automotive Competitiveness and Investment Scheme (ACIS), and which is WTO-compliant and retains overall funding levels as under the current scheme.

The current ACIS scheme promotes production, capital investment and R&D activity – all vital if the automotive manufacturing industry is to be viable and globally competitive. It sends an important international signal that Australia is committed to having a strong, local automotive manufacturing sector and, if extended, will contribute to a stable policy environment suited to the long lead times inherent in the industry. Moreover, the scheme promotes international competitiveness while remaining WTO-compliant. Any modified scheme should retain these principles.

Recommendation 3

The South Australian Government recommends that improved market access continue to be pursued, both in the multilateral and bilateral spheres. The South Australian Government is of the firm view that further reductions in Australian automotive industry assistance should not be contemplated until significant market access gains have been achieved in major automotive markets throughout the world and particularly in Asia.

Continued growth in the Australian automotive industry will be heavily reliant on the Commonwealth Government being able to leverage market access outcomes in overseas markets. South Australia is concerned about the lack of market access gains realised

through multilateral trade groupings since the 1997 inquiry. This is of particular importance to Australia where a relatively small domestic market means that companies are increasingly looking for export sales to remain viable by exploiting economies of scale.

Recommendation 4

The South Australian Government recommends that the Commonwealth Government have in place strategies to deal with structural adjustment issues should the automotive industry suffer a significant and sudden contraction in output and employment. Further, any such strategies should be designed to provide a focus on those individual regions in which the industry is concentrated.

Structural assistance programs should aim to:

- assist workers made redundant by structural change within the industry, including through labour, training and re-training programs; and
- assist regions negatively impacted by industry adjustment to find new economically sustainable industries to maintain overall levels of employment and economic wellbeing.

South Australia, as a regional economy and as proportionately most dependent on the automotive industry compared with all other states and territories, expects to have input into the development of such programs. The South Australian Government places a high priority on regional adjustment given the dependence of Adelaide's northern and southern suburbs on automotive production activity.

Programs should be specific and well-targeted. Key issues that should be investigated by the Productivity Commission are the effects on employment, investment, output and income levels in regions where the automotive industry is highly concentrated.

Recommendation 5

The South Australian Government recognises that the Commonwealth Government has a pivotal role in investment attraction for the automotive industry. It therefore, in encouraging the Commonwealth Government to bolster national investment policy:

(5.1) urges the Commonwealth Government to make implementation of the recommendations of the Blackburne Report, Winning investment: Strategy, people and partnerships, a priority; and

(5.2) affirms the key role the Strategic Investment Coordination program (SIC) plays in actively attracting and supporting mobile global capital – and recognises that on large investment projects there is a need for federal and state/territory cooperation.

Competition for new foreign investment in the automotive industry is strong, with Australian firms having to compete against a host of sister plants in numerous locations throughout the world and with governments who are prepared to go to great lengths to attract foreign investment. The long lead times required, specifically for the introduction of new car models, dictate the need for a degree of certainty in economic policy in order to allow firms to plan future investment in the domestic industry. A proactive and well-

resourced national investment policy is vital if Australia is to succeed in an industry as globally driven as automotive manufacturing.

Recommendation 6

The South Australian Government supports the Commonwealth Government's continued commitment to dedicated and general assistance to the industry as it is currently delivered through Commonwealth agencies and programs.

The automotive manufacturing sector receives Commonwealth Government assistance through dedicated resources within Commonwealth agencies, including Invest Australia, the Department of Industry, Tourism and Resources, Austrade and the Department of Foreign Affairs and Trade. Australia's overseas missions play an important role in identifying markets for Australian products. In addition, the industry receives assistance through non-industry specific programs including through R&D Start, the Export Market Development Grants scheme (EMDG), and R&D tax concessions. These resources form an important part of a national structure which is supportive of both the automotive industry and the economy more generally and should remain open to the sector.

South Australia recognises the need for this assistance to be performance-based and subject to regular review to ensure that objectives related to efficiency and the effectiveness of assistances are being achieved.

Recommendation 7

The South Australian Government recommends, in formulating its options for consideration by the Commonwealth Government, that:

- (7.1) the Productivity Commission take into consideration the additional expenditure, research and development that will be required by domestic vehicle assemblers and component suppliers to develop and comply with environmental regulations due to be implemented in Australia by 2006; and*
- (7.2) such options not delay the implementation of these environmental regulations but be consistent with the achievement of their aims.*

Australian automotive producers must increasingly take into consideration international environmental standards which, in the main, are becoming more stringent. The harmonisation of Australian standards with European ones imparts greater impetus to this process, both in order to meet domestic standards and to compete in international and domestic markets.

The South Australian Government recommends that the Productivity Commission, in considering options for future assistance to the industry, factor in the costs to the automotive industry associated with developing and meeting environmental standards, both domestic and international. Support for R&D to meet (and even exceed) standards should be a feature of any future assistance regime.

These recommendations of the South Australian Government collectively address the needs of industry development and growth in that they:

- promote investment by making Australia an attractive site for global automotive capital;
- promote R&D and innovation which lead to product improvement and more efficient and technologically advanced production;
- promote skills development with the sector workforce, including managerial skills;
- promote exports of automotive products through greater market access as well as through market development programs; and
- therefore contribute to the industry's self-reliance, viability and growth.

Importantly, the measures recommended aim to encourage greater industry self-reliance in the longer term while providing vital assistance as restructuring continues in the shorter term.

The success of any such arrangements should be evident in the continuing contribution of the industry to improvement in the economic performance of the Australian economy. A key measurement will be the generation of employment, particularly in regional areas, including those in South Australia. As an important by-product, the Australian consumer will have better access to good quality, fairly priced vehicles. Provision of such vehicles produced by local manufacturers will provide added impetus to the domestic economy – and to the community generally through positive environmental spin-offs through improved fuel and emissions standards.

It is the view of the South Australian Government that the recommended measures *will* meet the Commonwealth Government's desire for an efficient, internationally competitive industry which can increasingly contribute to the economic wellbeing of the nation. It is also the Government's view that they will contribute to the retention of a vibrant and important automotive industry within South Australia and Australia more widely.

1. INTRODUCTION AND KEY ISSUES

The automotive industry is a significant contributor to the Australian economy, with the bulk of its activities based within Victoria and South Australia, and is focussed around the four vehicle builders – Mitsubishi, Holden, Toyota and Ford.

The industry produces 360,000 vehicles per year plus a range of automotive products. It contributes almost 6% of manufacturing value-added and about 1% of GDP and it employs more than 50,000 people directly, with estimates of combined employment, both direct and indirect, of approximately 100,000.¹ In the calendar year 2001, national automotive exports were valued at \$4.94 billion, a 17% increase on the previous calendar year.

In South Australia, the automotive manufacturing sector represents proportionally a much larger slice of the economy.

In 1999-00, the automotive industry in South Australia employed 13,500 people directly, recorded an industry turnover valued at around \$5.3 billion - representing almost a quarter of the State's manufacturing turnover² - and generated almost \$1.5 billion of exports (in 2000-2001) - equal to around 17% of the State's total exports.³ Importantly, it accounted for 2.4% of Gross State Product and provided an industry value-added figure of almost \$1.0 billion or over 14% of all state industry manufacturing value-added.

In the five years since 1997, when the Productivity Commission conducted its most recent review of the industry, the Australian automotive manufacturing sector has experienced significant change in terms of its production mix, export markets and structural arrangements. These changes have been driven by various combinations of domestic factors (such as the changing focus of assistance programs and consumer preferences) and external factors (including the fall-out of global restructuring of automotive multinationals on domestic operations). Despite the difficulties and uncertainties often posed by this environment, the Australian automotive industry has achieved a degree of international competitiveness and specialisation that belies what is, by global scale, a relatively small market. These changes were in train before the Industry Commission's 1997 review of the industry, but have accelerated since that date.

Global merger and acquisition activity has seen a large reduction in the number of autonomous motor vehicle producing firms and there has been an increasing emphasis on the ability of local arms of foreign automotive operations to specialise in some part of the global operation's interests. By and large, the Australian automotive industry has been able to exploit the opportunities offered by the changing environment and, at the same time, consolidate its position within the global operations of parent firms.

The Australian automotive industry has proven resilient as it has transformed itself to accommodate the many changes in the industry, most of which are beyond the control or influence of the domestic industry.

¹ FCAI/FAPM 2002, *A Modern Perspective*, p. 28.

² FCAI/FAPM 2002, *A Modern Perspective*, p. 28.

³ FCAI 2002, Media Release, 20 February.

Significantly, the achievements of the industry have been recorded as the high protection traditionally accorded it has been decreased.

As trade protection in Australia has declined, however, it has not been met by significant improvements in market access in many of Australia's trading partners. The many efficiency gains achieved under previous protection reductions are now threatened by the artificial constraints on the Australian automotive industry in terms of further export and integration opportunities. Competition for automotive investment is intense, and Australia increasingly finds itself facing markets whose illiberal trading and investment practices threaten the existence and sustainability of our efficient and globally competitive automotive industry.

Domestic and global factors will continue to drive changes in the industry.

In this submission, the Government of South Australia examines the structure of the industry, its contribution to the national and South Australian economies, and the global influences that impact on domestic industry viability and development.

It argues that, while important reforms have taken place and while the industry has risen successfully to the challenge of decreasing government assistance, now is not the time to set the industry adrift. The industry is not an island – international support for domestic automotive industries is endemic. Global merger and acquisition activity will continue, while shifts to 'Tier 0.5' production and 'designer' vehicles have yet to fully impact present global supply chains and structures. The industry is heavily reliant upon high levels of mobile capital and investment decisions that are made on a global basis and usually determined outside of Australia.

To summarise, for the domestic industry to continue on its path toward greater efficiency and global competitiveness – which is supported by both the Commonwealth and South Australian Governments – ongoing assistance is required. Such assistance should drive change and improvement within an international environment that is in flux, is typified by significant levels of support and protection, and is driven by corporate investment and product sourcing decisions made at a global level.

Australia must stake its claim as an indispensable and innovative segment of the global industry if it wishes to have an automotive industry in the medium to longer term. Such an industry, with its important contributions to the economy, will come at some cost.

2. THE AUSTRALIAN AUTOMOTIVE INDUSTRY

2.1 DEVELOPMENTS SINCE THE 1997 REVIEW

In the five years since the last review in 1997, the Australian automotive industry has continued to experience significant change in terms of its production mix, export markets and structural arrangements. These changes have been driven by various combinations of domestic factors (such as the changing focus of assistance programs and consumer preferences) and external factors (including the fall-out of global restructuring of automotive multinationals on domestic operations). Despite the difficulties and uncertainties often posed by this environment, the Australian automotive industry has achieved a degree of international competitiveness and specialisation that belies what is, by global scale, a relatively small market. These changes were in train before the Industry (later Productivity) Commission's 1997 review of the industry, but have accelerated since that date.

This does not mean that the further reductions in tariffs below 10% will produce increase in national economic welfare.

Since 1997, nominal automotive tariff rates on imported vehicles have been reduced from 22.5% to 15% (beginning in the year 2000) and the industry has continued to function in an environment without quotas, local content requirements or licensing controls. Assistance schemes available to the industry have transitioned from the export-focussed Export Facilitation Scheme (EFS) to the introduction of the Automotive Competitiveness and Investment Scheme (ACIS) from 1 January 2001. This scheme provides \$2 billion in capped benefits in the form of import duty credits for production and investment in plant and equipment and R&D to vehicle assemblers, components producers, toolmakers and service providers. Industry consultation suggests that, in most cases, the take-up rate of ACIS has been high by those firms that are eligible under the scheme.

This chapter will argue that changes to the sector have occurred on a number of fronts, including sector structure, production, demand, exports, investment and R&D. Productivity and quality have been continuously improving. In short, these changes have seen the industry become more competitive, more efficient, and more globally integrated. One key to the industry's improvement has been innovation in design – another has been growing exports. The former has helped to ensure continuing investment from parent companies which see Australia as providing value-added product, while the latter has boosted production volumes and so helped Australian companies achieve greater economies of scale. It must also be noted that the decline in the value of the Australian dollar since 1997 has played a significant role in sustaining the vitality of the Australian automotive industry.

2.2 CONTRIBUTION TO THE ECONOMY

The automotive industry is a significant contributor to the Australian economy, with the bulk of its activities based within Victoria and South Australia, and is focussed around the four vehicle builders – Mitsubishi, Holden, Toyota and Ford. Nationally, the industry produces 360,000 vehicles per year plus a range of automotive products. It contributes almost 6% of manufacturing value-added and about 1% of GDP. It employs more than 50,000 people

directly, with estimates of combined employment, both direct and indirect, of approximately 100,000.⁴ In the calendar year 2001, automotive exports were valued at \$4.94 billion, a 17% increase on the previous calendar year. Of this total, around \$3.26 billion was accounted for by motor vehicle exports which reached a new record of 109,000 vehicles exported. The components sector accounted for a further \$1.68 billion in exports.⁵

2.3 STRUCTURE OF THE SECTOR

There are presently four local PMV manufacturers, two of which have their manufacturing operations located in South Australia (General Motors Holden and Mitsubishi) and two of whom are located within Victoria (Ford Motor Company and Toyota – including Holden’s engine plant in that State). Each of the assemblers represents the parent multinational’s sole Australian operations, given that none of the merger and acquisition (M&A) activity of recent times in the global automotive industry has led to a consolidation involving more than one of Australia’s present players. The four assemblers produce a wide variety of models (all in the medium-upper size category) from what are effectively five single platforms.

For each of the local vehicle assemblers, an increased focus on export markets, producing multiple model variants from a single platform and achieving a niche within the global parent’s business operations have all been necessary steps for continued survival during a period of strong consolidation and rationalisation in the global automotive industry. The increasing emphasis on a highly trained and qualified workforce, combined with continuing government assistance programs, has helped the industry adjust in a time of significant global market change.

The local components industry is more diverse in its geographical distribution, although the majority of component suppliers are concentrated within Victoria (and to a lesser extent, South Australia).⁶ In total, there are approximately two hundred automotive component firms and hundreds of tooling, design and engineering firms in Australia.

Although there has been no exit (or entry) of vehicle assemblers since 1997, there has been significant change in the ownership of the Australian automotive components industry. The shift towards globalisation has led to a considerable degree of foreign investment in local component firms. Reflecting global consolidation trends, the component industry is moving to greater responsibility for the development of components and the design and production of an increasing number of modular vehicle segments. It has also focussed more strongly on exports.

Another significant component of the automotive industry is the tooling sector. In total, the Australian tooling industry comprises around five hundred small enterprises with a turnover of around \$1 billion and exports of \$80 million. Employment in the tooling sector is around 10,000 people. In Australia, the tooling industry is characterised by small enterprises with unique specialised skills which predominantly service the automotive industry. Tooling work

⁴ FCAI/FAPM 2002, *A Modern Perspective*, p. 28.

⁵ FCAI 2002, Media Release, 20 February.

⁶ Of the 200 component firms, around 40 are located in South Australia.

undertaken for the automotive industry accounts for 47% of total tooling sales for Australia as a whole, whilst it accounts for around 60% of tooling industry sales in South Australia.⁷

Due to the product cycles in the Australian automotive industry (which often leads to ‘lumpy’ demand characteristics), tooling companies have taken the initiative to seek work outside of the local automotive sector to survive. They seek exports in the automotive field, as well as domestic sales in the whitegoods, electronics and packaging industries. In doing so, these small businesses have been exposed to world competition and have gained a better appreciation of their strengths and deficiencies as an industry. When the automotive industry moves back into heavy demand, such as with the pending introduction of new models, the tooling industry experiences capacity limitations. These limitations on industry expansion include a shortage of skilled labour, deficiencies in upgrading technology, project management and R&D.

Although relatively small, the tooling industry of Australia is able to serve most of the needs of the Australian automotive industry. These tooling firms are an integral part of the domestic automotive supply chain, so that there is a significant flow-on effect from the existence of this industry. The industry reports that ACIS has been a positive influence in the industry, but ultimately has been limited by the inability of 65% of Australian tool rooms to qualify for the scheme. Automotive industry work provides the tooling industry with the volumes it requires to enable it to efficiently supply numerous non-automotive industries.

2.4 INDUSTRY PERFORMANCE: PRODUCTION, PRODUCTIVITY AND QUALITY

Structural change in the domestic automotive sector, including the (pre-1997) withdrawal of the fifth and smallest local manufacturer (Nissan), and limitations on plant capacity have contributed to a relatively small overall increase in domestic output. Total domestic vehicle production has increased around 10% since 1997, from 318,000 units per year (including PMVs and light vehicles such as utes) to approximately 351,000 in the year 2000.⁸ Over this same period, the number of vehicles produced and exported from Australia increased 71% from 55,000 to 94,000,⁹ reflecting the growing attractiveness of Australian-made PMVs to foreign markets as well as to the global parents of Australian automotive firms. In calendar year 2001, total vehicle exports reached a new record of 109,000 units.¹⁰

Productivity, expressed as the number of vehicles produced per employee, has increased in the period since 1997, continuing the trend that was established during the early to mid-1990s. Table 2.1 below provides productivity data. It shows from 1990 to 1999 there was around a 40% increase in productivity per employee.

Table 2.1 – Australian vehicle manufacturing productivity

Year	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Vehicles per	11.6	10.8	11.6	12.8	15.8	15.8	16.1	15.5	15.8	16.3

⁷ Centre for Innovation, Business and Manufacturing 2002, *Business Indicators in the Australian Tooling Industry*, Survey, p. 7.

⁸ Johns, R. 2001, *Australian Automotive Intelligence Yearbook*, Melbourne, p. 34.

⁹ Johns, R. 2001, p. 37.

¹⁰ FCAI 2002, Media Release, 20 February.

