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# The Productivity Commission's Automotive Inquiry\*

**Gary Banks**

**Chairman  
Productivity Commission**

Thank you for this opportunity to address the Southern Region of the Federation of Automotive Products Manufacturers.

This meeting is particularly timely, since the starter's gun for the Productivity Commission's inquiry into post-2005 assistance arrangements for the automotive industry has only recently sounded. We had been in the 'ready-set' position since the Government announced the inquiry just before Christmas. So it's a relief to have finally got out of the blocks.

That delay has nevertheless given us a good opportunity to think carefully about how we should best approach the inquiry to maximise its value to the industry, the wider community and the Government, on whose shoulders responsibility for setting the policy framework ultimately lies.

So what I want to focus on this afternoon are some key messages about how we intend to run the inquiry. Perhaps the most important of these, given the historical involvement of the Productivity Commission's predecessors in this domain, is that we approach it with some knowledge about the industry's development but with open minds about how the government can best meet its objectives for the industry's future. Indeed, what my Associate Philip Weickhardt and I conclude about that will be influenced by what we learn from you and other participants.

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\* Address to the Southern Region of the Federation of Automotive Products Manufacturers, on the public inquiry into Post-2005 Assistance Arrangements for the Automotive Manufacturing Sector, Melbourne, 26 March 2002.

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So we welcome this opportunity to get some early feedback on key issues from an audience that probably encompasses the majority of Australia's automotive component makers.

I might note that while the inquiry is still only few days old, we have already had the opportunity for helpful discussions with FAPM and the FCAI in Canberra, as well as BTR in Albury Wodonga (where we toured the plant). Today we met with GMH, PBR, the Tooling Industry Forum of Australia and the Automotive Training Authority. Tomorrow our list of visits includes Air International and Robert Bosch.

### **The significance of the inquiry**

That the automotive industry is an important part of Australia's manufacturing sector needs little elaboration in this forum:

- The industry accounts for about 6 per cent of total manufacturing activity and employment. Sales by the components sector alone exceed \$6 billion a year, providing employment for more than 25 000 people. The industry's significance to the South Australian and Victorian economies is even greater. In the former, for example, the industry accounts for 14 per cent of value added by the manufacturing sector and more than 16 per cent of its output.
- Over the last six or seven years, the industry's exports have nearly trebled, to more than \$4.5 billion a year. Exports of components are rapidly approaching \$2 billion a year. The industry is now a larger exporter than some of our traditional primary export industries.
- Beyond these direct outputs, the industry is also an important customer for other manufacturing activities, including steel, rubber and plastics.

To sustain the automotive industry's place in the Australian economy, continuing investment by producers is crucial. Confidence about future policy settings impacting on the industry is necessary to facilitate such investment, particularly given the long lead times that are typically involved.

More broadly, the significance of the industry means that the post-2005 assistance arrangements are likely to have ramifications for the wider economy. And, in addition to these economy-wide effects, international considerations will inevitably be a factor in the future policy calculus. For instance, Australia is a signatory to the APEC agreement committing its developed country members to move to 'free and open' trade by 2010.

The terms of reference for the inquiry require the Commission to take into account "the Government's desire for an internationally competitive and globally integrated

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automotive manufacturing sector and to improve the overall performance of the Australian economy”. Among other matters, the Commission has been asked to:

- evaluate the outcomes of the Automotive Competitiveness and Investment Scheme and the reform of tariffs;
- assess the interdependence between vehicle assemblers and component producers;
- identify strengths, weaknesses and opportunities for the sector, including major impediments to its long term viability;
- examine the impacts of changes in road safety and environmental requirements; and
- report on progress in trade liberalisation in existing and prospective export markets.

The core task of the Commission’s inquiry is to elicit information on the pros and cons of various options for post-2005 assistance arrangements for the automotive industry. Inevitably, no one option will emerge as clearly superior against all of the assessment benchmarks. Hence, in its advice to the Government, the Commission will explicitly discuss the constraints and trade-offs that different options involve.

