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25 July 2002

Mr Gary Banks
Chairman
Automotive Industry Inquiry
Productivity Commission
PO Box 80
BELCONNEN, ACT. 2616

Dear Mr. Banks,

**RE : FURTHER SUBMISSION IN RESPONSE TO POSITION PAPER
DATED 27 JUNE 2002.**

We have had the opportunity to review your position paper and now submit to you our response to the issues you have raised and potential policy options that you have put forward.

Firstly we would complement you on one of the most balanced position papers presented by the Commission for many years. We agree with many of the assertions in your paper. The automotive industry certainly has transformed itself in recent years. We have seen, and continue to see, improvements in productivity and quality within our own organisation and amongst our supply base. We have also experienced first hand the benefits of a focus on innovation and engaging actively in the global industry via exports and international expansion.

We also agree that there is more that the industry needs to do in order to become truly internationally competitive and that Government assistance has a critical role to play in this process.

There are of course some areas of your paper where our opinions differ, or where we feel that you may have failed to appreciate the full merits of our position. In particular we feel that your paper does not give appropriate weight to the significant impact technology will have on the industry and the potential for these changes to add to the forces of change and adjustment currently impacting the industry. Alternate fuel systems, electronic braking and steering and the greater use of lightweight materials such as plastics, aluminium and magnesium will each drive the need for significant further adjustment in many segments of the industry. In many of these areas, Australian suppliers may be dealt a doubly painful blow. Not only will these technologies drive significant re-positioning, R & D and plant and equipment investment but the new competing technologies will, in many cases, be able to be imported from overseas under tariff classifications that afford the industry little real protection. These shifts to new technologies therefore effectively represent a more rapid dismantling of the tariff structures than the Commission are proposing in any of their proposed policy options.

It is, of course, the future of the transitional tariff and ACIS assistance mechanisms that are of critical importance to the industry and that represent the Government's most powerful tools to ensure an internationally competitive and globally integrated automotive manufacturing sector and improve the overall economic performance of the Australian economy. It is to these forward looking areas that we would like to devote the balance of our response.

In all the analysis and debate that might rage about peoples' varying interpretation of the past, we don't want you, the Government, or the balance of our industry to lose sight of what this inquiry is all about. From PBR's perspective, this inquiry is about ensuring that we have an internationally competitive and globally integrated automotive manufacturing sector that improves the overall economic performance of the economy. To be of any real assistance to the Government, we need to provide an answer to this question that not only holds up to critical review, but provides firm recommendations as to how these objectives can be achieved.

We underlined the words globally integrated above because we believe that they represent the major unresolved issue in the debate to date. We all know what internationally competitive means and can readily attest to the improvements in quality, productivity and delivery driven by the Government's existing and historical assistance mechanisms for the industry. However it is our view that pursuit of international competitiveness without a clear perspective of how our industry will find it's niche within the global industry is fraught with danger.

Few would dispute that the automotive industry is one of the most sophisticated and competitive industries in the world. It is also currently one of the most globalised and is rapidly becoming more so through industry consolidation and rationalisation. In our submission and in the submissions of numerous other industry participants clear trends in these areas were identified.

For PBR, we look at these trends and conclude that the future for our company lies in embracing these challenges and working hard or find our niche in this global industry. For us this has involved two important moves:

1. A focus on developing globally competitive product and process technology.
2. Achieving strategic relevance with global industry players. In our case this has involved stepping beyond export based growth to develop our own production capabilities in the USA.

While we appreciate the danger in extrapolating the experience of individual participants in an industry across the entire industry, we have seen these same issues addressed in the submissions of other participants. Holden, for example, sees itself securing a viable place within the global General Motors organisation through a focus on it's product technology and etching out a place in GM's global product line strategy. Robert Bosch Australia's mandate to drive the technology development and production of ABS and certain electronic components is another example of an industry participant focusing on technology and global relevance in it's search for a long term viable position within the relatively small Australian market.

We believe that to comprehensively answer all aspects of the Government's question, particularly global integration, the Commission cannot just analyse the data and past experiences contained in the submissions it receives, but must capture and observe these examples of potential ways forward.