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Source: ISR, KAS 2001, Table 29, Appendix A

Similarly, there has been a measured increase in the quality of domestically produced vehicles when measured in terms of survey responses to the sample average number of faults found in new vehicles. Table 2.2 below provides a rough indication of the generally higher quality of vehicle now sold compared to that of a decade ago.

Table 2.2 – Australian vehicle quality – average faults per vehicle

Year	Model					
	Ford Falcon	Holden Commodore	Toyota Camry		Mitsubishi Magna (V6)	
			4-cyl	V6	4-cyl	V6
1988	4.4	3.2	2.4	-	2.2	-
1989	3.2	3.3	2.1	-	2.0	-
1990	2.9	2.9	2.1	-	1.8	-
1991	2.4	2.5	1.6	-	1.9	-
1992	2.2	2.0	1.4	-	1.8	-
1993	2.0	2.1	1.4	-	1.7	-
1994	2.2	1.9	1.7	-	1.8	-
1995	2.1	1.9	1.8	-	1.6	-
1996	1.8	1.9	1.4	1.6	1.5	1.6
1997	1.8	2.1	1.4	1.6	1.4	1.6
1998	2.1	2.4	1.6	1.4	1.4	1.4
1999	1.6	1.6	0.8	0.8	-	1.1

Source: ISR, KAS 2001, Table 16, Appendix A

In summary, since 1997 the Australian automotive industry has consolidated its move to a more export-focussed basis of operations but has continued to lose PMV market share within Australia. There has been an increase in productivity (measured in terms of vehicles produced per employee) and in quality (measured as average faults per car), which has been common to all four of the existing automotive manufacturers.

2.5 DOMESTIC DEMAND

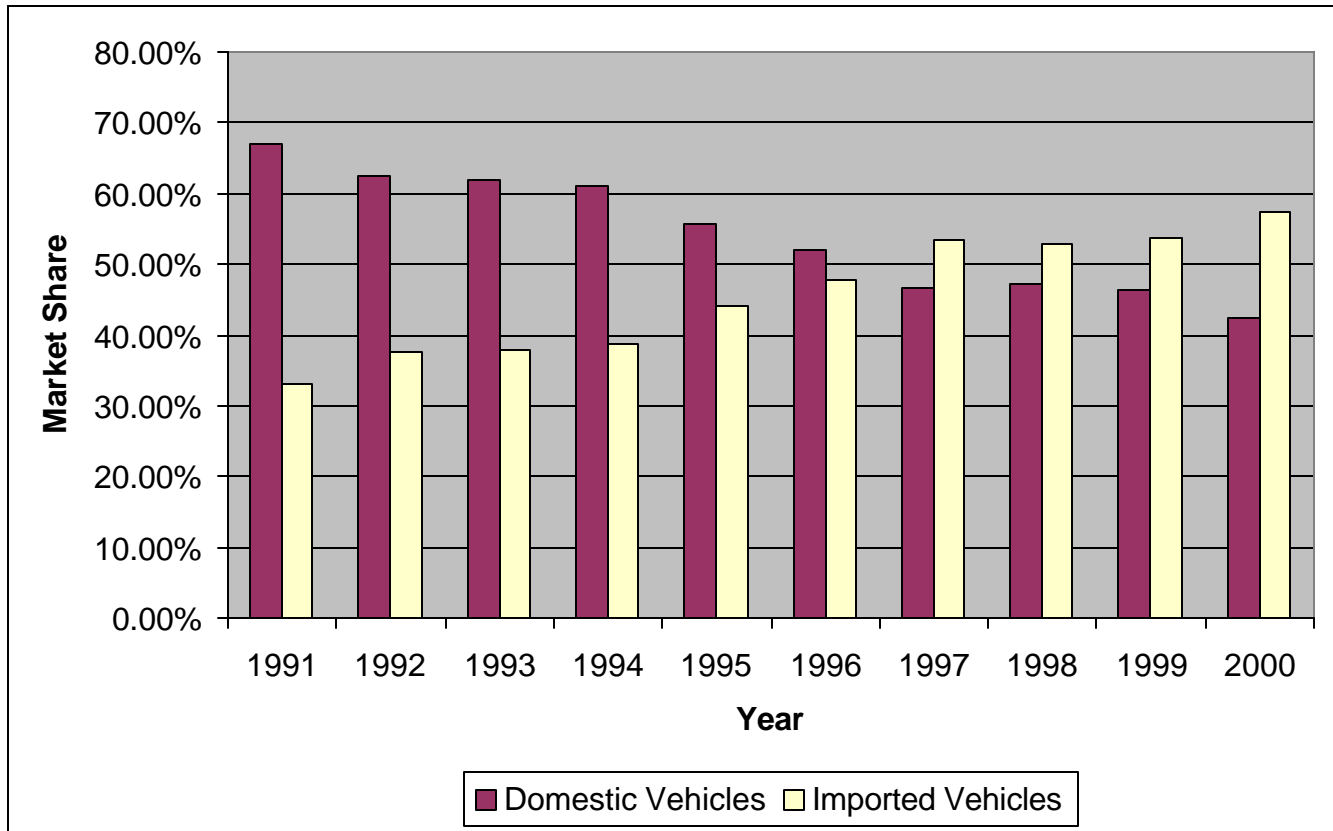
Domestic demand for PMVs has risen significantly since 1997, reflecting sustained economic growth in the same period. Domestic demand for PMVs steadily increased over the past decade, with 374,527 PMV sales in 1991 rising to 555,139 sales in 2000 (see Table 2.3 below). Annual PMV sales in the period 1997-01 averaged 551,082 compared to 452,403 in the 1992-96 period. This represents an increase in demand of around 48% over the period. This has reversed a long-term stagnation in the overall market size, reflected in 1997 sales figures which were the highest in the industry since 1985.¹¹

The overall increase in market size since 1997 can effectively be described as a one-step increase, with the market since holding constant at a total of approximately 780,000-800,000 units per year (including light and heavy vehicles).

¹¹ Autoweb website 2002, 'VFACTS Industry Summary – January 2002', www.autoweb.com.au/start/:showall /id_MSC/doc_msc0202071/article.html

This has been accompanied by a continued decline in the proportion of sales accounted for by domestically produced vehicles along with a noticeable boost in export volumes (see Figure 2.1 below).

Figure 2.1 – Relative shares of domestic PMV market – Domestic and imported vehicles



Source: Data from Table 2.3.

Table 2.3 demonstrates that between 1997 and 2000 the relative market share held by domestically produced vehicles declined significantly, from 47% of the market to 42%.¹² The bulk of the increase in the overall Australian market size can be attributed to imports.¹³ This reflects a continuation of a trend that has been evident for most of the previous decade, as the domestic market share of domestically produced vehicles has continued to decline.

Table 2.3 – Composition of local PMV market by source of vehicle

Year	Sales of Locally Made PMVs	As % of Total PMV Market	Sales of Imported PMVs	As % of Total PMV Market
1991	250,819	67.0%	123,708	33.0%
1992	244,543	62.4%	147,406	37.6%
1993	258,748	62.0%	158,663	38.0%
1994	287,259	61.2%	182,256	38.8%

¹² Based on data presented in Table 2.1.

¹³ As Table 2.1 shows, imports now account for around 60% of domestic PMV sales.

1995	270,938	55.8%	214,843	44.2%
1996	265,197	52.1%	243,848	47.9%
1997	246,281	46.7%	281,267	53.3%
1998	281,659	47.1%	316,701	52.9%
1999	249,163	46.4%	288,067	53.6%
2000	235,668	42.5%	319,471	57.5%

Source: Various in Johns, R. 2001. Data separated by author.

Despite a falling ratio in domestic sales, Australian PMV producers have been consistent and dominant performers in the domestic large and medium car market. Reflecting the dominance of upper-medium cars in the Australian market as well as their competitive strength, the four families of vehicle produced in Australia have consistently been placed in the top model sales since 1997.

However, the data do not indicate the extent to which small PMV sales and four-wheel drive (4WD) vehicles have been growing their share of the overall vehicle market over the past decade. These are segments that domestic vehicle assembly does not currently cater for, although there has been significant small and medium car production in the past and production of new variants of vehicles based on local vehicle platforms are expected in the near future. These may address to some extent the growing gap between local demand patterns and local production.¹⁴

The fleet market (both government and private sector) currently accounts for in excess of half of the total sales each year of Australian-produced vehicles. Fleet demand for Australian-made vehicles assists in maintaining volumes within the local industry, as well as driving competition between the local vehicle assemblers. A large proportion of fleet passenger vehicles is disposed of via auction. Via this process, fleets provide a constant stream of relatively new vehicles for the secondhand market that often offer competition with new (but smaller and cheaper) imported vehicles.

The South Australian government vehicle fleet, operated by FleetSA, is currently comprised of passenger vehicles (including locally produced utilities) which are Australian-made and commercial vehicles which are entirely imported, as Australia does not possess any local production capacity of this latter group. FleetSA also purchases a very small number of small passenger vehicles, notably the Toyota Prius hybrid electric/petrol vehicle, on the basis of its low environmental impact.¹⁵

Data from the Australian Fleet Management Association's *Purchasing Intentions Survey 2002* indicate that whilst the impetus to 'Buy Australian' remains a significant driver in the replacement policies operated by fleet managers, the overwhelming emphasis in the purchasing decision remains on 'whole-of-life cost' for the vehicle's operation.¹⁶

2.6 TRADE PATTERNS

¹⁴ For example, Holden's 4WD 'cross-over' vehicle based on the Commodore platform.

¹⁵ Department of Administrative and Information Services 2002, Government of South Australia.

¹⁶ Australian Fleet Managers Association 2002, *Purchasing Intentions Survey 2002*, p. 8.

The Australian automotive industry has now reached a key point in its evolution. Consolidation of both vehicle and component manufacture (resulting in a concentration of decision making), combined with growing interest in and awareness of the capabilities of the Australian automotive industry, has led to a greater integration of Australia into the global automotive supply chain. All four of Australia's automotive assemblers engage in export activities. For example, Mitsubishi, Toyota and Holden all have significant export markets in the Middle East. Exports of fully built-up vehicles and components have increased significantly in recent years, reaching \$4.94 billion in the year 2001¹⁷ from around \$2.72 billion in 1997.¹⁸

A key factor in the relative success of many of Australia's PMV producers has been the introduction of models that have been able to capture export markets (including a widening of left-hand drive engineering capability). The market position of Australia's locally assembled vehicles does, however, indicate the relative precariousness of the operations given the reliance on manufacturing from a single platform.

Conversely, and contemporaneously, the value of imports has risen from \$12.05 billion in 1997 to \$16.0 billion in 2001. Hence, Australia's trade deficit in automotive products has continued to increase, despite the rapid growth of Australian automotive exports. Despite this deficit, the loss of the Australian automotive industry, including both vehicle assembly and component manufacture, would be expected to have significant ramifications for the national balance of trade. The Federation of Automotive Products Manufacturers notes that, in the local industry's absence:

Imports of vehicles could rise by 260,000 units per annum (the current level of domestic sales of Australian produced vehicles) at a gross cost (assuming \$25,000 per vehicle) of approximately \$6.5 billion. Taken together with the loss of exports of vehicles and components worth \$4.6 billion per annum, and having regard to offsetting reduction in imports of original equipment automotive components (in the order of \$5 billion), the presence of the industry directly improves the balance of payments by approximately \$6 billion – it also improves the terms of trade.¹⁹

Given the possibility of reallocation of production and therefore of exports, this stands as an upper estimate of a balance of payment figure.

2.7 INVESTMENT, R&D AND INNOVATION

Between 1997 and 2005, the automotive industry's total investment expenditure is anticipated to reach \$4 billion.²⁰ Investment in new production capacity (via new pressing panel facilities), a new engine plant and other infrastructure is key to the Australian automotive industry retaining a strong degree of global competitiveness. The commercial nature of investment makes its extent hard to quantify further but, as an example, Mitsubishi in April 2002 committed to a \$976 million investment in South Australia for extensions to its plant

¹⁷ Department of Foreign Affairs and Trade 2001 - www.dfat.gov.au/media/releases/trade/2001/mvt163_01.html

¹⁸ Johns, R. 2001, p. 37.

¹⁹ The Allen Consulting Group & Deloitte Touche Tomatsu 2002, *The Automotive Industry's Contribution to the Australian Economy: A Modern Perspective – Report to the Federal Chamber of Automotive Industries and the Federation of Automotive Products Manufacturers* pg. 41.

²⁰ Hon. John Moore, n.d., "Driving The Future – Australia's Automotive Action Agenda", Competitive Australia.

and a research and development centre.²¹ New investment by Holden to increase plant capacity in South Australia and the construction of a new engine plant in Victoria is expected to total \$2 billion over next five years.²²

The automotive sector is a key driver of R&D in Australia’s manufacturing sector. The importance of these activities will grow as the automotive industry increasingly becomes an industry in which high skill levels, heavy use of advanced design and manufacture skills, and increasing incorporation of knowledge-intensive inputs gain importance in determining global competitive advantage. Already, the growing emphasis placed on alternative fuel sources (such as hybrid petrol electric vehicles utilising fuel cells) as well as the increasing importance of electronics (such as vehicle telematics) is increasing the demands on vehicle R&D. There is a strong possibility that without adequate incentives, much of the scope for this type of critical research to be carried out within Australia could be lost.

Automotive industry R&D is a significant portion of the national manufacturing R&D effort. Annual automotive industry expenditure on R&D has fluctuated around an average of \$400m (as shown in Table 2.4 below), contributing about one fifth of the broader manufacturing R&D effort in each year.

Table 2.4 – Automotive industry R&D spending

Year	Auto Industry R&D Expenditure (\$m)	All Manufacturing R&D Expenditure (\$m)	Auto Industry as % of Total Manufacturing
1997-1998	\$441	\$2,229	19.8%
1998-1999	\$380	\$2,055	18.5%
1999-2000	\$420	\$2,052	20.5%

Source: ABS Catalogue No. 8104.0, Research and Experimental Development, Business Enterprises, Australia.

Table 2.5 below compares R&D efforts in the automotive manufacturing sector of Australia with the entire national R&D effort in terms of thousands of person years devoted to such activities. It shows the industry as increasing its R&D effort on a sustained basis, and also indicates that on a person-effort basis the automotive industry is a slightly more significant component of Australia’s R&D activity than when calculated according to direct expenditure.

²¹ Carol Altmann, “Double or nothing: Mitsubishi’s winner”, *Weekend Australian*, 27-28 April 2002, pg 6.

²² Dialinfolink - www.dialinfolink.com.au/articles/0a/0c00860a.asp

Table 2.5 – Automotive industry R&D effort

Year	Auto Industry R&D Effort (in 1000 person years)	All Manufacturing R&D Effort (in 1000 person years)	Auto Industry as % of Total Manufacturing
1997-1998	2.7	13.8	19.6%
1998-1999	2.8	13.5	20.7%
1999-2000	3.1	14.1	22.0%

Source: ABS Catalogue No. 8104.0, Research and Experimental Development, Business Enterprises, Australia.

2.8 STRENGTHS OF THE AUSTRALIAN INDUSTRY

Australian vehicle manufacturers have so far been able to play a small but growing role in their respective international parents' market strategies. In some cases, components manufacturers have done likewise, such as in the case of Robert Bosch Pty Ltd. Australia has increasingly become a niche global centre in the production of upper-medium size cars, with the ability to seek significant growth potential in derivatives of current vehicle products.

According to a recent review by Austrade, the Australian automotive industry is characterised by a number of significant competitive advantages:

- niche and small volume production;
- highly flexible production lines allowing for rapid tool changeover and the optimising of capital equipment costs;
- strong supporting industries – tooling, services, design and engineering, testing equipment, light metals and raw materials;
- highly educated and skilled workforce; and
- world-class engineering and safety standards for liquefied petroleum gas (LPG) and compressed natural gas (CNG) application.²³

The industry leads the way in niche volume vehicle production from 10,000 to 150,000 units. Given the differences of scale definition in the automotive industry depending on the country being discussed, Australian firms can seek to exploit their position as relatively small but capable and innovative players in the market. In particular, they have a strong advantage in supplying markets such as the US with component and tooling production runs which are often too small to be economic for larger foreign firms but well suited to the scale of some local component producers. In their own way, Australia's vehicle producers also have a significant strength in niche products – for example, the Holden Monaro coupe is anticipated to yield positive financial returns despite having a very small (by world standards) annual production run.

Education levels in the automotive industry are increasing rapidly. From 1995 to the year 2000, the proportion of the automotive workforce with Vocational Education and Training (VET) qualifications more than doubled (from around 20% to 40%) and the proportion of the workforce possessing tertiary qualifications (graduate and post-graduate) also increased significantly in a relative sense, rising in the same period from 13.2% to 14.3%.²⁴ As would

²³ Austrade 2001, *Automotive Capability Review of Australia* – www.austrade.gov.au

²⁴ The Allen Consulting Group & Deloitte Touche Tomatsu 2002, *The Automotive Industry's Contribution to the Australian Economy: A Modern Perspective – Report to the Federal Chamber of Automotive Industries and the Federation of Automotive Products Manufacturers*, p. 30.

be expected, there was a commensurately large reduction in the proportion of the automotive workforce whose formal educational achievement did not extend beyond secondary school level education. (South Australian details can be found later in this submission).

In addition, the Australian industry is a highly sought after 24-hour engineering base as Australia's geographic location and talent allows for the dispersal of 'around the clock' projects to Australia.

These Australian strengths have traditionally been underscored by favourable domestic policy which encourages investment and growth within the industry. Given structural changes in the global industry (see later in this submission), Australia is well-placed to exploit its strengths and establish itself as a vital player in the international sector.