### **The Commission’s (and Commissioners’) role**

At the end of the day, the provision of robust information on the tradeoffs in different policy choices is likely to be the Commission’s most important contribution. At the same time, the Commission’s advice is being sought because Governments value a truly independent assessment of what options best serve the interests of the community over the longer term. So we will certainly be seeking to provide clear guidance on that.

The Commission’s independence from the policy arms of government and from specific industry stakeholders is critical to the integrity and credibility of its advice.

In the last few weeks, I have heard some political commentators suggest (possibly tongue-in-cheek) that the Commission was likely to be opposed to the appointment of any Associate Commissioner who “knew too much” about the automotive industry, given the experience of the last review by the Industry Commission. There may be others here who are wondering why someone with a strong background in the automotive industry has not been appointed to the inquiry.

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The answer is straightforward. Good public policy about assistance to a particular industry needs to be made at arm's length from the industry. The principle that regulations should be reviewed at arm's length from both regulator and regulated, is a long standing one in public policy. And it has been endorsed by all Australian governments as part of the Competition Principles Agreement of 1995.

That is not to say that an industry under review should not have every opportunity to make its case; nor that the reviewers should not be expected to understand the industry's operations and market circumstances, as well as its point of view.

It is for these reasons that I have always strongly supported the important role in our processes of Associate Commissioners who can bring relevant skills and experience from outside the Commission. But it is also important that those desirable qualities are not accompanied by industry connections that could prejudice an Associate Commissioner's ability (or perceptions about his or her ability) to make an objective assessment.

In that light, I welcome the Government's appointment of Philip Weickhardt to this inquiry. He brings a much-needed business perspective, which will complement my own background in economic policy analysis. I say that in recognition that Philip's strong business credentials were largely formed in an industry that historically in Australia has not always been an advocate of unfettered international trade! Of course it should also be said that that industry, like other industries, had to adjust to a significant reduction in tariffs over the last 15 years, and did so successfully.

### **The Industry has come a long way**

In taking this fresh look at the automotive sector, Philip Weickhardt and I are acutely aware that the automotive industry itself has come a long way over the last 15 years. The 10 per cent tariff that has been legislated to apply in 2005 would have been unthinkable when the Button Car Plan was conceived in the mid-1980s. Australia has now moved from an era of made-to-measure assistance involving high tariffs, quantitative import restrictions and local content schemes, to a much more open regime designed to expose the industry to, rather than shield it from, international competitive pressures. To its credit, the industry has not only survived, but has transformed itself from an inward-looking industry to one that is competing successfully on the global stage.

While many factors will have contributed to the ongoing productivity and quality improvements that have supported this transformation, reductions in the very high levels of government support for the industry, and changes to the way in which that support has been provided, have clearly been important.

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## The future policy environment

However, that need not mean that the policy approach of the last 15 years should simply continue unaltered in the future. The issues surrounding the extent and form of any future assistance to the industry are now much more complex and subtle. While tariff assistance provided to Australia's automotive industry is still higher than that provided to all other manufacturing activities except textiles, clothing and footwear, the extent of the disparity is much lower than in the past. A number of participants argued at the 1997 inquiry that any improvements in efficiency across the wider economy from further proportionate assistance reductions would be smaller than when assistance disparities were higher. One implication is that the adjustment costs associated with further reductions in assistance may loom larger in the overall policy calculus.

Of course, domestic efficiency and adjustment issues are not the only games in town. There are also international dimensions to policy choices. The justifiable furore over the recent US decision on steel tariffs serves to highlight that decisions to provide special treatment for particular activities can have wider ramifications. Closer to home, the Automotive Competitiveness and Investment Scheme (ACIS) — which replaced the automatic by-law and export facilitation arrangements — is an illustration of how the current assistance arrangements have been shaped by international agreements to which Australia is a party, notably the WTO's Subsidies Code.