In fact, the vision statement for the industry, developed as a part of the activities of the Automotive Council, is to be "a competitive and integral part of the global automotive industry". This is strong evidence that the industry recognises that both competitiveness and integration with the global industry is essential to long term success. It is clear that the policy options selected by Government post 2005 will impact the industry's ability to deliver on these dual objectives of global competitiveness and integration.

While there has been significant progress in competitiveness over recent years there is obviously further work to be done. From a component manufacturer's perspective, industry participants are at varying stages of readiness to respond to wholesale reductions in tariffs. We believe that the industry as a whole requires a gradual reduction of tariff barriers to ensure that local vehicle volumes are maintained and to prevent sudden disruptive loss of business from import competition. We also feel that the Commission needs to consider the impact of changes in technology on the effective level of protection afforded to the industry in it's selection of policy options. For this reason we believe that the Commission's Option 3 is most appropriate.

With respect to competitiveness but more importantly, global integration, the most positive Government initiative to date has been the ACIS scheme. In particular, the benefits that flow from the pursuit of R & D expenditure have been, and will continue to be, essential to our pursuit of globally competitive product and process technology. We would go as far to say that, without the continuation of ACIS, and in particular it's R & D component, the Australian Automotive Component Industry has little hope of finding it's niche in one of the world's most competitive and globally integrated industries. For this reason we support the Commission's Option 1 with respect to extending ACIS funding at a level of \$2.8 billion over 5 years ceasing in 2010. We believe that this option maximises certainty and focuses support into a period of time where it is needed most.

In terms of the structure and composition of the ACIS scheme, we believe that the current proportionate share of total funding between car makers and component suppliers should be maintained into the future. This would mean instigating separate funding pools for component manufacturers and car makers. We believe that the segregation of funding pools would be essential if any move is made to change the basis of claim for car makers to an R & D and plant and equipment driven arrangement. There are significant differences in the size and frequency of this expenditure between car makers and component manufacturers and we would be concerned at the distortions this may cause in the allocation of the total available assistance budget. As we have stated above, the continuation of ACIS at it's current levels is essential to the long term position and survival of the Australian Automotive Component Industry.

Also consistent with the objectives of global relevance and integration of our local industry, the Government's international trade policies and related initiatives need to be focussed on significant improvements in market access and market development support.

With respect to the issue of policy certainty PBR believes that as we approach 2010, the industry should again be reviewed in terms of it's progress in delivering on its objectives and it's net impact on the Australian economy. It is impossible to predict how factors such as relative exchange rates and the prevailing policy settings of governments in other jurisdictions will impact this progress. Certainly unforeseen developments or a lack of reciprocity in these areas would justify reassessment however we would hope that the industry finds itself in a position where it can commit to a predetermined date at which time it can "stand on it's own two feet" from the perspective of industry specific support.

In summary PBR supports the following policy recommendations:

1. **A Gradual reduction in Tariffs** – leave the tariff at 10% until 2010 and then reduce it by 1% p.a. to reach a level of 5% in 2015.
2. **Continuation of ACIS with certainty as to quantum and duration** – ACIS funding continues at a level of \$2.8 billion over 5 years ceasing in 2010.
3. **Instigate separate funding pools for car makers and component suppliers** – segregated funding pools put in place based upon current claims history to ensure that component manufacturers are not disadvantaged by changes in the total level of claims by car makers.
4. **Focus on significant improvements in Market Access and Market Development Support** at a Federal level.
5. **A further review of the industry prior to 2010.**

The Australian Automotive Industry is in one of the most exciting and challenging positions that it has found itself in it's history. For the first time it is in sight of internationally competitive levels of productivity and quality despite it's comparatively minute local market volumes. At the same time the global industry is changing in ways that potentially make these low volumes and it's regional isolation much greater millstones. Certainly the transition process is well under way and the Government's patience and vision in seeing the industry through this stage in it's development is critical to the industry and the economy as a whole.

We would respectfully request that your final report and recommendations to the Federal Government give due consideration to the matters raised in this and our original submission.

Yours faithfully



John McKenzie
President