3. THE AUTOMOTIVE INDUSTRY IN SOUTH AUSTRALIA

Although the automotive industry is smaller in absolute size in South Australia than in Victoria, it is relatively more significant in the local context. In summary, in 1999-00 the automotive industry in South Australia:

- employed 13,500 people directly;
- accounted for 16% of the State's total manufacturing workforce;
- had an average wage in the sector of almost \$44,000 p.a., significantly above the State's overall average (approximately \$37,000 p.a.);
- recorded an industry turnover valued at around \$5.3 billion, representing almost a quarter of the State's manufacturing turnover;
- generated approximately \$1.5 billion of exports (in 2000-01), equal to around 17% of the State's total exports for that period;
- provided an industry value-added figure of almost \$1.0 billion, which accounted for over 14% of all state industry manufacturing value-added; and
- accounted for 2.4% of Gross State Product (GSP).²⁵

In addition, the industry is developing increasingly strong links with tertiary institutions within the State and, with enhanced investment in R&D (such as recently announced by Mitsubishi) and improved tertiary training of managers, the South Australian sector is moving to become a centre of automotive excellence.

Two of Australia's four PMV producers are located in South Australia (Holden and Mitsubishi). Around 40 components producers are also located within the State. These have significant linkages to supporting industries (such as steel, plastics and tooling). They benefit from the scale economies that arise from having a relatively large-scale industrial infrastructure in place. The industry also has vital national and international linkages.

3.1 STRUCTURE OF THE INDUSTRY IN SOUTH AUSTRALIA

The motor vehicle industry in South Australia has been an integral part of the economic development of the State historically. With the location of two of the major assembly plants in Adelaide, around 40 component suppliers are also established within the State, and have had substantial success in exporting, as well as supplying the local industry. It is clear that the industry makes a greater relative contribution to South Australia than to the national economy, contributing 1% of GDP nationally and 2.4% to the State.

The following analysis of the industry in South Australia is derived from the input-output tables of the South Australian economy in two periods: 1992-93 and 1999-00. The 1992-93 tables were produced by the SA Centre for Economic Studies in 1995, while the 1999-00 tables were produced by Econsearch Pty Ltd in 2002.

The 1999-00 input-output tables of the State suggest that the automotive industry provides some 6.4% of industry turnover in the State, 2.9% of wage and salary income, and 2.3% of FTE jobs (including 14.5% of jobs in the manufacturing sector). In South Australia, employment in the automotive sector makes up 25% of national automotive manufacturing employment. The industry therefore underpins a large proportion of the South Australian economy, both directly and indirectly.

²⁵ FCAI/FAPM 2002, *A Modern Perspective*, p. 28.

This South Australian perspective on the importance of the industry has been clearly presented to the Productivity Commission in the past, including assessments of the general significance and inter-relationships in the industry. However, the point is worth reinforcing. Moreover, in more recent times as the State has struggled with structural adjustment pressures, the presence of the automotive sector has been critical in underpinning private sector investment and production activity.

Tables 3.1 to 3.2 present the key statistical measures relating to the structure of the automotive industry in South Australia. Estimates for 1999-00 indicate a value of production in automotive assembly and parts of \$5.2 billion. Around \$2.8 billion of this value is made up of intermediate purchases from other local companies and \$1.4 billion of imports from interstate and overseas. Wages and salaries make up \$0.6 billion, leaving returns on capital in the year of less than 10% of turnover.

The input-output tables suggest a number of significant structural changes to the industry over time, including:

- stability in the value of turnover – with an average 2.2% annual increase;
- significant increases in labour productivity – the turnover per employee increased from \$283,000 in 1992-93, to \$389,000 in 1999-00, a 5% nominal increase or over 3% real increase per year on average;
- a decline in wages as a proportion of turnover - by 0.2 percentage points per year on average;
- Increased relative reliance/inter-relationships with the local South Australian economy - with the value of local purchases increasing from 41% of turnover to 55%;
- an overall increase in intermediate inputs to 82% of turnover in 1999-00, up from 68% in 1992-93. (From a South Australian perspective, inputs from out of the State or from overseas have remained relatively constant at 27% of inputs). As noted above, while some of that strengthening of backward linkages has been in components, consistent with the changing technologies being applied, a large proportion derives from support from business services and research; and
- significant increases in overseas exports of product - averaging 16% per annum. It should be noted that ABS statistics for motor vehicles indicate that export growth from South Australia increased even more strongly in 2000-01 and the growth rate over the whole decade was stronger than that indicated in Table 3.1.

Given that the tables are prepared using a combination of ABS data for South Australia and mathematical interpolation, and are a snap shot of a period of time, these findings should not be interpreted judiciously. But the overall thrust is consistent with information from the ABS manufacturing census. The 1999-00 manufacturing census data confirms that in that year industry value-added was low, and the non-wage component was less than 6% of turnover. This compares to 17.5% in 1998-99, which suggests that the value of local and intermediate purchases as a proportion of turnover is somewhat overstated for 1999-00, but the underlying level is still higher than 1992-93.

Table 3.1 – Estimates of key characteristics of the automotive sector in South Australia

	99-00		92-93	
	\$ billion	Propn of Turnover	\$ billion	Propn of Turnover
Value of turnover (\$ billion)	5.218		\$4.48	
Value of local purchases (\$ billion)	2.848	55%	\$1.82	41%
Value of external purchases (\$ billion) – i.e. imports of intermediate goods into SA from interstate and overseas	1.42	27.2%	1.197	26.7%
Value of wages (\$ million)	621	11.9%	565	12.6%
Employment (FTEs)	13,416	2.57 FTEs per \$m turnover	15,845	3.54 FTEs per \$m turnover
Forward linkages				
Exports - Interstate (\$ billion)	3.06	59%	2.999	67%
Exports - Overseas (\$ billion)	0.82	16%	0.291	7%

Source: Input-output tables of the South Australian economy for the relevant periods, produced for the Department of Industry and Trade. The 1999-00 tables were produced by Econsearch Pty Ltd in 2002, while the 1992-93 tables were produced by the SA Centre for Economic Studies in 1995.

Table 3.2 shows the breakdown of local purchases. Purchases within the sector (primarily purchases of components by assemblers) represent an estimated 31% of total local purchases. The other industries of significance include basic iron and steel (14.7%), various services, and paint. Unfortunately the 1992-93 tables were structured on a different basis and did not include the same detail on services – but there has been a substantial expansion in purchases from the services sector which is indicated in the table. The purchases indicated in the 1992-93 input-output tables for the entire finance and business services sector (not shown) amounted to only 6.4% of local purchases. An important component is the significant spending in the scientific research sector, reinforcing the growing linkages in terms of knowledge-based industries.

Table 3.2 - Estimates of local intermediate purchases of the automotive sector in South Australia

	99-00		92-93	
	\$ billion	Prop'n of local intermediate purchases	\$ billion	Prop'n of local intermediate purchases
Local purchases by major sector (\$ billion)				
Components	0.882	31.0%	0.506	27.8%
Iron and steel	0.418	14.7%	0.209	11.5%
Property services	0.216	7.6%		
Wholesale trade	0.19	6.7%		
Business services	0.178	6.3%		
Other chemicals (primarily paint)	0.161	5.7%		
Scientific research	0.113	4.0%		
Other	0.69	24.2%		
Total	2.848	100%	1.82	

Source: As per table 3.1

Table 3.3 indicates the underlying regional multipliers developed for the South Australian economy for the automotive and components sector. These multipliers indicate the impact of a change in final demand for the automotive sector on state economic activity. Their inclusion in an economic model requires careful application (discussed further below) but generally they indicate the linkages the automotive sector has. The value-added linkage remains the same, despite the fall in direct value-added, while the employment linkage has declined partly because of inflation but primarily due to increased productivity in the industry.

Table 3.3 - Estimated multipliers for the automotive sector in South Australia

Multipliers	99-00		92-93	
	Direct	Total	Direct	Total
Value-added	0.179	0.766	0.325	0.7968
Employment	2.6	9.8	3.5	12.7

Source: As per table 3.1

A comparison between Table 3.2 and Table 3.4, which shows the structural statistics for the Australian industry in 1996-97, suggests that the industry in South Australia is significantly more interconnected than the national industry and is less reliant on overseas imports. Wages as a proportion of turnover are lower in South Australia than nationally.

Table 3.4 - Estimates of key characteristics of the automotive sector in Australia

Australia	96-97	
Value of Turnover (\$ billion)	15.267	
Value of local purchases (\$ billion)	6.992	46%
Major sectors		
Components	2.093	29.9%
Iron and Steel	1.224	17.5%
Property Services	0.453	6.5%
Wholesale trade	0.477	6.8%
Business Services	0.332	4.7%
Other Chemicals	0.192	2.7%
Scientific Research	0.218	3.1%
Value of imports into production (\$ billion)	3.510	23%
Value of Wages (\$ million)	2205	14.4%
Forward Linkages		
Exports - Overseas	1.943	13%

Source: Input-output tables of the Australian economy for the respective period, direct allocation of imports, produced by the ABS.

3.2 FACES IN THE INDUSTRY

The above description provides the core characteristics of the industry as a whole, but also hides the fact that an industry is made of individual companies. It is worth considering the nature of the individual companies involved.

Holden has been a critical player in the South Australian economy for half a century. According to Holden, it has been associated with transportation in Australia since James Alexander Holden established a saddlery business in Adelaide, South Australia. The development of the City of Elizabeth, the focus of a national and State immigration program, was primarily related to the development of the Holden assembly plant there in the 1950s. The Elizabeth assembly plant undertakes vehicle assembly, body tool design, stamping, plastic moulding, paint and body hardware. In 2000, production totalled 133,151 vehicles and daily production averaged 563 vehicles.

In 2000, Holden employed around 7,800 people nationally (including subsidiaries),²⁶ 4,300 of whom were employed in South Australia, and had annual revenue of almost \$5 billion. Factory capacity is presently around 140,000 units per year, although it has a present investment plan that would see it capable of building 180,000 units per year by 2008 if implemented. In 1999 it produced \$2.5 billion worth of product and around 130,000 vehicles. (Note that Holden also employs some 3,500 people at Fishermen's Bend, Victoria, where engine production occurs). Holden purchases around \$300 million of component inputs from South Australian suppliers with the bulk of this related to the operations of the Elizabeth assembly plant. In 2001, Holden sold 28,800²⁷ Commodore (and Statesman/Caprice variants) to export destinations such as the Middle East, New

²⁶ IBIS World - <http://www.ibisworld.com.au/alliance/seek/seekco.asp?code=30>

²⁷ Federal Chamber of Automotive Industries, 2002, Media Release, 20 Feb.

Zealand and South America. There is some speculation that certain variants of the Commodore range might also be exported to North America, Europe and several Asian destinations (such as China).²⁸

Mitsubishi Motors Australia Limited is a major player in the Australian vehicle market, with significant investments in capital and people. Almost 3,400 people are employed at the two production facilities in Adelaide. Total turnover in 2000 was \$2.5 billion²⁹ and the number of people employed was approximately 3,360.³⁰ In 2001, Mitsubishi's export volume rose 60% on the previous year to 19,215 units out of total production of around 45,000 units.³¹ The primary export destination for Mitsubishi Australia is the United States, although a significant proportion of vehicles are destined for the Middle East and several Asian markets (except Japan).

3.3 THE IMPORTANCE OF THE INDUSTRY: A CASE STUDY

The importance of the industry may be demonstrated by using Mitsubishi as a case study. The following study analyses its contribution to the State economy. Withdrawal of Holden from the South Australian and national economies would impact even more heavily.

The core functions being undertaken at Mitsubishi's two plants in South Australia include:

- Assembly - the production facilities at Tonsley Park and Lonsdale produce the Magna and Verada range. The vehicle assembly plant at Tonsley Park can produce up to 320 vehicles per day for domestic and export markets, and the assembly plant at Lonsdale provides V6 engines.
- Component Manufacture - The Lonsdale plant, one of Australia's largest foundries for the production of secondary components, manufactures engine components for the domestic and export markets.
- Tooling Facilities - The Tonsley Park plant also houses a tooling maintenance facility, providing skilled labour, up-to-date NC equipment and services both to Tonsley Park manufacture and the Lonsdale engine plant. Activities undertaken included die repair, jig and fixture construction and maintenance, general fabrication work and the manufacture and maintenance of engine core boxes.

The direct employment of almost 3,400 people at Mitsubishi³² represents only part of the influence the manufacturer has on the South Australian economy. Because of the effects of purchasing and supplying there are many linkages that need to be considered. An indicative estimate for the total effect is provided below.

The direct employment of 3,400 people translates into the payment of wages to the order of \$180 million. The spending of the wages and salary incomes within the local community could, using industry (input-output based) multipliers,³³ be expected to support in the order of \$100 million worth of value-added in local businesses and support an additional 1,600 jobs.

²⁸ GoAuto website - www.goauto.com.au/mellor/mellor.nsf/story2/NT004BA93A

²⁹ IBIS World - www.ibisworld.com.au/alliance/seek/seekco.asp?code=81

³⁰ Mitsubishi Motors Corporation 2001, *Facts and Figures 2001*, October – www.mitsubishi-motors.co.jp

³¹ Automotive Online - www.automotive-online.com/English/Channel_1/News_Australia_Left.htm

³² Mitsubishi Motors Corporation 2001, *Facts and Figures 2001*, October – www.mitsubishi-motors.co.jp

³³ These multipliers are derived from input output tables for South Australia – adjusted for inflationary and productivity changes over time, and in cases for supply side constraints.

As well as the Mitsubishi-produced components, there will be component purchases from other companies in the State. Industry averages suggest that the value of an assembled car is made up of some 40% of input components and that about 30% of that value could be expected to be locally sourced. Using this as an indication, it would be reasonable (and probably conservative) to expect that some \$150 to \$200 million of inputs for the Mitsubishi processes would be sourced locally. This would directly and indirectly support some \$130 to \$160 million of value-added incomes and support between 1,500 and 1,800 jobs. In the absence of Mitsubishi, some of this material may be diverted to Holden or interstate.

There are also a range of other purchases from the local economy (eg finance industry services, office supplies, electricity and water). Again, industry averages suggest these would be in the order of 20-30% of value, and if it is assumed that 50% is supplied locally, this would suggest in the order of \$200 million of expenditure within the SA economy, supporting value-added incomes of some \$180 million and some 3,000 jobs (the jobs impacts for the non-manufacturing sector are somewhat higher than for motor vehicle manufacturing).

The importance of the Mitsubishi activities to the state economy is clearly indicated in the magnitude of the above figures. Directly and indirectly, and using conservative linkage relationships, the operations of Mitsubishi account for the creation of incomes (ie relevant contribution to Gross State Product) in South Australia of an estimated value in the order of \$600 million. (Note that this excludes the other value-added or returns on capital accruing to Mitsubishi itself which are significant – which is in turn inter-related with investment).

These estimates of implications of the operations of Mitsubishi on the State of South Australia are undertaken firstly by estimating the direct employment and investment contributions (to estimate direct outcomes) and then by estimating the underlying support expenditures and tracing them through input-output (adjusted for supply side constraints) multipliers for the state economy. In general this is a reasonable methodology at the state level in the context of the importance of job outcomes and regional activity representing economic welfare at the state level. However, it is emphasised that these multipliers have been adjusted to reflect productivity shifts in industry generally.

Impacts (and therefore implicit multipliers) derived from alternative models (eg a CGE model, which acknowledges supply constraints) would usually provide a slightly more conservative estimate than the straight application of input-output multipliers – but, in the context of the adjustments in the assumptions used in this study and the relative labour force flexibility between states, the results of a CGE modelling exercise versus the use of these adjusted multipliers would not be significant. A comparison of studies in the past in which both input-output models and CGE models have been used to assess the same issues suggests that, at the State level where similar scenarios are modelled, the outcomes are in the same order of magnitude.

This is of course dependent on a focus on outcomes at the State level. At the national level it is “usual” that a CGE analysis of the loss of a company would result in no changes in employment and in itself minimal changes in consumer welfare (the typical measure of benefit in a CGE analysis). Indeed, if government subsidies are required to support a company, CGE analysis would generally suggest that nationally there would be consumer welfare gain from not supporting the company. Exchange and wage rate adjustments would result in other industries picking up the “slack”. There would be compensating gains in employment and in economic activity (as well as in consumer welfare), primarily in other states which offset the losses.

The 1997 Productivity Commission Inquiry into the automotive sector incorporates Monash CGE modelling that indicates a 6% decline in the automotive sector nationally (evenly spread across the automotive states in response to tariff reductions) would result in 1,100 jobs lost in South Australia. It also cites modelling, using the Murphy CGE model, which suggests that a 25% decline in the automotive sector would result in 10,000 jobs lost in South Australia. Given the significance of Mitsubishi Motors in SA and in the context of the national automotive industry, these results suggest that the estimates above are, if anything, very conservative.

3.4 RECOGNITION OF THE NON-LINEAR RELATIONSHIPS

The measures of significance provided above, and modelling results that will be developed by the Productivity Commission in its consideration of the issues, are limited by the extent to which modelling can hope to reflect reality. Necessary, but simplifying, assumptions limit the extent to which the modelling can reflect reality, and such modelling is intended really to identify directions and orders of magnitude changes. In particular, such models use elasticities of supply and demand based on historical estimates and based around a small changes context.

It is the South Australian Government’s contention that modelling such a significant industry as if it represents “small changes” is not “appropriate”, particularly in the regional context.

From a South Australian perspective particularly, but also extending to the national context, issues such as a critical mass and key supplier relationships are important in sustaining activity within the State and nation. Some of the arguments that are relevant here are as follows:

- If an assembler is lost there is little likelihood that more than a small proportion of the output will be picked up by another local company – it is more likely to be replaced by imports. This is based on historical evidence (ie see what has happened with the demise of Nissan) and the highly competitive nature of the international industry.
- The Australian automotive industry has worked hard to improve efficiencies and lift productivity in response to falling prices resulting from the tariff decline. The possible responses to price falls are to reduce unit costs and/or increase volume of production to achieve greater economies. While the industry recognises that there are additional actions to be taken to improve efficiencies, and that structural change will continue, the profit margins of the industry remain low and output is only marginally above break-even. As the industry reaches its limits of improving relative efficiency, the

issue of improving outputs becomes critical. For example, an establishment with 25% of costs fixed and a linear variable cost relationship would require sales volumes to increase by 25% to maintain break-even point in the event of a 5% price decline – all other things equal. The increase in volume will be higher for lower fixed cost proportions and less for higher fixed cost proportions. In short, reductions in price must lead to either reduced costs or reductions in profit – and in the end corporations will consider the costs of relocation against those issues.