Reference to ACIS in turn serves to illustrate a more general point — namely that industry policy involves more than just tariffs. Unfortunately, this is easily lost in the heat of public debate.

Australian governments are sometimes berated for not *having* an industry policy. Such a view is generally predicated on misconceptions about what industry policy involves. Unless one still adheres to discredited notions of centralised planning, it must be recognised that government's industry policy role is really about creating an environment conducive to entrepreneurship, innovation and efficient investment and trade. The responsibility for specific decisions in these areas must rest with autonomous enterprises across an industry, sector or economy.

Two examples of this broad conception of industry policy that have already been raised in discussion with the industry include:

- industrial relations regulation, which is critical to achieving the enterprise flexibilities necessary to make best use of changing technology and for managing the risks of such process innovations as just-in-time delivery systems; and

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- R&D policy, which should facilitate the technological innovation which automotive enterprises recognise is essential to their future competitiveness.

There have been significant developments in these and other areas since the industry was last reviewed. Indeed, the ACIS scheme, which commenced in 2001, is directly linked to R&D expenditure. It generally provides greater assistance than would otherwise be available through the 125% tax concession.

Again, Philip Weickhardt and I are keen to hear your views about these and other elements of the policy environment in which you operate.

### **A streamlined inquiry process**

Turning to the Commission's processes, as you are all aware, time is now very tight for an inquiry of this magnitude and importance. Moreover, while we have been given 6 months, we appreciate that with the slippage in commencement date an earlier report would be welcomed. Accordingly, we will be doing our best to provide our final report to the Government by the end of August. However, for this to happen, timely input from the industry is an imperative.

For our part, some modifications to the Commission's standard approach will be necessary to meet the compressed timetable. Nevertheless, there will still be ample opportunity for participants to contribute to the Commission's initial deliberations and to comment on its preliminary analysis and findings. These will be publicly released in the form of a 'Position Paper'. We ourselves will bear the main burden of the tight timeframe, by compressing the time allotted to finalising the report after the public hearings.

We have already released an initial inquiry circular which outlines a list of matters on which we are seeking information and comment. Recognising the familiarity of the major interest groups with both the inquiry process and key inquiry issues, we judged this to be a more timely way of proceeding than the traditional process of preparing a more extensive Issues Paper.

### **Some questions for participants**

The list of questions in the first circular is by no means exhaustive. It is more of a primer, and people are free to comment on any matter they consider pertinent to the inquiry. The issues on which we are seeking comment largely reflect the terms of reference and will not appear novel to this audience. Let me pluck out some examples to give you a flavour of what we are after:

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- *What is Australia's role in a globalised automotive assembly and component manufacturing industry?*
  - *What are the main factors likely to influence demand for motor vehicles in Australia over the next decade? How important are exchange rate movements to the future competitiveness of the industry?*
  - *What are the emerging opportunities for the Australian automotive industry? Will these mainly arise in export markets or will the domestic market also provide new opportunities?*
  - *Are there significant impediments to the long term viability of the automotive manufacturing sector? Is the relatively small scale of the local industry a significant problem?*
  - *How important are fleet sales to the industry's future?*
  - *Are firms encountering significant trade barriers in further developing export markets? How significant are head office policies in constraining export opportunities?*
  - *How have the Australian components, tooling and service sectors performed relative to overseas competitors?*
  - *How has the industry adjusted to the tariff reductions from 30 per cent to 15 per cent since 1994?*
  - *Is the automotive manufacturing sector now at a stage where it could operate with comparable levels of support to other industries? If not, what benefits are provided by the industry to the economy that would justify differential treatment?*
  - *Would there be likely to be significant adjustment costs from further assistance reductions? Which Australian regions are particularly vulnerable to changes in the composition and size of the automotive sector?*

Importantly, we always treat submissions as public documents and place them on our website. This means that people have the opportunity to see what others are putting to us and to comment on each others' views. However, we appreciate that some information supporting particular arguments may be commercially sensitive. We will therefore accept such information on a confidential basis. The first circular outlines specifically how we go about this.