A second factor to consider in the modelling is that changes in the industry will not be evenly spread across firms or regions as they respond to tariff changes. A reduced domestic market has the potential to result in the closure of individual plants rather than be spread across plants. South Australian operations remain at risk – Mitsubishi because of overall volume and scope, Holden at Elizabeth because of the current multi-plant set up and pressure to consolidate. While this can be recognised specifically in the modelling, the issue extends to component suppliers. Component suppliers in South Australia are located in the State because of the presence of Holden and Mitsubishi – but also supply other national assemblers and exports.

A relevant question is therefore what would be those firms' locational decisions in the absence of one or both of these assemblers. The expectation is that in the medium term the "loss" of one of the assembling plants within SA would lead to a greater than proportional loss of value in component suppliers as they relocate whole businesses closer to key markets interstate or overseas. There would also be the loss of indirect businesses. If it is indicatively assumed that, on average, component suppliers have one dollar of other markets for every dollar of input into the SA assemblers, the economy-wide impacts would potentially be twice that estimated in the models, placing the whole components sector at risk.

These arguments are relevant in the context of current industry structures, but the relationships will become even more important due to the changes occurring in the assembly and component sectors. The process of modularisation has resulted in components producers manufacturing larger and larger vehicle segments which are simply dropped into place – whole sections at a time. This implies that the component industry will also grow and take more responsibility for vehicle production. Under the current (and what will become the old) technology structure, there is the possibility of losing "bits" of the industry in an unpredictable manner based on the contribution of the automotive sector to critical mass. With modularisation, a region may instead lose larger "slabs" of the component sector and so find itself much diminished in the international supply chain. Potentially, the negative impact becomes greater and may be particularly acute in smaller economies such as in South Australia.

In a more dynamic context, the critical mass issue is significant in terms of skill transfer and the attraction of other investments. A key feature that has emerged, and is emphasised in papers like the Allen Consulting Group's report *The Automotive Industry's Contribution to the Australian Economy: A Modern Perspective*, is the importance of research and development and the contribution of the automotive sector to the knowledge industry. In a simple way this is reinforced by the purchase of inputs of the industry from the scientific and technical research sector with over \$100 million of expenditure locally in SA and over \$200 million per annum nationally.

The South Australian Government would reiterate that the automotive sector's role in skill and knowledge development is critical. In many ways this is an extension of an old argument for supporting the sector – the defence effect. A traditional argument for supporting automotive industry development was that it gave a national economy flexibility to shift resources into defence products in the case of national security issues. The argument has matured, but is similar. That is, an active automotive sector, as one of the single largest product markets within a nation, supports skills and research development that translates across to other industries for a national gain.

4. GLOBAL INFLUENCES ON THE AUSTRALIAN AUTOMOTIVE INDUSTRY

As the key global manufacturing groups look to leverage their automotive development resources located across the globe, the opportunities as well as the challenges facing the Australian automotive industry have never been greater. Although Australia has long had an automotive industry that is inextricably linked to the global industry (if mainly through ownership and investment flows), it is only in relatively recent times that automotive groups are seeking to fully exploit the synergies and specialisation opportunities provided by their global networks.

Each of the multinational automotive manufacturers with production facilities in Australia has been engaged in a similar approach to dealing with the globalisation trend, particularly in the case of Holden and Ford who:

Are all in the process of integrating their worldwide businesses. Each has different design, development, and industrial structures, but the underlying theme is the same: sharing costs across regions, designing products flexible enough to be tailored to local tastes, and increasing global sourcing.³⁴

These developments cover a range of issues, as discussed below.

4.1 MERGER AND ACQUISITION ACTIVITY

To some extent, the international automotive industry has experienced a more turbulent recent history than the local industry. Merger and acquisition (M&A) activity in the automotive industry has been occurring on an unparalleled scale in recent years, with merger, acquisition and alliance activities worth around A\$220 billion occurring in 1999.³⁵ These activities have resulted in a continued consolidation of the control and ownership of previously independent marques and component suppliers.

The chairman and managing director of Holden, Peter Hanenberger, has described the situation in which Holden is presently situated as follows:

The world automotive industry is moving rapidly towards a structure in which only the truly global will survive. Each global entity will need to consist of two types of operation. There will be the large high volume mass-market organisations with enormous profit potential offset by all the agility of a dancing hippopotamus. And these will be complemented by quasi-separate specialist niche-filler organisations that thrive on chaos and dance in and out without being crushed by the hippos.³⁶

³⁴ Sage, L. 1998 (on Ernst & Young website), 'Is Global Overcapacity Hurting the Industry', p. 6 -

www.ey.com/global/gcr.nsf/International/Auto_Overcapacity-Automotive

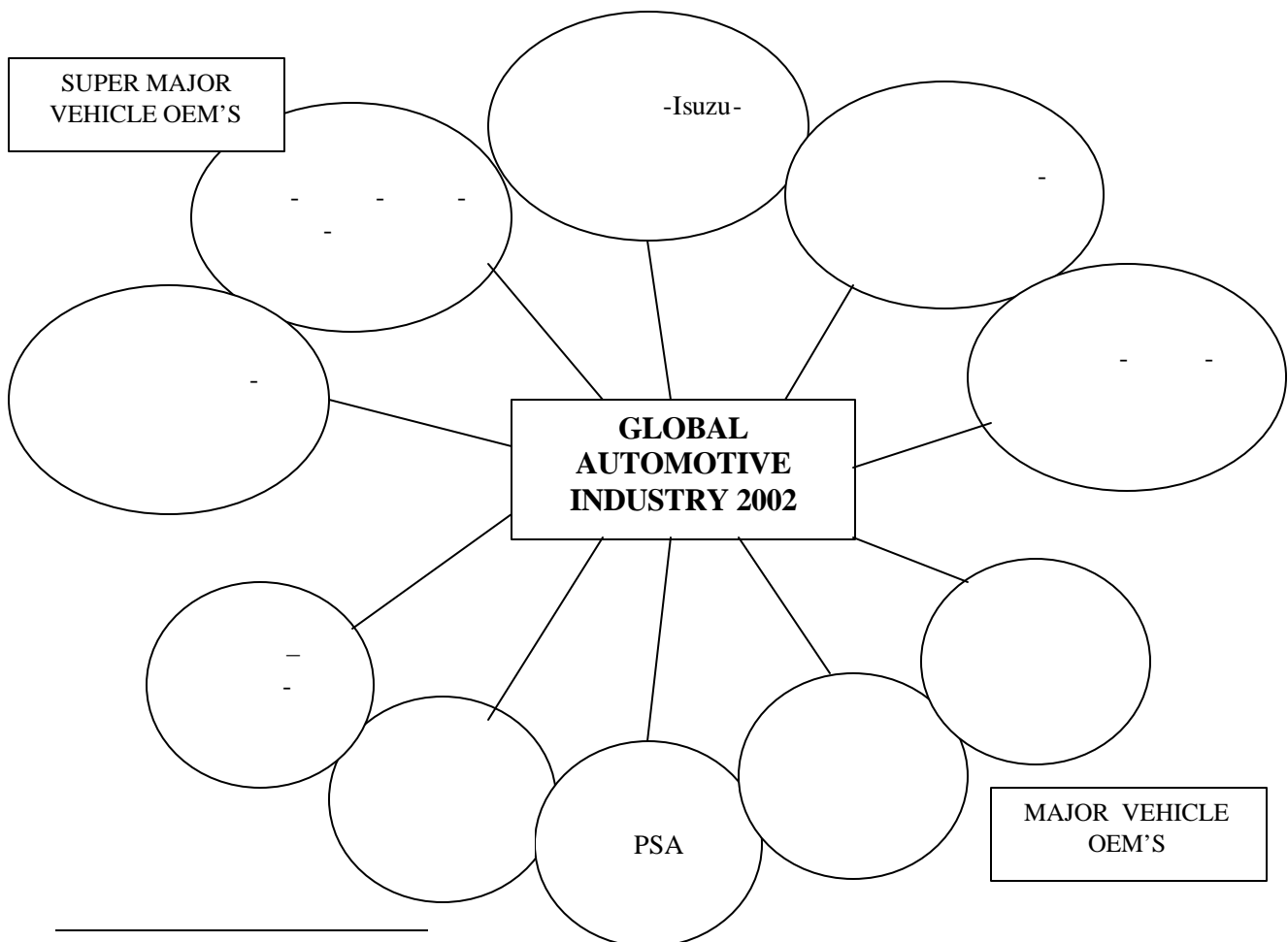
³⁵ PricewaterhouseCoopers Global 2000, Press Release, 22 May – www.pwcglobal.com

³⁶ Committee for the Economic Development of Australia 1999 - www.ceda.com.au/Bulletin/0003Going%20global-Peter%20Hanenberger.htm

Global consolidation has focussed attention on the capabilities and skills that the Australian division of each firm can offer to the global parent. As each multinational with operations in Australia now has operations in at least two-dozen other nations, the intra-firm competition is intense. Competition is now between divisions of the parent firm as much as between competing global companies. The practical result of this is that local automotive assemblers must both achieve profitability and find themselves a productive niche within the global strategic plan.

After the most recent bout of mergers and acquisitions, there are now ten major players - five 'super major groups' and five 'major groups' - involved in production of vehicles (represented in Figure 4.1). It has been estimated that by 2010, there will be only five (consolidated) major players in the industry.³⁷ Other forecasts indicate that by 2010 the global automotive industry will be dominated by just six 'Super Major' manufacturers with potentially only Honda left as an independent 'Major' manufacturer.³⁸ At present, the top six automotive groups account for approximately 86% of the world's annual production of approximately fifty-five million cars.³⁹ Although the categorisation of the manufacturers by size varies, the underlying story of an increasingly concentrated industry remains constant.

Figure 4.1 – Vehicle OEM Groupings



³⁷PriceWaterhouseCoopers 2000, 'Even Without Big Car Company Deals, Global Consolidation Will Continue

www.pwcglobal.com/extweb/indissue.nsf/DocID/C30555ED103B90DB852569AC00647CB1

³⁸ Wormald, Dr. J. 2002, Presentation, 'The World automotive industry and Australia', Autopolis, 21 March.

³⁹ Wormald, Dr. J. 2002

4.2 COMPONENT SUPPLIER TIER INTEGRATION

M&A activity has not been limited to the large vehicle assemblers. The components industry, although lower profile by nature, has also been subject to considerable consolidation. Recent M&A activity in the Australian component sector has included the Arrowcrest purchase of TRW's steering business and Austrim Nylex's purchase of Invensys' engineered polymers business.⁴⁰ It has been estimated that:

By the year 2010, only 25 to 30 Tier 1 suppliers will survive globally, all of them focussed on core competencies - and that is down from the more than 600 Tier 1 suppliers currently. A similar downsizing is underway among the 10,000 Tier 2 suppliers, which will be whittled down to about 600 over the same period.⁴¹

Australian component suppliers will therefore face a growing incentive to access export markets, including in the relatively undeveloped but rapidly growing Asian region,⁴² in order to integrate themselves into a supply chain that is expected to become increasingly narrow. It is recognised that parent firms based overseas will also play a role in allocating markets to their subsidiaries located around the world, including in Australia. Without appropriate market access, however, the dynamics of choosing Australia as a supply source will be altered in a detrimental manner.

In what is a global trend, design, R&D and investment have increasingly been shifted from vehicle assemblers to components producers. The increasing demands on components suppliers have resulted in the formation of what some in the industry characterise as the creation of 'Tier 0.5' level of suppliers, ie suppliers that are producing increasingly large segments or modules of vehicles for inclusion directly into the final vehicle.

Modularisation, whereby a variety of components sourced from numerous suppliers are combined in a final product ready to be 'dropped in' to the actual vehicle within the factory, is a growing trend within the global automotive industry. This process therefore demands that a growing proportion of R&D, investment and design efforts is carried out at the component supplier level rather than by the vehicle assemblers themselves. It is relatively common for this process to offer a supplier a greater degree of certainty in being selected as a source of components in return for the greater degree of risk borne by taking on such an expanded role.

4.3 SCALE AND CAPACITY ISSUES

The global automotive industry is marked by significant over-capacity (in a technical sense of capacity exceeding demand), much of which relates to the important role that volume can play in yielding cost efficiencies. The automotive industry is a relatively capital intensive

⁴⁰PriceWaterhouseCoopers 2000, 'Consolidation Sweeps Automotive Industry' - www.pwcglobal.com/extweb/ncpressrelease.nsf/DocID/93FEA232C6F4D7DC852568E70016E996

⁴¹PriceWaterhouseCoopers 2000, 'Even Without Big Car Company Deals, Global Consolidation Will Continue

⁴² The Asian region is projected to account for 30% of global automotive volume by 2006 - www.pwcglobal.com/extweb/ncpressrelease.nsf/DocID/93FEA232C6F4D7DC852568E70016E996

one, and much of its production processes are characterised by high fixed costs (both in product/model development as well as in actual production plant) and relatively low variable costs.

It is estimated that the current global automotive production capacity of seventy million units is serving an annual global demand for around fifty-five million vehicle units.⁴³ Given the potential for 'third shifts' and other techniques to increase a vehicle plant's physical capacity, this figure may be understated. The over-capacity issue is further complicated by:

- the differentiation of vehicle segments (over-capacity is more common to plants that manufacture smaller vehicles); and
- varying definitions of what constitutes a manufacturing plant (ranging from assembly of kit vehicles to full stamping and painting plants).

Much of the over-capacity is located within Asian nations, where commitment to various national car projects has often led to widespread repudiation of trade liberalisation on most matters pertaining to automotive trade.

4.4 GLOBAL AUTOMOTIVE INDUSTRY ASSISTANCE

The global automotive industry is characterised by subsidisation, protection and assistance. The extent of assistance is unknown - countries are not renowned for publicising assistance measures and much information is deemed commercial-in-confidence. This said, assistance can be broadly categorised into three groupings:

- protection from imports in the form of tariffs and non-tariff barriers to trade,
- investment attraction incentives, and
- measures to build industry capability, including innovation capability.

In their February 2002 report, the Allen Consulting Group and Deloitte Touche Tohmatsu examined assistance measures in eleven⁴⁴ comparator overseas countries. The report divided the countries into two categories, developed and developing countries. A conclusion of the report was that:⁴⁵

- developed nations have moved away from offering their domestic industries protection from foreign imports and towards providing investment attraction incentives and assistance to build innovation capability (such as R&D incentives and subsidised training), although Japan is the exception to this rule; and
- developing countries tend to have higher barriers to trade than developed countries and also provide significant incentives to attract foreign investment.

⁴³ Sage, L. 1998 (on Ernst & Young website), 'Is Global Overcapacity Hurting the Industry', p. 6 - www.ey.com/global/gcr.nsf/International/Auto_Overcapacity-Automotive

⁴⁴ Germany, Japan, USA, Canada, Sweden, UK, Republic of Korea, Malaysia, Thailand, Poland, South Africa.

⁴⁵ The Allen Consulting Group & Deloitte Touche Tohmatsu 2002, *Benchmarking the Automotive Industry Policy Environment – Report to the Federal Chamber of Automotive Industries and the Federation of Automotive Products Manufacturers*, February.

4.4.1 TARIFF AND NON-TARIFF BARRIERS TO TRADE

The ability of the Australian automotive industry to win export orders has been and will continue to be hampered by trade protection measures in key markets, particularly in Asia. There continues to be a lack of progress in some areas in market access gains through Asia Pacific Economic Cooperation (APEC) and World Trade Organisation (WTO) processes.

Table 4.1 shows tariff levels in APEC economies and highlights the significant tariff barriers to vehicles imports that exist in a number of key Asian markets such as the PRC, Indonesia and Malaysia. The table highlights the general divergence between developing and developed countries within APEC in regard to the level of tariff protection afforded to domestic automotive industries. Developed countries generally have lower tariffs, while developing countries have higher tariffs, however the Republic of Korea is an exception to this trend. In almost all APEC countries tariffs on imported components are significantly lower than on assembled vehicles.

Table 4.1 - Automotive tariffs in the APEC region

Country	Automotive Tariffs		
	Car	Truck	CKD/Parts
Australia	5% - 15%	5% - 15%	5% - 15%
Canada ¹	6.1%	6.1%	0%
Chile ²	10%	10%	10%
China (PRC) ³	80%-100%	30% - 50%	35% - 60%/20% - 50%
Philippines ⁴	30%	3% - 30%	3% - 10%
Peru	12%	12%	12%
Hong Kong	0%	0%	0%
Indonesia ⁵	65% - 80%	5% - 45%	0% - 50%
Japan	0%	0%	0%
Korea	8%	10%	8%
Malaysia ⁶	35% - 300%	30%	0% - 120%
Mexico ⁷	20% - 30%	23%	13% - 23%
New Zealand	0%	0%	10% - 17.5%
Russia	30%	10% - 20%	5% - 25%
Singapore	0%	0%	0%
Taiwan ⁸	30%	30% - 37%	15%
Thailand ⁹	80%	40% - 60%	10% - 20%
United States of America ¹⁰	2.5%	4% - 25%	2% - 4.4%
Vietnam ¹¹	100% - 200%	60%	30% - 60%

Source: United States Automotive Trade Policy Council, 2001, as modified by DFAT in respect of China and Taiwan Accession to the WTO

Notes:

¹ 0% for USA, Mexico and Chile.

² 0% for Argentina, Brazil, Canada, Mexico.

³ Acceded to the WTO December 2001. By Mid 2006 tariffs phased to: Cars 25%; Trucks 20% - 30%; Parts 10%.

⁴ Vehicle tariffs not bound in WTO. Commitment to reduce tariffs for AFTA countries to between 0% and 5% by 2002.

⁵ Vehicle tariffs not bound in WTO. Commitment to reduce tariffs for AFTA countries to between 0% and 5% by 2002.

⁶ Vehicle tariffs not bound in WTO. Commitment to reduce tariffs for AFTA countries to between 0% and 5% by 2002 (Cars by 2005).

⁷ 0% for Canada and United States by January 2004. 0% for EU, Colombia, Venezuela by 2007. 0% for Chile.

⁸ Acceded to the WTO December 2001. By 2010 tariffs will be phased to 17.5% (vehicles) and 9% (parts).

⁹ Commitment to reduce tariffs for AFTA countries to between 0% and 5% by 2002.

¹⁰ 0% for Mexico and Canada.

¹¹ Commitment to reduce tariffs for AFTA countries to between 0% and 5% by 2006. Not a WTO member.

Table 4.2 summarises tariff and non-tariff barriers identified in 11 markets by the Allen Consulting Group & Deloitte Touche Tohmatsu:⁴⁶

Table 4.2: Automotive Tariff Rates in Selected Countries

Country	Automotive import tariff rates	Non-tariff barriers to trade
Canada	6% on vehicles and automotive components; imports from NAFTA members will be duty free in 2003.	No significant non-barriers to trade
Germany	No tariff is levied on goods originating from other European Union (EU) countries. The EU has common tariff rates of 10% on PMVs and 3.5% to 4.5% on automotive components from non-EU countries.	No significant non-barriers to trade
Japan	No tariffs on automotive imports.	Barriers include the Vehicle Type Approval system; design rules; environmental and safety standards; a complex and rigid vehicle distribution system.
Korea, Republic of	8% for PMVs and between 10% and 13% for automotive components	A variety of customs delays and indirect taxes on automotive imports. Until recent Koreans were required to indicate the make and model of their cars on tax returns. The result of owning a foreign car would be a tax audit.
Malaysia	140% to 300% for PMVs; 60% to 200% for 4WD; 25% to 42% on components	A local content scheme requiring 45 to 65 percent local content in PMVs; a quota on imported vehicles; and restrictive and discretionary applied import licenses.
Poland	A range of tariff rates ranging from 0% to 293% dependent on the vehicle type and the country of origin. No tariff is levied on goods originating from other European Union (EU) countries.	The excise tax on vehicles is higher on imported vehicles than domestic vehicles; customs clearance fees; lack of transparency in the application of customs procedures.
South Africa	23% to 40% dependent on vehicle size; currently 30% on vehicle components but will fall to 25% in 2007	No significant non-barriers to trade
Sweden	No tariff is levied on goods originating from other European Union (EU) countries. The EU has common tariff rates of 10% on PMVs and 3.5% to 4.5% on automotive components from non-EU countries.	No significant non-barriers to trade
Thailand	60% to 80% on vehicles; 10% to 46% on automotive components	Excise duties of between 35 and 48 per cent on imported vehicles ; customs regulations that lack transparency and consistency, however this is improving.
United Kingdom	No tariff is levied on goods originating from other European Union (EU) countries. The EU has common tariff rates of 10% on PMVs and 3.5% to 4.5% on automotive components from non-EU countries.	No significant non-barriers to trade
United States	2.5% on PMVs and automotive components; 25% on light trucks	No significant non-barriers to trade

Source: The Allen Consulting Group & Deloitte Touche Tohmatsu 2002, *Benchmarking the Automotive Industry Policy Environment – Report to the Federal Chamber of Automotive Industries and the Federation of Automotive Products Manufacturers*, February.

⁴⁶ Information on countries such as Thailand and Malaysia differ from the information presented in Table 4.1 reflecting the different sources of information.

The table highlights the considerable level of assistance given by developing countries to prevent entry to foreign exports when compared to developed countries. For example, Malaysian PMV tariffs on vehicles range from 140% to 300%, whereas the common external tariff on automotive products by the European Union is 10%. Tariffs on components are equally variable, but in general lower – in Malaysia these range between 25% and 42% compared with the EU where components tariffs are set at negligible levels between 3.5% and 4.5%. Within the EU, there are no tariffs on EU-produced automotive goods.

Table 4.3 also demonstrates that non-tariff barriers to trade are widespread, although harder to quantify and, in many cases, to identify. They include mechanisms such as complex import regulations, design rules, import licensing restrictions, and local content rules – but are in no way limited to these. The fine web of disincentives on the importation of motor vehicles may be illustrated by the Republic of Korea's (ROK) recently discontinued practice of subjecting purchasers of foreign vehicles to a tax audit.

4.4.2 OTHER FORMS OF ASSISTANCE

Automotive industry assistance is not limited to trade barriers and restrictions. Assistance designed to build domestic capacity and competitiveness includes incentives to attract foreign investment, incentives to encourage R&D, and measures to promote education and training.

Incentives come in many forms, but the most popular are cash grants, tax holidays, interest free loans, investment credits that can be used to offset import duties and/or taxes, production subsidies and incentives to support activities in regional areas. As Allen Consulting Group & Deloitte Touche Tohmatsu found in their February 2002 report:

Recognising the growing importance of innovation to the future of the automotive industry and the need for automotive companies to have access to well educated and highly trained people there has been a trend in virtually all countries considered for support to be provided not only for R&D programs but also for special education and training programs aimed at the automotive industry.⁴⁷

The report identified differences in the types of assistance offered between developed and developing countries, namely:⁴⁸

- Developed countries, especially the US, the UK and Germany, provided generous investment incentives to attract and retain major investments in automotive industry production and R&D facilities. However, individual state/regional governments in each country, as distinct from national governments, offer the bulk of the assistance.
- Developing countries seeking major investments in their automotive industries have adopted two broad models: championing national industry with largely local ownership and actively seeking investment from and relocation of the leading automotive

⁴⁷ The Allen Consulting Group & Deloitte Touche Tohmatsu 2002, *Benchmarking the Automotive Industry Policy Environment – Report to the Federal Chamber of Automotive Industries and the Federation of Automotive Products Manufacturers*, February, p. 2.

⁴⁸ Allen et al 2002

companies. Those following the second model generally offer generous tax holidays as their primary investment attraction activity.

Three national examples – Malaysia, Thailand and the US - illustrate varying approaches to industry development assistance for capital investment (including re-investment), R&D, and skills development and training.⁴⁹

Malaysia is following a ‘national champion’ model, which involves the exclusion of foreign automotive products in the home market and the direct provision of capital investment into the industry. In Malaysia, investment incentives designed to attract both domestic and foreign investment include payment of tax on only 30% of income for five years, an investment tax allowance of 60% for five years on new capital expenditure, an accelerated capital allowance of 40% in the first year and 20% in years two and three and a reinvestment allowance of 60% of capital expenditure for firms who have been operating in Malaysia for a minimum period of 12 months.

In Thailand the automotive industry is a ‘targeted industry’. Companies that invest in the industry receive an eight-year corporate tax exemption and exemptions from import duty on machinery. If the investment is in a designated investment promotions zone, further incentives, such as three- to eight-year extensions on corporate tax exemptions and a five-year exemption on duty payable for the import of manufacturing inputs, are available.

R&D support varies. The US Federal Government offers a tax credit of 20% on R&D expenditure over historical levels and 20% of any payments to research organisations, while a number of US states provide R&D assistance in individual company support packages. Both Malaysia and Thailand have a 200% tax concession on eligible R&D expenditure, while the Malaysian Government will also provide funding to majority-owned Malaysian companies of between 50% and 70% of eligible R&D expenditure.

Education and training measures in the US vary from state to state, with incentives ranging from education and training grants, courses and program development, and tax credits. In Malaysia, companies can claim 95% of eligible training activities and there is a 200% tax refund on a range of eligible training expenditure. In Thailand, there are no formal programs but assistance is offered on a case-by-case basis.

In addition, government supply of infrastructure support (both hard and soft), bureaucratic resources, and marketing programs also contribute to national efforts to attract investment and sway decisions on plant locations.

A quantitative analysis of global industry development assistance is beyond the scope of this submission – and is deemed to be a difficult task in any case, given the hidden nature of much assistance. The conclusion from the limited study by the Allen Consulting Group & Deloitte Touche Tohmatsu and from anecdotal evidence, however, is that assistance is broad, widespread and, in many cases, generous. The automotive industry globally is the recipient of very significant national support.

⁴⁹ Allen et al 2002

4.5 ENVIRONMENTAL STANDARDS

Environment standards are a core concern in the automotive industry. International obligations, standards harmonisation and trends in materials use are all contributing to a strong demand on local producers to implement considerable change in their practices. In the near future, there are three key environmental matters that are likely to exert significant influence on the viability of the Australian automotive industry:

- environmental standards and policy (for example, Kyoto Protocol and the development of low emission vehicles);
- regulation of vehicles and fuel specifications; and
- extended producer responsibilities.

These will present both challenges and opportunities to the Australian automotive industry.

The environmental performance of new vehicles in Australia is regulated by Australian Design Rules (ADRs) made under the Commonwealth's *Motor Vehicle Standards Act 1989*. Commonwealth policy seeks achievement of harmonisation with international standards, namely the European standards. This will occur in 2006 by which date the ADRs for both diesel and passenger vehicle emissions will adopt Euro 4 and Euro 3 specifications, respectively. By then the fuel quality standards set by the Commonwealth *Fuel Quality Standards Act 2000* and based on the relevant European motor vehicle fuel specifications will also take effect, recognising that vehicle and fuel characteristics both affect emissions performance.

As noted in previous chapters of this submission, the Australian automotive industry is increasingly pursuing markets across the entire globe. One challenge will be meeting increasingly stringent international environmental standards. Particularly in Europe, there is a strong and growing tendency towards both the adoption of strict emission standards (from a greenhouse emission perspective, as well as of noxious emissions) as well as an emphasis on the life-cycle of the vehicle itself.

Whether or not Australia ratifies the Kyoto Protocol of the United Nations Framework Convention on Climate Change it is very likely that Europe, the United Kingdom and Japan will ratify prior to 2005. Australia and the United States will be under pressure as parties to the Framework Convention to take action which at least parallels that being taken by Europe and Japan. Both for greenhouse gas emission reduction and air pollution reduction there is likely to be a substantial international pressure to develop low emission vehicles, either for part or the total of the manufactured fleet. It will be critical that Australian manufacturers do not get left behind in their future planning by not recognising this factor and that vehicles produced meet the standards of trading partners.

Meeting standards (domestic and international) will require investment in designing, tooling up, producing engine management system refinements and exhaust cleaning technologies and converting to new emission test cycles. Moreover, overseas manufacturers also geared to European standards will be highly competitive in the Australian market in relation to domestic sales.

Australia's niche is increasingly in medium to large vehicles with (correspondingly) large engines. Though there are a variety of ways to meet the growing regulatory challenges, and

there is not necessarily a direct link between engine/vehicle size and emission output (owing to technology differences, for example), the burden on local automotive producers is likely to be significant. Low production volumes increase the relative burden (per unit produced) of developing new technologies to meet national and international environmental standards. Smaller production runs, such as exist in Australia, reduce the opportunities to spread costs, disadvantaging the Australian industry relative to other global segments of the sector. Australian adoption of European fuel quality standards will also impact on the tuning of engines in domestic vehicles to minimise their environmental impact.

Regulatory requirements in Europe now address the life-cycle of materials used in vehicles; capability to recycle vehicle components is increasingly expected. Over the past decade, the European Community has implemented the concept of Extended Producer Responsibility (EPR), which places primary responsibility for the ultimate disposal and recycling of products at the end of their life on their manufacturers. This growing focus is likely to increase the demands on Australian producers to incorporate systems that facilitate environmentally efficient recycling of components, recovery of hazardous materials and, ultimately, might involve the recovery by industry of vehicles that have reached the end of their useful lives.⁵⁰

Although Australia does not presently have a system equivalent to the European Union's on the life-cycle of motor vehicles, South Australia already operates a system that reclaims a significant proportion of the materials (mainly metals) contained within disposed vehicles. Despite this, a requirement to meet the actual requirements of the various EU Directives would impose a significant barrier on trade in automotive products. Present export plans of Australia's four manufacturers are largely concentrated on non-EU nations, which reduces the compliance cost burdens on the local automotive industry.

Changes in environmental regulation also pose some opportunities for Australian producers. For example:

It should be noted that Daimler-Chrysler is leading R&D for automotive fuel cell technology. As such there could be potential for it concentrating that R&D and early production in Adelaide, at the Mitsubishi plant, to take advantage of the relatively smaller facility with proven operating efficiency and backed by Australia's reputation for engineering innovation.⁵¹

For example, the small Australian market may enable Australian producers to pioneer new technologies such as fuel cells. Opportunities also exist in the development of hybrid vehicles such as the ECOmmodore, which use significantly innovative Australian-sourced technologies such as super capacitors.

In terms of market development, the global trend to harmonisation with European standards will benefit Australian vehicle manufacturers which export to Europe and other nations with equivalent standards. Global standards diminish the need for costly upgrades to models designed for one market and then destined for another.

⁵⁰ Department of Environment and Heritage 2002, Government of South Australia.

⁵¹ Department of Environment and Heritage 2002, Government of South Australia.

4.6 NEW BUSINESS PRACTICES

E-commerce has emerged as a possible driver of the new consolidated global automotive industry, with the creation of a worldwide Business-to-Business (B2B) e-commerce exchange named COVISINT. Involving Ford, General Motors, DCM, Renault-Nissan and Toyota, it is anticipated that this global trading exchange might eventually handle 60% of global automotive B2B activity.⁵² Developments such as this could have profound impacts on global automotive procurement practices and serve to provide a reminder of the importance of seemingly non-automotive related microeconomic reform in areas such as communications.

⁵² PricewaterhouseCoopers, 'Consolidation sweeps automotive industry' - www.pwcglobal.com/extweb/ncpressrelease.nsf/DocID/93FEA232C6F4D7DC852568E70016E996

5. CASE FOR GOVERNMENT ASSISTANCE TO THE INDUSTRY

The Commonwealth Government has affirmed its desire for an internationally competitive and globally integrated automotive manufacturing sector as well as for improvement in the performance of Australia's overall economy. As demonstrated in chapters 2 and 3 of this submission, over the last decade the Australian automotive industry has risen to the challenge of becoming more efficient and competitive. It is an important contributor to the national economy through direct employment and investment, R&D and technological advances, and spill-over effects into other industries. It has also increased its entry into international markets and integration into global supply chains.

The recent performance of the Australian automotive manufacturing industry and global trends suggest significant potential for the local industry to grow and contribute to national and regional economies, provided dedicated assistance is continued beyond 2005. As demonstrated in earlier chapters, the automotive manufacturing industry is one marked by significant R&D efforts, rapidly growing skill levels and in many ways is heading the transformation of the entire manufacturing sector to one in which 'knowledge inputs' are becoming increasingly important. In this context, the significant growth potential of the automotive industry should not be downplayed or ignored.

In South Australia, where it comprises a greater proportion of the economy than for any other state or territory, the automotive manufacturing sector is an even more significant contributor to overall economic performance (chapter 3). The South Australian Government accordingly supports, indeed regards as vital, the continuation of Commonwealth Government assistance to the automotive industry.

5.1 THE CASE FOR THE AUTOMOTIVE MANUFACTURING SECTOR

A view that has been put in the 'new economy' debate is that Australia should focus on industries other than manufacturing on the basis that, as a relatively advanced and developed economy, there is no longer any significant benefits or justification for retaining a manufacturing sector. Australia, the argument goes, should concentrate on 'new economy' industries not 'old economy' sectors like automotive manufacturing. Yet, as an automotive industry academic has noted:

The automotive sector retains its position as one of the world's largest industrial activities. Its recent development shows the absurdity of categorising activities in either the 'old' or 'new' economy. The auto industry is dynamic and constantly renews itself in the face of industrial challenges and market pressures. Within this industry the 'new' economy is effortlessly absorbed and digested within a continuing updating process. The automotive sector as a result remains at the forefront of process development and product advance and as a consequence is an activity that remains suited to a high wage mature economy.⁵³

⁵³ *Financial Times*, August 2001, 'The Motor Industry – an Epitomy of Resilience', Professor Garel Rhys, Director, Centre for Automotive Industry Research, Cardiff University Business School, Wales.

The industry's contribution to the Australian economy and community is indisputable, as demonstrated in this submission. In addition, the sector is highly interdependent with other sectors delivering important spill-over effects to the broader economy. It is an important source of modern design, engineering and production technologies, and management techniques which are disseminated to its suppliers and to industry generally. This has been recognised by the Productivity Commission itself:

The Australian automotive industry has strong links to other industries. It is a large purchaser which contributes to the use of technology and skill levels across the economy... The automotive industry is a significant user of advanced technologies which are associated with design and engineering, production, material handling, inspection and testing processes and communication.⁵⁴

The automotive sector also provides valuable linkages for Australian companies to international networks, which can be important as sources of knowledge and for providing export market opportunities. The global structure of the sector has enhanced Australia's international integration.