Suffice to say that whatever people may want to put in initial submissions to us, we need to receive them by *Friday May 10* if we are to give those submissions full consideration in formulating the Position Paper.

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## **Public consultation**

Prior to receiving submissions, we will continue to hold informal discussions with a broad cross section of interests in the inquiry – suppliers, users and regulators. Given that time constraints will prevent us holding public hearings prior to the release of the Position Paper, these discussions — and the input in initial submissions — will be particularly important to us.

Of course, we won't have time to visit everyone who may want to talk to us. We will also need to get the right balance between discussions on inquiry issues and inspection of production facilities, recognising that some of the latter will be essential in helping us understand how the industry has changed and what steps it has taken to improve its productivity and competitiveness.

Our intention is to release the Position Paper for public comment towards the end of June. We will be holding public hearings a month later — in Adelaide and Melbourne and possibly in other locations if there is sufficient demand. To supplement presentations at the public hearings there will be the opportunity to make further written submissions. However, these will have to be in soon after the hearings, given our intention to report to the Government by the end of August.

Finally, before giving you the opportunity to ask questions, there are a couple of other procedural matters on which I would like to comment.

## **The parallel Automotive Council process**

In addition to the Commission's inquiry, the Government has established a new Automotive Council to report on issues concurrently with the inquiry. It comprises the Ministers for Industry and for Trade, and the CEOs of the main producers and importers and their peak organisations. The Council supersedes the Automotive Trade Council which had previously advised the Government on matters affecting trade for the industry.

While the two processes are quite separate, some cooperation is obviously desirable to minimise duplication of effort and impositions on industry participants. In this regard, the early indications are very positive. I was given the opportunity to address the inaugural meeting of the new Council in February. I have also offered to provide a further briefing on the findings in the Commission's Position Paper. At an administrative level, the Commission will be providing the Council secretariat with copies of submissions received and itineraries for industry visits and discussions.

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We hope that there will also be scope for the Council to share with the Commission some of the messages emerging from its own deliberations, or any work that it commissions.

## Getting the most out of modelling

The second procedural matter I want to raise concerns the processes associated with any economic modelling conducted for the inquiry.

Economic modellers and models tend to cop plenty of flak — some of it probably deserved. While modelling can provide useful insights about how the impacts of policy changes in one area can flow through to other firms and industries, it is easy to lose sight of the limitations of modelling approaches. In particular, the results generated by economic models can be highly sensitive to the assumptions and abstractions that must be made to reduce the complexity of a modern economy to manageable analytical dimensions. Data limitations are a further constraint. Moreover, where individual parties rely on different models:

- there can be debate on the technical intricacies of those ‘competing’ models; and
- even if the assumptions and workings of each model are transparent, if different scenarios are being analysed, it can be difficult to ascertain commonalities and underlying differences in projected outcomes.

It would be fair to say that economic modelling in the last inquiry was sometimes used in such a way as to *confuse* rather than clarify the tradeoffs in different policy choices. That did not help the Government and it did not do justice to the considerable efforts of the people involved. We therefore want to avoid any repetition of that in the present inquiry.

To this end, the Commission intends to draw on all modelling inputs – those commissioned or conducted by us and those prepared by participants. We will facilitate that by devising some base-case scenarios of future assistance arrangements and making those publicly available in the next week or so. We will also be organising a workshop in mid to late May to allow technical experts to swap notes before the Position Paper is finalised. In that way, the Commission can take an arms length view of the merits of the different modelling exercises and draw on them as appropriate in the paper.

## Looking ahead

In conclusion, Philip and I and our staff look forward to a very challenging 5 months ahead. We encourage you to participate in this public inquiry to the

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maximum extent possible and look forward to meeting many of you, either in our early discussions or later at the public hearings.