The spill-over benefits, or positive externalities, include the following:

- **Technology transfer** – As multinational automotive companies invest in Australia they bring new or improved technology. The process is two-way: technology developed in Australia also finds its way into the global industry through parent companies. This results in increased international competitiveness in the domestic industry but also can provide Australian branding to developments transferred out.
- **Research and development** – The automotive industry is a large source of research and development activity. New developments in components, manufacturing techniques, design and development processes sourced from the automotive industry have application elsewhere. In the case of components companies, for instance, transferability may be as close as the adjacent workshop serving another industry sector, such as whitegoods.
- **New product development** – New product development, while increasing export opportunities, also provides the consumer with PMVs which are, amongst other things, safer, more fuel efficient, and produce reduced levels of emissions, all of which have benefits to the broader community. Both product improvements and their associated developments in production techniques are transferable across industries and find application in other industries. Once transferred domestically, these deliver greater international competitiveness across the economy.
- **Skills transfer** – The automotive industry has, in the past, been slow to implement training programs to improve the skills levels of its workers. Since 1997, as discussed in chapter 2, the industry has turned around its performance in this area and, in the five-year period from 1995 to 2000, doubled the percentage of its workforce with TAFE-level qualifications. There have been improvements in training involving new technologies and labour practices and more demands for university-level engineering expertise. The result is a growing pool of highly skilled people available to other manufacturing industries.

⁵⁴ Productivity Commission 1999, *Microeconomic Reforms and Australian Productivity: Exploring the Links*, Commission Research Paper, AusInfo, Canberra, p44.

5.2 WHY ASSISTANCE HAS HELPED

As chapter 2 demonstrated, the automotive manufacturing sector has experienced continual improvement in the last decade and, in particular, since 1997. Greater efficiency and competitiveness have occurred during a time when government assistance has been reduced – but is also the result of such assistance. Government assistance, through the maintenance of tariffs on automotive products (albeit at significantly lower levels) and through the EFS and ACIS schemes, must be credited for its contribution to a better performing sector. It has contributed in a number of key ways.

- It has allowed structural adjustment within the industry to take place at a realistic and measured pace within a secure policy environment, which has promoted investment, long-term planning, and the development of technology and new management practices.
- It has provided important signals (including through the retention of tariffs) to the automotive industry, which is globally driven by the major ten vehicle building firms (none of which are owned by Australia), that Australia continues to be committed to a domestic automotive industry.
- It has ensured that the Australian automotive industry has enjoyed some parity in attracting investment with its global competitors which continue to receive government support through a variety of mechanisms, both overt and hidden, often on a much broader scale. Automotive assistance acts to increase the attractiveness of investing in Australia by reducing the opportunity costs when compared to investing in a global competitor's market, where often much greater levels of assistance are on offer.
- It has encouraged further integration of the sector into the global economy.

5.3 REGIONAL AUSTRALIA: THE AUTOMOTIVE INDUSTRY AND STRUCTURAL ADJUSTMENT

Tariff reductions from previous high levels have provided an overall economic outcome that has proven to be positive for Australia, but not without significant 'losers' from industry adjustment pressures.

As an example, previous modelling by the Productivity Commission, done for its recent inquiry into Australia's general tariff arrangements, showed that with the removal of general tariffs of 5 % or less, South Australia, particularly regional areas, would be negatively impacted, although Australia as a whole would benefit. In the exercise, the Productivity Commission divided Australia into 75 regions and generated employment and output effects in each. The modelling showed, when compared to leaving the tariffs in place, that all regions within South Australia were expected to see a fall in employment. It also demonstrated that out of the four regions nationally that would see a reduction in output, three were in South Australia - Outer Adelaide, Yorke and Lower North and the South East (see Table 5.1).⁵⁵

⁵⁵ Productivity Commission 2000, *Review of Australia's General Tariff Arrangements*, Report No. 12; AusInfo, Canberra, pp46-47

Table 5.1 - Estimated long-run effects of removing general tariffs of 5% or less disaggregated by state and regions

(Percentage derivations from base case values)		
	<i>Gross Regional Product</i>	<i>Employment</i>
South Australia	0.02	-0.07
Adelaide	0.03	-0.06
Outer Adelaide	-0.02	-0.11
Yorke & Lower North	-0.01	-0.08
Murray lands	0.00	-0.05
South East	-0.11	-0.31
Eyre	0.01	-0.03
Northern	0.12	-0.04

Source: Productivity Commission 2000, *Review of Australia's General Tariff Arrangements*, Report No. 12; AusInfo, Canberra, pp. 46-47.

It has been shown in a number of studies that the scale of structural adjustment – brought about by changes including to tariffs but not limited to them - has been greater in smaller economic regions throughout Australia. As stated in the Productivity Commission report *Aspects of Structural Change in Australia*:

One likely explanation for this is that larger regions tend to have more broadly based industry structures. Thus, changes in the relative size of one or two core industries typically account for smaller proportions of their employment bases than smaller size regions. There is also a greater likelihood of offsetting intra-industry changes in employment within regions with larger individual industry groups.⁵⁶

A contraction in the automotive industry will therefore more highly impact regional economies, such as within Adelaide, with a high concentration of automotive activity. South Australia, as a smaller state economy, is particularly vulnerable to shifts within the industry and any adjustment costs arising from changes in government policy.

5.3.1 REGIONAL LABOUR ISSUES

The automotive industry has faced a great deal of adjustment pressure as government assistance to the industry has been reduced progressively throughout the 1980s and the 1990s. While this pressure has been significant, there is no denying that reductions in industry assistance have resulted in a more competitive, export-focused industry.

At that same time, there have been reductions in the numbers employed within the industry as it has rationalised. For example, the number of people employed in the industry in 1989 was 67,400 compared to 44,228 in 2000.⁵⁷ The burden of generating new economic activities to replace the lost jobs has fallen on states where the automotive industry has traditionally been located, namely South Australia, Victoria and, to a lesser extent, New South Wales and Tasmania.

⁵⁶ Productivity Commission 1998, *Aspects of Structural Change in Australia*, Research Report, AusInfo, Canberra, p30

⁵⁷ Automotive industry employment is defined as Australian Bureau of Statistics (ABS) ANZSIC codes 2813, 2819, and 2811.

As discussed in chapter 3, in South Australia the automotive industry plays an important role in providing economic activity and employment in regional labour markets within the State. The concentration of the automotive industry within the northern and southern suburbs (regions of relatively low socio-economic standing) of Adelaide is a key consideration in the maintaining assistance for the industry.

Although there has been a significant increase in the average educational level of workers in the automotive industry in Australia in the past few years, as detailed elsewhere in the submission, the automotive sector remains an industry in transition. The workforce is comprised of a significant proportion of relatively lower skilled jobs - and is marked by a mature workforce – predominantly male - that (in comparison with the economy as a whole) has lower literacy and numeracy capabilities. Most jobs are full-time. In summary, the workforce shares characteristics with those groupings of that have lower success rates in finding meaningful work once unemployed.

Given the concentration of the automotive industry, particularly in South Australia, the costs of further rationalisation of employment are likely to be magnified within already struggling regions characterised by high local unemployment and high social security profiles. As the Productivity Commission noted in its 1997 automotive inquiry report:

High unemployment rates in automotive producing regions indicate that it will be more difficult for displaced automotive workers to find new employment. This is a regional problem that goes beyond a problem concerning just the automotive industry and its employees.⁵⁸

As is well known, the costs of unemployment in such circumstances extend beyond that of the individual to families, the community and the economy as a whole. Aside from the increased demands placed on Commonwealth and state support services, there are also costs in terms of physical and mental health, social functioning and a decline in work skills as participation in the workforce declines. South Australia already experiences considerable structural unemployment, as evidenced by the relatively high average duration of unemployment - 56 weeks against a national average of 47 weeks. It is clear that any move to reduce assistance to the Australian automotive industry needs to be made with a full appreciation of the long-term labour and social consequences that will most likely result.

5.3.2 ADDRESSING ADJUSTMENT

It is recognised that the Commission has a particular concern with allocative efficiency concepts. The South Australian Government awaits the release of the Commission's position paper to learn of its estimates of the welfare gains from lowering tariffs below 10% and will respond at that time.

The historical significance of the automotive industry to certain regions of Australia is an outcome of business decisions and government policies that were made decades ago. The planned reductions in automotive tariffs from 15% to 10% in 2005 could yield some benefits for the nation as a whole – but is unlikely to provide the degree of benefit, given the

⁵⁸ Productivity Commission 1997 *The Automotive Industry*.

historically low tariff levels, that have accrued from past changes when tariffs were pegged at a significantly higher level.

Any overly optimistic belief in national gains in allocative efficiency flowing from tariff cuts threatens to ignore the real costs of regional adjustment, which have both regional and national implications. In particular, issues such as fiscal equalisation programs, under-utilisation of infrastructure and relocation costs need to be factored in to any assessment of the national costs and benefits. In South Australia's case, it could be argued that national policies to facilitate this structural adjustment have been inadequate to compensate for the disproportionate concentration of those costs within this State.

In regions where significant adjustment costs are identified structural adjustment programs need to be designed. These programs should focus on assisting, in this case, the automotive industry further increase its overall level of international competitiveness and provide mechanisms for displaced economic resources to be reallocated to other industries and occupations within affected regions.

5.4 WHY ASSISTANCE NEEDS TO CONTINUE

As stated previously, the South Australian Government awaits the Commission's estimates of the welfare benefits (if any) of lowering automotive tariffs below 10%. The South Australian Government accepts that the assistance regime supported in this Submission would come at a cost. However, it is held that such costs are outweighed by the benefits of modest assistance to the industry.

Australia's automotive industry is currently working to integrate itself into a global industry undergoing major structural change. There is an interesting analogue between the growing sharing of platforms and specialisation in the vehicle assembly process and the increasing demand for more common componentry and more sophisticated supply engineering in the component-manufacturing sector. Moreover, there are contradictory trends at the assembler level which see, on the one hand, an increasing concentration of ownership and large economies of scale versus, on the other, niche markets, designer products, and smaller more flexible production runs.

Australia's producers must achieve not only locally acceptable returns on investment, but must also compete regionally with other divisions of parent companies to which they belong. Just as Australia's vehicle assemblers must continue to exploit their niche in upper-medium cars, so too must the local component industry exploit its niche in small volume runs (by the standards of the international industry) and its competitive advantage in design and engineering abilities.

The challenges facing the Australian industry are large. To meet them successfully, it must position itself as an indispensable segment of global industry with a reputation for high value-added input. While the industry has made important moves in this direction, ongoing government assistance is necessary for the process to continue.

Firstly, the work of adjustment and improvement is not yet over. Adjustment within the industry, from high levels of protection, has been incremental – and will do best to continue in such a manner. The Australian industry has made significant improvements in performance

to narrow the gap in international competitiveness, but further improvement is needed to achieve world best practice throughout the supply chain.

Secondly, the Australian industry is not an island. It operates in a highly competitive environment, in which large segments of the global industry receive significant levels of protection and support (section 4.4). No level playing field exists – assistance to and protection for the industry are endemic. Taking away investment incentives will do nothing to change the global nature of automotive investment decisions, nor will it affect the concentration of ownership at the assembler level. What it may affect is future decisions on the direction of capital flow which may serve to cut Australia from the industry or diminish its part in the supply chain. It is unrealistic to expect that the domestic industry can, in such an environment, compete fairly for market share and investment without some level of government assistance being brought to bear.

Thirdly, the global industry will be subject to further significant structural change resulting from global excess capacity driving rationalisation and technological changes leading to alterations in global sourcing arrangements. Structural change will also be effected by the (nascent) move in the market to ‘designer’ vehicles which require greater production flexibility and require smaller production runs. This latter change may well prove to Australia’s advantage, should the industry successfully position itself for this change.

Fourthly, the industry is highly dependent on foreign investment decisions made by parent companies, especially of global vehicle producers. The trend for design and production to be pushed down the line (section 4.2) to components producers, tool makers and service providers, means there will also be greater competition for investment dollars (for capital and R&D) expenditure down the line. It is the nature of capital to flow to those countries which provide stable and secure investment environments and clear government commitment to the industry into the longer term. Long product development lead times require policy stability.

Fifthly, the structure of the industry in part dictates supply chain dynamics. The components and tooling sectors are dependent on the continuing presence of the four vehicle assemblers in Australia. The viability of these sub-sectors requires ongoing commitments of producers to remain in Australia. Any failure of the sub-sectors will, moreover, adversely affect the provision of products and services to other sectors, such as the white goods industry, electronics, textiles and packaging.

Lastly, the continued viability of the Australian industry is dependent on growth in exports (section 2.6). This can only occur where markets are open and where companies are in a position to exploit opportunities. Market access is clearly a government responsibility – where it applies to reducing government imposed trade barriers - with market development an associated role.

Ongoing assistance to the automotive manufacturing sector, then, is key to its process of change and improvement within an international environment which is in flux, is typified by significant levels of support and protection, and is driven by corporate investment and product sourcing decisions made at a global level. Australia must stake its claim as an indispensable and innovative segment of the global industry if it wishes to have an automotive industry in the medium to longer term. Such an industry, with its important contributions to the economy, will come at some cost. Its growth will provide important returns.

5.5 THE CHALLENGE FOR THE INDUSTRY

Previous sections of this chapter have discussed the reasons why the automotive industry should receive government assistance, but the effectiveness of this assistance will depend on the capacity and desire of the industry itself to take up the challenge to work to entrench its position within the global marketplace. Having created a policy environment conducive to the growth and development of the industry, governments may justifiably seek commitments from automotive assemblers and component manufacturers to work in partnership with each other and the public sector to achieve the goal of an internationally competitive and globally integrated automotive industry.

The South Australian Government is committed to forms of assistance that are effective and performance-based, and whose costs are exceeded by the benefits.

The future of the automotive industry will be shaped by the ability of Australian automotive companies to increase exports through access to global supply chains. This may be easier for Australian companies that are subsidiaries of global automotive companies, as they can leverage relationships built by parent companies. For wholly Australian-owned companies, becoming links in the supply chain may be more difficult and will depend on their ability to promote their products and services either independently or via work supplied to assemblers. Nevertheless, domestic companies must be willing to face outwards in their quest for viability and growth.

The achievement of sustainable export growth will require unrelenting effort by the industry to not only match world best practice in terms of productivity, quality, price, and supply reliability but, in addition, to also promote Australia's reputation for flexibility and innovation in developing and supplying products to niche markets for both vehicles and components. To secure an ongoing and viable role for Australia in the global automotive industry therefore requires significant and sustained levels of investment by the industry in training and skills development and in R&D capability.

The ability of the industry, both assemblers and component manufacturers, to work together will be key to achieving these desired outcomes. With ongoing rationalisation in both vehicle assembly and component manufacture, and with the trend towards greater value-added work being performed by component makers, the relationship between assemblers and component manufacturers is changing. The future performance of the Australian industry will be affected by the ability of assemblers and component makers to capitalise on their interdependence in ways which strengthen, rather than detract from, the industry's international competitiveness.

As many companies in Australia are subsidiaries of major global automotive companies, the ability to undertake many of these activities is constrained by decisions made elsewhere. Given this, governments, and indeed the broader community, will be looking to Australian subsidiaries to build strong business cases for enhanced R&D and export functions to be based in Australia. Australian subsidiaries should also use the leverage of their foreign ownership linkages to identify and access new market opportunities for Australian-made automotive products.

As discussed earlier, one of the reasons why governments around the world assist their automotive industries is because of the substantial positive external benefits that accrue to the broader economy through the industry's presence. The Australian industry is also expected to continue to be a source of such external benefits and to provide leadership to the broader Australian manufacturing sector in the introduction and dissemination of world-class production technologies, work and management practices.

6. COMMONWEALTH ARRANGEMENTS FOR THE AUTOMOTIVE INDUSTRY

In previous chapters the importance of the automotive sector to the Australian economy has been discussed and a case has been constructed for a competitive automotive sector into the future. A case for assisting the automotive industry has also been constructed. This chapter will state the position of the South Australian Government in regard to the automotive industry and more specifically the future of industry assistance to it. The Commonwealth Government has affirmed its desire for an internationally competitive and globally integrated automotive manufacturing sector. It also desires improvement in the performance of Australia's overall economy. South Australia shares the Commonwealth's aims and makes its recommendations accordingly.

The South Australian Government recognises that successive reductions in industry protection for the automotive industry over the last three decades involving, amongst other things the reduction in tariffs and the elimination of quotas, have provided significant benefits in terms of improvements in efficiency and competitiveness of production, price and quality of vehicles. The South Australian Government also recognises, however, that previous reductions in industry protection have not always been complemented with adequate adjustment assistance measures and has resulted in economic hardship for a section of the community, which has now come to fear new reductions in industry assistance.

The case has been made for continuing government assistance to the automotive sector. Assistance should be tailored to developing an industry which is increasingly self-reliant, albeit realising that no automotive industry anywhere in the world is wholly self-reliant. To do so, ongoing assistance should aim at achieving a number of objectives. It should attempt to promote the take up of improved production capabilities which make the automotive industry competitive, cost efficient and viable. It should allow the industry to build on Australia's recognised strengths in engineering, design, flexibility and niche products. It should promote the development of leading edge skills, technologies and innovation activities. And it should ensure that the industry is able to integrate into the global automotive industry by providing assistance for Australian companies to exploit export opportunities.

Specifically, assistance arrangements should:

- promote investment by making Australia an attractive site for global automotive capital;
- promote R&D and innovation which leads to product improvement and more efficient and technologically advanced production;
- promote skills development with the sector workforce, including managerial skills;
- promote exports of automotive products through greater market access as well as through market development programs; and
- therefore contribute to the industry's self-reliance, viability and growth.

While this Productivity Commission review deals with a range of assistance measures for the automotive industry, it became clear to the South Australian Government during consultations with members of the industry that the focus of the review should be on future tariff levels, the future of Automotive Competitiveness and Investment Scheme (ACIS) and

market access issues insofar as these provide the types of outcomes most suited to developing a more efficient industry.

Of particular concern to industry participants was that significant levels of investment in capital equipment, new product lines, R&D and training would not be able to be continued – seriously threatening the viability of the industry - unless Australian governments provided a level of assistance which makes Australia an attractive investment location.

In South Australia's view, current levels of assistance to the industry should be maintained for at least five years from 2005, when tariffs on passenger motor vehicles (PMVs) and components fall to 10%.

Specifically, it is proposed by South Australia that the Commonwealth Government commit to the following assistance arrangements after 2005:

- maintenance of a 10% tariff on PMV and components imports after 2005 and at least until 2010;
- continuation of an assistance scheme which promotes investment, R&D and production within the industry, such as has been provided under ACIS, at least until 2010 – such a scheme should be WTO-compliant and should retain current levels of funding; and
- increased efforts to ensure improved international market access for Australian automotive products and services.

6.1 TARIFF LEVELS

The South Australian Government does not oppose the reduction of PMV and components tariffs in 2005 from the current level of 15% to 10%. Beyond 2005, however, South Australia recommends the retention of these tariffs at 10% at least until 2010 and until real market access outcomes are achieved that result in increased access to markets throughout the world and particularly in Asia.

Table 6.1 summarises the current arrangements relating to automotive tariffs in Australia. The South Australian submission focuses on PMV and components tariffs. The South Australian Government believes there is no need to change the existing arrangements for tariffs, in the foreseeable future, on 4WD, LCVs and HCVs and components used in them, as well as for used motor vehicles. South Australia therefore recommends the retention of tariffs on light LCVs and 4WDs and components for these vehicles at the current level of 5% after 2005 and at least until 2010.

Table 6.1 - Australian import tariff measures

Market Segment	Tariff Measure
Passenger Motor Vehicles (PMVs) and components	The PMV tariff was lowered to 15% in 2000 with a scheduled reduction to 10% in 2005.
4WD; Light Commercial Vehicles (LCVs); Heavy Commercial Vehicles (HCVs) Components for 4WDs and LCVs	Tariffs were lowered to 5% in 1996 and have remained at this level since. The present tariff will stay in place after January 2005.
Used Motor Vehicles	The Australian Government introduced a duty of A\$12,000 per vehicle on volume imports of used vehicles in 1991. A scheme exists which allows limited imports of specialist vehicles at general duty rates as well as special arrangements for individuals who have purchased used cars overseas. The present specific tariff will stay in place after January 2005.

Source: Australian Automotive Intelligence, *Australian Automotive Intelligence Year Book*, Melbourne, November 2001, pp10-13.

In regard to PMV and components tariffs, the South Australian Government does not oppose their reduction in 2005 from the current level of 15% to 10%. Beyond 2005, however, the South Australian Government recommends the retention of PMV and components tariffs at 10% at least until 2010 and until real trade liberalisation is achieved that results in improved import penetration into global and particularly Asian automotive markets.

Beyond 2005 tariffs should be held at 10% for the following reasons:

- Automotive tariffs should not be reduced until real market access gains have been made for Australian exporters – reciprocity should be sought before any decision is made to further reduce Australian tariffs.
- The existence of a tariff helps to attract foreign investment by global automotive companies – even at low levels it is an important signal to the industry that the sector has national support.
- For reductions below 10%, any welfare gains through improvements in allocative efficiency will be trivial and will be outweighed by adjustment costs.
- Tariff reductions should be made incrementally to allow the automotive industry time to adjust.

6.1.1 MARKET ACCESS

Given the current historically low levels of Australian automotive tariffs, the question of the overall economic benefits, when compared to the costs, of further tariff reductions without significant market access outcomes needs to be questioned.

The South Australian Government believes that there is little economic benefit to be achieved through further unilateral tariff reductions and that future tariff reductions should not be made unless there is significant market access gains in key markets throughout the world. The South Australian Government does not share the view of some sections of the trade policy community that unilateral tariff reductions enable Australia to have greater influence at the negotiating table when it comes to market access negotiations. In fact, it could be argued that

the existing tariff on passenger motor vehicles provides the Australian Government with some leverage in ongoing market access negotiations.

The South Australian Government also believes Australia's APEC commitment to move to zero tariffs by 2010 will not be matched by other developed APEC members and that the 2020 deadline for developing countries is also looking doubtful. As a result, combined with the fact that APEC commitments are non-binding, a move by Australia to hold tariffs at 10% should not present too much of a trade policy difficulty for the Commonwealth Government.

6.1.2 ATTRACTING INVESTMENT

The importance of reducing automotive industry assistance is not only an issue for increasing exports. As discussed already in this submission, the use of assistance by other countries affects the investment decisions of global automotive companies. Assistance offered to the automotive industry, in this case tariff protection, helps Australia attract foreign investment in two ways. Firstly, it offsets the opportunity costs, for global automotive companies, of investing in Australia, when compared to investing in other competitor countries which often have much greater levels of assistance.

Secondly, it sends a signal to the global automotive industry that Australia is committed to ensuring the long-term survival of the industry. This is important as most investment decisions are based on medium- to long-term business cases. Greater certainty about the long-term survival of the Australian automotive industry increases the chances of investments being made in Australia.

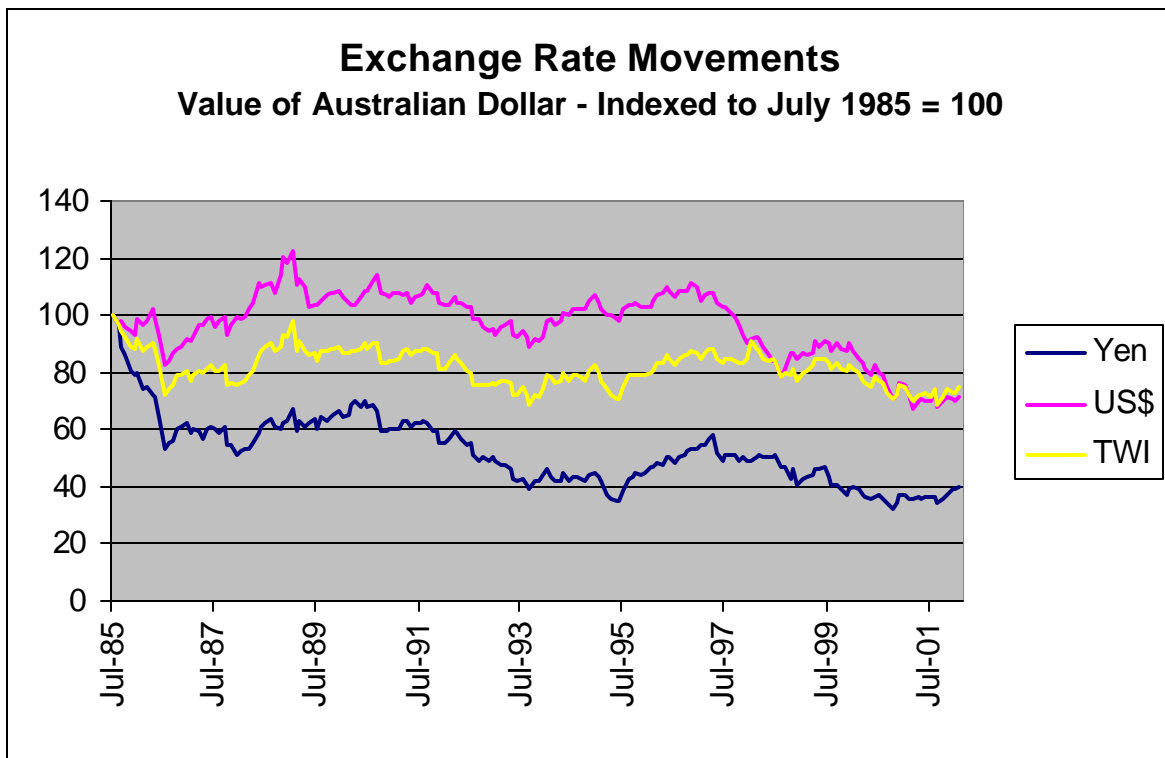
6.1.3 ADJUSTMENT TO PREVIOUS CUTS IN TARIFFS

It will take time for the industry to adjust to the cut to a 10% tariff from 15% on 1 January 2005. As a result, the South Australian Government sees the maintenance of the tariff at 10% at least until 2010 as essential.

The full effects of previous tariff reductions are yet to be realised by the automotive industry. Falls in the value the Australian dollar, particularly against the United States dollar, have had the effect of insulating the domestic industry from the full impacts of previous reductions in assistance.

Over most of the 1990s, and certainly over the last few years, the value of the Australian dollar has substantially declined, particularly against the US dollar, but also against the Yen. Figure 6.1 illustrates the relative patterns. The value of the Australian dollar has declined on average against the US dollar by 14% per year over the period of the chart, and in the last few years has been even further below trend. This has been driven in part by corrections against general tariff declines, but primarily is a consequence of factors like declining world commodity prices.

Figure 6.1 – Australian Dollar Exchange Rate Movements



The impact has been to substantially reduce the “damage” that tariff decline would have done to the automotive industry – particularly over the last five years. The concern is that, to the extent this pattern is reversed (and there have been some minor indications over the last month that there is some reversal), the automotive sector will for the first time become exposed to the “full” impact of the tariff decline or, at the least, a significantly negative impact if the dollar should only partially rally.

The result of any increase in the value of the Australian dollar relative to other currencies would be to make Australian automotive exports less competitive in global markets while making imports less expensive to Australian consumers. (They would also decrease costs of imported inputs.) The South Australian Government is concerned about the capacity of the domestic industry to adjust to, potentially, both a decrease in export sales and an increase in import competition at the same time.

Before further tariff reductions below 10% are contemplated, the South Australian Government recommends that a positive economic welfare case needs to be made. This would include detailed analysis of both the costs and benefits of any further reduction, identifying regions that would be disadvantaged by further tariff cuts. An assessment also needs to be made of the capacity of the Australian automotive industry to absorb the effects of a rise in the value of the Australian dollar relative to other currencies.

Further, in regions where significant adjustment costs are identified structural adjustment programs need to be designed. These programs should focus on assisting the automotive industry further increase its overall level of international competitiveness and provide mechanisms for displaced economic resources to be shifted to other industries within affected regions. This is discussed later in this chapter.

6.2 AUTOMOTIVE COMPETITIVENESS AND INVESTMENT SCHEME (ACIS)

The South Australian Government recommends that the Commonwealth Government continue for at least five years from 2005 an assistance scheme which promotes investment, R&D and production within the industry, such as has been provided under the Automotive Competitiveness and Investment Scheme (ACIS), and which is WTO-compliant and retains overall funding levels as under the current scheme.

The South Australian Government regards tariff policy as only one element of a more comprehensive industry policy that must be developed if the automotive industry is to remain viable into the future. The South Australian Government believes that future non-tariff assistance to the automotive industry should be tailored to achieve the following outcomes:

- increased industry investment,
- increased industry R&D activity,
- increased industry exports, and
- maintenance or growth of current levels of employment within the industry.

The key to achieving these goals is to increase the relative competitiveness of the automotive industry in Australia. In the past, this has been driven by progressively opening up the Australian automotive industry to more competition. However, given the current level of automotive industry protection, the scope for this to drive increased competitiveness into the future is limited.

During consultations with the automotive industry it was made clear to the South Australian Government that it placed great importance on Automotive Competitiveness and Investment Scheme (ACIS). As discussed earlier, the scheme provides \$2 billion over five years in transferable import duty credits to eligible automotive firms. Within ACIS there is a difference between the activities that automotive assemblers and automotive component firms, toolmakers and automotive services (eg engineering, design) firms can claim import duty credits for. Eligible automotive assemblers are able to claim (1) 25% of the value of production of motor vehicles, engines and engine components multiplied by the relevant tariff rate and (2) 10% of the value of new investment in productive assets. Eligible automotive component firms, toolmakers and automotive services firms can claim (1) 25% of the value of new investment in productive assets and (2) 45% of the value of investment in R&D.

The current ACIS scheme promotes production, capital investment and R&D activity – all vital if the automotive manufacturing industry is to be viable and globally competitive. It sends an important international signal that Australia is committed to having a strong, local automotive manufacturing sector and, if extended, will contribute to a stable policy environment suited to the long lead times inherent in the industry. Moreover, the scheme promotes international competitiveness while remaining WTO-compliant. Any modified scheme should retain these principles.

Unlike previous assistance measures to the industry, such as its predecessor the Export Facilitation Scheme (EFS), ACIS is not designed to give direct export subsidies to the

industry but instead provides an incentive to the industry to become more internationally competitive and ultimately win additional export income.

It does this by offering import duty credits to eligible firms which invest in plant and machinery and R&D activity.⁵⁹ The advantage of this type of assistance is that it removes the additional cost imposed on automotive manufacturers when importing dutiable products to be used in the production of their goods and services as well as providing assistance for competitiveness enhancing activities.

The ACIS scheme was designed with WTO-compliance in mind. It does not directly promote exports nor is it discriminatory, ie it does not exclude foreign companies. Any automotive company operating within Australia, meeting the eligibility criteria, can access the scheme and take advantage of the benefits. The result of these measures is that the scheme is defensible within a WTO dispute context and therefore offers much greater certainty that the scheme will not be challenged and ultimately found to be a form of prohibited subsidy. This in turn allows automotive companies accessing the scheme certainty that investment decisions based on receiving ACIS assistance (in its current form) will not be jeopardised through international challenge.

Given these factors, the current Automotive Competitiveness and Investment Scheme (ACIS) is seen by the South Australian Government as a valuable assistance measure for providing incentives for R&D and investment, particularly for component manufacturers. This said, ACIS only commenced operation in January 2001, and is only one year into its five-year lifespan. It is too early to make a full assessment of its effectiveness – apart from the anecdotal evidence of companies and an assessment of the principles on which it has been constructed, which are generally positive. The scheme should therefore be fully assessed at a later date, but with a current commitment to its extension as the industry needs ample warning of any changes due to long decision-making timelines.

Further, the assistance offered by ACIS replicates a growing trend among countries that compete with Australia of assisting the industry to attract investment and increase R&D expenditure (chapter 4). By cutting ACIS, the Government would be sending a signal, incorrectly, to automotive firms that the Australian Government is not as committed to the industry as other governments in competitor countries.

As a result, of the issues discussed above the South Australian Government recommends that the ACIS be continued beyond 2005 with funding being retained at current levels at least until 2010. Any modified scheme should retain ACIS's general principles, as discussed here.

6.3 MARKET ACCESS

South Australia recommends that improved market access continues to be pursued, both in the multilateral and bilateral spheres. The South Australian Government is of the firm view that further reductions in Australian automotive industry assistance should not be contemplated until significant market access gains have been achieved in major automotive markets throughout the world and particularly in Asia.

⁵⁹ Automotive assemblers to receive import duty credits for overall production levels as well. A measure that was introduced into ACIS to ensure that none of the automotive assemblers were disadvantaged when the EFS was replaced by ACIS.

Continued export growth in the Australian automotive industry will be heavily reliant on the Commonwealth Government being able to leverage market access outcomes in overseas markets. Significant barriers to export, both tariff and non-tariff barriers, present a risk to the Australian automotive industry in two ways:

- They prevent Australian automotive products being sold into major world automotive markets, denying the domestic industry avenues to grow, gain economies of scale, and ultimately become more competitive.
- Automotive companies are less likely to invest in Australia, especially with the growing trend to global products, if they cannot export their product from an Australian base into major markets because of tariff and non-tariff barriers. They are more likely to invest in the heavily protected market to avoid trade barriers. The result will be a local industry that becomes less viable due to lack of investment in new plant and equipment and R&D.

The South Australian Government is concerned about the lack of market access gains realised through multilateral trade groupings, such as the World Trade Organisation (WTO) and the Asia Pacific Economic Cooperation forum (APEC), since the 1997 inquiry. In the past greater market access in protected overseas markets has been used as a trade-off for domestic tariff reductions. However, Australian exports still face major barriers in critical markets throughout the world.

As a result, the South Australian Government recommends that further reductions in automotive industry assistance should be consistent with a sensible trade liberalisation agenda. Before Australia liberalises further, it should be able to point to greater liberalisation elsewhere and in key markets in particular. Further, the measures offered to Australia by these countries should be both transparent and verifiable.

The launch of new trade liberalisation round (the Doha round) within the WTO provides an opportunity for the Commonwealth Government to win significant market access gains. The South Australian Government considers it an unwise move to unilaterally “give away” potential bargaining measures for these negotiations.

The proposed free trade agreements with Thailand and the United States provide Australia an opportunity to use current automotive assistance arrangements as a bargaining tool for removal of barriers to automotive exports. Again it would not make sense to unilaterally reduce levels of assistance without first leveraging real market access gains in both markets, but particularly in Thailand.

Market Access also plays an important role in determining the direction of investment in the automotive industry. With the growing trend towards global platforms the ability of automotive assemblers to enter markets is a key determinant in location decisions for their investment.

This is of particular importance to Australia were a relatively small domestic market means that companies are increasingly looking for export sales to remain viable. If the ability of the local assemblers to win export orders is inhibited by significant barriers to export then parent

companies will not be willing to invest in Australia and instead will invest in markets with larger domestic volume and export back into Australia.

The assistance offered to the automotive industry by the Commonwealth Government, while providing limited protection against imports, is much more useful as a signal to foreign automotive companies, who could potentially invest in Australia, that the Government is willing to offset some of the negatives that exist in investing in Australia rather than other larger markets, which may be more heavily protected.

By unilaterally reducing assistance to the industry in Australia the differential between countries offering high levels of assistance, particularly in Asia, is increased and there is a greater disincentive to invest in Australia.

For this reason it is vital that the Commonwealth Government puts significant effort into trying to reduce the barriers to trade existing in many of Australia's potential and existing export markets before it reduces assistance to the domestic industry in a unilateral manner. The South Australian Government urges the Commonwealth Government to maintain adequate resources within the Department of Foreign Affairs and Trade (DFAT) to achieve real automotive market access gains for Australian exporters. It also supports Australia's continuing commitment to work in the APEC Automotive Dialogue, which is addressing a number of issues relating to the industry including market access.

6.4 STRUCTURAL ADJUSTMENT

The South Australian Government recommends that the Commonwealth Government have in place strategies to deal with structural adjustment issues if the automotive industry suffers a significant and sudden contraction in output and employment. Further, any such strategies should be designed to provide a focus on those individual regions in which the automotive industry is concentrated.

As already discussed, the automotive industry is a key industry in sustaining the economic wellbeing of South Australia. It has many linkages to other sectors in the economy and generates a significant amount of economic activity, directly and indirectly.

The decline of traditional industry sectors in combination with demographic factors (such as an ageing population and low population growth) have posed a great challenge to the pursuit of high economic growth and better employment outcomes in South Australia. At this stage, further reductions in industry assistance beyond 2005 are likely to exacerbate these challenges and impose widespread costs on automotive regions.

As an example, the loss of one of the two assemblers in South Australia would have significant consequences for the South Australian economy as a whole. This loss would in turn have serious negative impacts on the automotive industry throughout the Australian economy.

It would be unfortunate if the long-term viability of the industry were damaged by ill-timed or poorly planned reductions in industry assistance. When determining its options on assistance, the Productivity Commission needs to look at both questions of overall national economic welfare and examine regional impacts. There needs to be an examination of the

distributional effects of changes in policy. The South Australian Government believes a modest tariff for the automotive industry is consistent with both the National Interest and the needs of regions.

As the commission has itself stated:

While reforms are about bringing overall net benefits to the community, it is also the case that the benefits and costs, as well as transfers of income and wealth, are unlikely to fall evenly — some individuals, industries and regions will emerge as winners from reform, while others may lose, at least in the short term. Judging whether a policy change is worthwhile, therefore, requires consideration of its likely distributional consequences and their implications, having regard to relevant social welfare and equity objectives.⁶⁰

As the positive impacts on the industry and the wider economy of further reductions in industry assistance reduce (law of diminishing returns), it is important that a positive economic welfare case be made before further reductions in assistance proceed. This would include detailed analysis of both the costs and benefits of any further reductions, identifying regions that would be disadvantaged and recommending assistance to those groups of people disadvantaged as a result of changed government policy.

The South Australian Government believes that among those options for the automotive industry canvassed by the Productivity Commission, consideration should be given to a comprehensive package of structural adjustment assistance measures to be introduced in the event of significant sector contraction. This would include programs designed to:

- assist workers made redundant by structural change within the industry, including labour, training and re-training programs; and
- assist regions negatively impacted by industry adjustment to find new economically sustainable industries to maintain overall levels of employment and economic wellbeing.

Assistance measures for the automotive industry therefore should be seen in the context of their role in easing adjustment costs for employers, businesses and communities affected most directly by significant change within the industry. This is supported by the Productivity Commission Research paper, *Structural Adjustment – Key Policy Issues*, which states:

In principle, [structural adjustment] measures should target a particular problem as directly as possible (that is, provide assistance to the adversely affected group), and facilitate the process of change.⁶¹

The South Australian Government believes that structural adjustment programs should be specific and well-targeted in this regard. Key issues that should be investigated by the Productivity Commission are the effects on employment, investment, output and in income levels in regions where the automotive industry is highly concentrated, if significant industry contraction occurs.

⁶⁰ Productivity Commission 2001, *Structural Adjustment – Key Policy Issues*, Commission Research Paper, AusInfo, Canberra, p. 24.

⁶¹ Productivity Commission 2001, *Structural Adjustment – Key Policy Issues*, Commission Research Paper, AusInfo, Canberra, p. 70.

While not advocating any one measure or discussing the merits of different structural adjustment measures, which is beyond the scope of this submission, the emphasis should be on measures that encourage the development of new employment opportunities for disadvantaged automotive workers and assist workers while they are in transition to new employment. These could include strategic industry development strategies, re-skilling and training programs, wage subsidies to employers to employee displaced automotive workers and financial retrenchment assistance, amongst others.

Labour adjustment must be linked with adjustment assistance which promotes regional economic growth – which can provide longer term employment opportunities in areas, such as Adelaide’s northern and southern suburbs, already struggling with high unemployment. The South Australian Government requests that the Productivity Commission and the Commonwealth Government examine such projects.

It also seeks the Commonwealth Government’s demonstrated commitment to regional and labour adjustment programs, as has been demonstrated elsewhere. Within the automotive industry, for example, previous labour adjustment programs (LAPs) have attempted to reduce the negative impact of structural adjustment. For example, in 1991 a PMV LAP was introduced. The main assistance items offered under the program were:

- formal vocational or English language training for a period of 52 weeks,
- wage subsidies for up to 26 weeks for employers engaging retrenched PMV employees, and
- relocation assistance for participants moving to a job, to look for work, or to take up formal training.

With the closure of the Nissan plant in Victoria in 1992 a centre, designed to assist retrenched workers to access assistance under the PMV LAP, was established within the factory to assist workers find new employment. The centre also coordinated the activities of various local government and charity organisations assisting those workers retrenched by the closure of the Nissan plant.⁶²

A more recent example of Commonwealth Government structural adjustment assistance occurred with the closure of the BHP steel making plant in Newcastle in 1999. Forewarned of the closure, the Commonwealth Government implemented a number of initiatives to help the Hunter Valley region in 1997. The aim of this assistance was to help the local community diversify and develop the region’s economy. Commonwealth assistance targeted investment, funded tourism initiatives, promoted the creation of new businesses, and provided 300 extra places in the Special Employer Support program, among other things.

Commonwealth Government assistance has also been directed to the rail industry.

⁶² Productivity Commission 1997, *The Automotive Industry*, Inquiry Report 58, AGPS, Canberra, p. 369.

6.5 OTHER ASSISTANCE

6.5.1 INVESTMENT ATTRACTION

The South Australian Government recognises that the Commonwealth Government has a pivotal role in investment attraction for the automotive industry. It therefore encourages the Commonwealth Government to bolster national investment policy.

Competition for new foreign investment in the automotive industry is strong, with Australian firms having to compete against a host of sister plants in numerous locations throughout the world and with governments who are prepared to go to great lengths to attract foreign investment. The long lead times required, specifically for the introduction of new car models, requires a degree of certainty to be maintained in regard to economic policy to allow firms to plan future investment in the domestic industry. A proactive and well-resourced national investment policy is vital if Australia is to succeed in an industry as globally driven as automotive manufacturing.

The Commonwealth Government has a strategic role in investment attraction and support. The Government of South Australia affirms its support for the Blackburne Report, *Winning investment: Strategy, people and partnerships*, which reviews the Commonwealth's investment promotion and attraction efforts. The report, published in August 2001, recommends that the Commonwealth (among other things) engage in industry-specific investment attraction while structurally concentrating its efforts across government to maximise success. The global structure of the automotive industry in particular, relying in large part on the existence of ten main vehicle assemblers (with none Australian-owned), requires expert and targeted action on the part of government.

*South Australia urges the Commonwealth Government to make the implementation of the recommendations of the Blackburne Report, *Winning investment: Strategy, people and partnerships*, a priority.*

The automotive industry has access to the Commonwealth Government's Strategic Investment Coordination program (SIC). It plays a key role in Australia actively sourcing and supporting mobile global capital across all industries where Australia faces direct competition on specific and large investment projects. The size of investments being competed for takes this beyond the budgets of individual state governments. In the automotive industry, Holden has been a successful applicant for assistance under the scheme (the only automotive producer to so far be successful under the scheme). In cases of large investment, as applies to SIC grants, mutual financial commitment by both Commonwealth and state and territory governments should continue.

Investment cooperation may be exemplified in the 26 April 2002 announcements of the Prime Minister and Premier of South Australia of an \$85 million performance-based package for Mitsubishi Motors Corporation, the parent company of Mitsubishi Motors Australia Ltd (MMAL). Under the package, Mitsubishi accepted a \$35 million offer of assistance from the Commonwealth Government plus \$50 million in cash and 'in kind' assistance from the State Government to facilitate a major new investment in Mitsubishi's Adelaide plant as well as the establishment of a global research and development centre in South Australia.

South Australia affirms the key role of SIC plays in actively attracting and supporting mobile global capital – and recognises that on large investment projects there is a need for federal and state/territory cooperation.

6.5.2 INDUSTRY DEVELOPMENT AND MARKET ACCESS

The South Australian Government supports the Commonwealth Government's continued commitment to dedicated and general assistance to the industry as it currently delivered through Commonwealth agencies and programs.

The continued application of sound economic policy that creates a business environment that encourages new industry investment is essential to sustain the long-term viability of the automotive industry. General economic management supported by sector-specific programs provides the backbone for industry development.

The automotive manufacturing sector also receives Commonwealth Government assistance through dedicated resources within Commonwealth agencies, including Invest Australia, the Department of Industry, Tourism and Resources, Austrade and the Department of Foreign Affairs and Trade. Australia's overseas missions play an important role in identifying markets for Australian products. These resources provide assistance with industry development, export development, and market access.

In addition, the industry receives non-industry specific programs including through R&D Start,⁶³ the Export Market Development Grants scheme (EMDG), and R&D tax concessions.

It is the view of industry that the programs provided (both dedicated and general) are on the whole useful. In the case of Austrade, for example, the industry has expressed the view that services for exporters and potential exporters are of particular benefit to small and medium businesses without the internal resources to find market information, clients and contacts.

The South Australian Government supports the Commonwealth's continued commitment to dedicated and general assistance to the industry as it currently exists. These resources form an important part of a national structure which is supportive of both the automotive industry and the economy more generally. South Australia recognises the need for this assistance to be performance-based and subject to regular review to ensure that objectives related to efficiency and the effectiveness of assistances are being achieved.

6.6 INTERNATIONAL STANDARDS

The South Australian Government recommends that, in formulating its options for consideration by the Commonwealth Government, the Productivity Commission take into consideration the additional expenditure, research and development that will be required by domestic vehicle assemblers and component suppliers to develop and comply with environmental regulations due to be implemented in Australia by 2006.

⁶³ Note that receipt of ACIS R&D assistance from the Commonwealth precludes automotive companies from receipt of R&D Start support.

It further recommends that such options not delay the implementation of these environmental regulations but be consistent with the achievement of their aims.

Australian automotive producers must increasingly take into consideration international environmental standards which, in the main, are becoming more stringent. The harmonisation of Australian standards with European ones imparts greater impetus to this process, both in order to meet domestic standards and to compete in international and domestic markets.

Environmental standards – both general and directly applicable to vehicle production and performance – pose challenges and opportunities to the industry. They highlight the importance of R&D and investment in designing and producing vehicles ready for both the domestic and international markets. They also pose questions about the concentration of Australian production on medium to large vehicles which release higher levels of nitrogen oxides, respirable particulates, BTX and carbon monoxide into the atmosphere.

The industry needs to ensure that it is not displaced in markets by products which can more quickly and cheaply meet these standards both at home and abroad. At the same time, Australia's competitive advantages in design, technology and engineering should see it successfully exploit higher standards for fuel emissions and efficiency, engine management systems, materials used in vehicle production, and so on.

The South Australian Government recommends that the Productivity Commission, in considering options for future assistance to the industry, take account of the costs to the automotive industry associated with developing and meeting environmental standards, both domestic and international. Support for R&D to meet (and even exceed) standards should be a feature of any future assistance regime.

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APPENDIX A: SUPPORT FOR THE AUTOMOTIVE INDUSTRY: THE ROLE OF THE DEPARTMENT OF INDUSTRY AND TRADE

The South Australian Government is committed to maintaining the long-term viability of the South Australian automotive industry. While support is provided on a number of fronts, the South Australian Department of Industry and Trade is the prime agency which works to promote enterprise and industry development within the State.

Enterprise Improvement

The South Australian Government, through the Centre for Innovation Business and Manufacturing (CIBM), employs industry experts who are able to liaise with companies in a range of industry sectors, including for the automotive and tooling sectors.

Advice and assistance is available to assist businesses to introduce or implement a range of activities. The most common are:

- Market and Export Market Planning,
- Enterprise Improvement,
- Product and Service Innovation,
- Factory Layout and other Business Solutions,
- Process Improvement,
- Technology Planning, and
- Financial Management.

CIBM specifically caters for existing businesses wanting to grow and expand and provides business development programs that are aimed at South Australian manufacturing and services companies with the following attributes:

- good trading records for two years or more,
- turnovers greater than \$1 million,
- employment of 10 employees or more,
- production of goods and services that are innovative and export-oriented, and
- generation of greater than 30% of revenue from outside South Australia.

CIBM Industry Managers are experienced business people who provide a resource to assist businesses to implement improvement initiatives in businesses. As the key interface between CIBM and the State's industry base, a CIBM Industry Manager:

- acts as a broker into the forms of government assistance available and relevant to companies (including AusIndustry and Austrade programs),
- assists firms to focus on international competitiveness,
- acts as a mentor for industry,
- networks with a wide range of industry and government representatives,

- obtains information on international developments, and
- analyses sector strengths and weaknesses and identifies market opportunities.

In South Australia, approximately 56% of the tooling industry's sales are derived from the automotive industry. The linkages between the two sectors are strong and assistance to the tooling industry to improve efficiency also helps the automotive industry. The South Australian Government performs a range of activities to assist the industry, delivered by CIBM, including:

- representing and liaising with the Engineering Employers Association of South Australia (EEASA) Tooling Council (the industry body representing South Australian toolmakers),
- producing a quarterly report outlining the status of the South Australian industry and providing a comparison with other Australian toolmakers,
- conducting the SA Toolmaker of the Year Awards recognising the best performing tooling companies in the State in various categories,
- generating benchmarking activities on cost and delivery on a global basis,
- providing strategic assistance for individual companies,
- supporting overseas marketing initiatives,
- identifying and supporting industry training initiatives,
- hosting an industry website,
- identifying and disseminating global best practice information, and
- promoting the industry at local, national and international events.

Investment attraction

The South Australian Government's prime agency for the attraction of investment into South Australia is Invest SA, which is located within DIT. Invest SA assists local companies to re-invest in their South Australian operations and in attracting complementary investment by companies new to South Australia.

Edinburgh Parks Automotive Precinct

Edinburgh Parks Automotive Precinct (EPAP) is being developed by the South Australian Government in response to the changes to the automotive industry worldwide. It is an initiative to support Holden's future expansion and to assist the South Australian automotive industry to remain globally competitive. Holden has decided to upgrade its Elizabeth manufacturing operations in line with the global General Motors' strategy to develop "first tier supplier parks" adjacent to the main car assembling facility. The South Australian project was fuelled largely by Holden's rapid growth in export sales and future production plans, however Mitsubishi also stands to benefit from the sequencing facilities created within the EPAP.

The development is a collaborative process involving Commonwealth, State and local governments and consists of an area of 88 hectares adjacent to the current Holden production facility in Elizabeth, to be developed in two stages. The first stage of 56 hectares, and with direct "tuggerway"⁶⁴ link to Holden's production facility, was

⁶⁴ A private road network linked by an overpass the Holden plant, to enable sequenced delivery of component sections to the Holden assembly line.

opened 19 June 2001. A proposed second stage will add another 32 hectares to the project.

The project is expected to be one of Australia's leading industrial developments and the first automotive supplier park in the Southern Hemisphere. The major expected outcomes will be "direct automatic delivery" (as opposed to "just-in-time" delivery), in-line sequencing, outsourcing whole subassemblies to those suppliers located within the EPAP, and significantly improved efficiencies throughout the supply chain.

The economic impact of the EPAP development makes it the biggest manufacturing expansion within the State for more than a generation. The total impact on the Gross State Product by the most conservative estimate is \$750 million over the next 10 years, with the creation of 1,100 new full time jobs over the next 10 years – bringing a total economic gain to South Australia of up to \$2.1 billion.

Air International, one of Australia's largest automotive component manufacturers, commenced its operations at the EPAP in December 2001. The company has invested \$32 million in the first stage 17,000 m² facility and currently employs 330 full time employees in the EPAP. Air International expects to increase its South Australian employment by more than 500 FTEs over seven years.

Australian Arrow, a division of Yazaki Corporation, is constructing a new factory of 5,700 m², which will be completed by August 2002 and will employ up to 59 fulltime employees by the completion of stage two of the project in 2004. The company produces electronic components and assembles instrument clusters.

Meritor, a division of the USA-based ArvinMeritor Group, will construct a factory of 1,500 m² by August 2002, employing 19 fulltime employees initially and up to 49 fulltime employees by 2004. Meritor supplies the latest technology for the assembly of electric window mechanism motors.

Other components companies are currently negotiating inclusion in the development.

Market access

In addition, DIT liaises with the Commonwealth Government on issues of market access and actively promotes greater national effort to open markets for Australian automotive products.

APPENDIX B: SUPPORT FOR THE AUTOMOTIVE INDUSTRY: TRAINING IN SOUTH AUSTRALIA

The increase in the proportion of the automotive workforce with VET qualifications (particularly amongst South Australia's vehicle assemblers) is largely explained by the introduction and participation in tailored national competency-based training programs such as the former Vehicle Industry Certificate (VIC) (equivalent now known as the Certificate II in Automotive Manufacturing). Training within these nationally accredited qualifications can be progressed to more advanced levels such as the Advanced Diploma in Automotive Manufacturing (Design & Development).

The Government of South Australia provided substantial support for development and funding of the VIC from 1995-96. In 1999 and 2000, the State Government provided \$720,000 and \$411,375 respectively for training in the VIC. These figures do not include funds provided to component manufacturers for training in automotive-related fields such as engineering.

User Choice

The User Choice scheme enables employers who take on an apprentice or trainee (now referred to as New Apprentices) to select their choice of registered training organisation (RTO) to deliver training. Under the scheme, the employer and New Apprentice are permitted flexibility to tailor the content of the training to be delivered, choice on the location and timing of the training being delivered, and selection of the RTO to deliver the training. Payments under the scheme are forwarded from the State Training Authority (the Department of Education, Training and Employment) directly to the RTO as training targets are achieved.

Funding for the scheme was budgeted at \$37.2m in 2000-01 and \$30.4m in 2001-02. Demand for training from User Choice has, however, consistently outstripped the allocated budget.