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**FEDERAL CHAMBER
OF AUTOMOTIVE
INDUSTRIES**

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The Secretary
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SUBMISSION TO THE INQUIRY INTO AUSTRALIA'S MANUFACTURING INDUSTRY NOW AND BEYOND THE RESOURCES BOOM

This submission is made on behalf of the Federal Chamber of Automotive Industries, representing the interests of motor vehicle manufacturers and importers of passenger cars, sports utility vehicles, light commercial vehicles and motor cycles in Australia.

This submission seeks to address several of broad issues relating to the competitive and policy environment facing the Australian automotive industry. In particular the submission highlights the extent of recent changes in the competitive environment facing the Australian automotive industry and concludes that it is essential that the Australian Government maintain flexibility to adjust existing policy arrangements to ensure that Australia remains an attractive and competitive location for global automotive investment.

A. THE COMPETITIVE ENVIRONMENT

The evolving competitive environment for Australian automotive manufacturers has become significantly tougher over the past two or three years. These changing circumstances have strongly impacted the performance of Australian vehicle manufacturers and, in turn, this has added to the competitive pressures being experienced by many firms in the component manufacturing sector.

Over this period, the competitive environment facing the Australian automotive industry has been strongly influenced by a range of factors, including the following:

- *Sustained appreciation of the \$A*: A booming resources sector, strong commodity prices and surging terms of trade have underpinned an appreciation of the \$A of more than 30 per cent since late-2002.
- *Global corporate environment*: The commercial pressures on many parts of the industry are demonstrated by the ongoing extent of bankruptcies and closures among significant

component suppliers and corporate realignments and restructuring being undertaken by many international vehicle manufacturers. The competitive challenges facing the parent companies of Australian-based vehicle manufacturers are well documented.

- *Global supply chain management:* As global manufacturers have sought to better integrate diverse international manufacturing operations, supply chain management has been increasingly influenced by global approaches to sourcing, pricing and quality. These developments have placed increased competitive pressures on Australian vehicle manufacturers and local component suppliers.
- *Emergence of China, India and Thailand:* These economies have been successful in rapidly expanding productive capacity in vehicles and automotive products. At the same time, these and other emerging economies, apply various tariff and non-tariff barriers which impede Australian automotive exports.
- *Changing Market Segmentation/Fragmentation of Local Market:* The Australian vehicle market is characterised by a proliferation of brands and models. There are 40 brands competing in the light vehicle segments of the market, more than in many much larger markets. As a result, average volumes per brand in Australia are much lower than in major international markets such as the United States, Japan and the European Union. The market share of locally manufactured vehicles has declined steadily over more than a decade and has continued to test record lows in recent months.
- *Fuel Prices:* Rising fuel prices have been a factor compounding the impact of changing market segmentation over the past year. Consumer sensitivity to increased fuel prices and fuel economy issues has contributed to falling market share for large passenger cars.

It is noted that much of the recent change in competitive circumstances has been driven by factors which are beyond the control of the Australian industry, or government policy. Indeed it is readily acknowledged that Australian automotive manufacturers operate with the support of policy settings, calibrated to underpin ongoing investment in the industry.

Impact on Cost and Price Competitiveness

These circumstances have contributed to a significant shift in the competitive balance between imported and locally manufactured vehicles in the period since the completion of the most recent review of policy arrangements for the automotive industry in late 2002.

Table 1, over page, provides an indication of the approximate deterioration in cost competitiveness for a locally manufactured vehicle, relative to an imported vehicle of similar original value. On the basis of this generic calculation, the competitive position of a locally made vehicle has deteriorated by around \$5,000 since late 2002, for a \$20,000 locally made vehicle, against an imported vehicle of similar value.

From Table 1, it is noted that local manufacturers have received some cost saving as a result of the currency effect on the imported proportion of components used in production but this is more than offset by the exchange rate benefit for the fully imported vehicle. This calculation also takes into account the benefit of ACIS production credits received by vehicle

manufacturers, although the average value of these credits is affected by changes in the tariff changes in the modulation rate.

Of course, this deterioration in the cost competitiveness of manufacturers in the domestic market would also be reflected by a similar deterioration in the competitive position of Australian made vehicles for export.

Table 1: Changing Cost Competitiveness

Dec Q 2002				
Imported Vehicle		Locally Made Vehicle		Comp Adv (\$)
Item	Cost (\$)	Item	Cost (\$)	
		Local content	14,000	
		Imported content	6,000	
Import value (fob) (\$US11,200/0.56)	20,000	Factory cost	20,000	
Tariff (@15%)	3,000	ACIS prod credit	(640)	
Net cost	23,000	Net cost	19,360	3,640
Dec Q 2005				
Imported Vehicle		Locally Made Vehicle		Comp Adv (\$)
Item	Cost (\$)	Item	Cost (\$)	
		Local content	14,000	
		Imported content	4,380	
Import value (fob) (\$US11,200/0.75)	14,933	Factory cost	18,380	
Tariff (@10%)	1,493	ACIS prod credit	(410)	
Net cost	16,426	Net cost	17,970	(1,544)
Net change				(5,184)

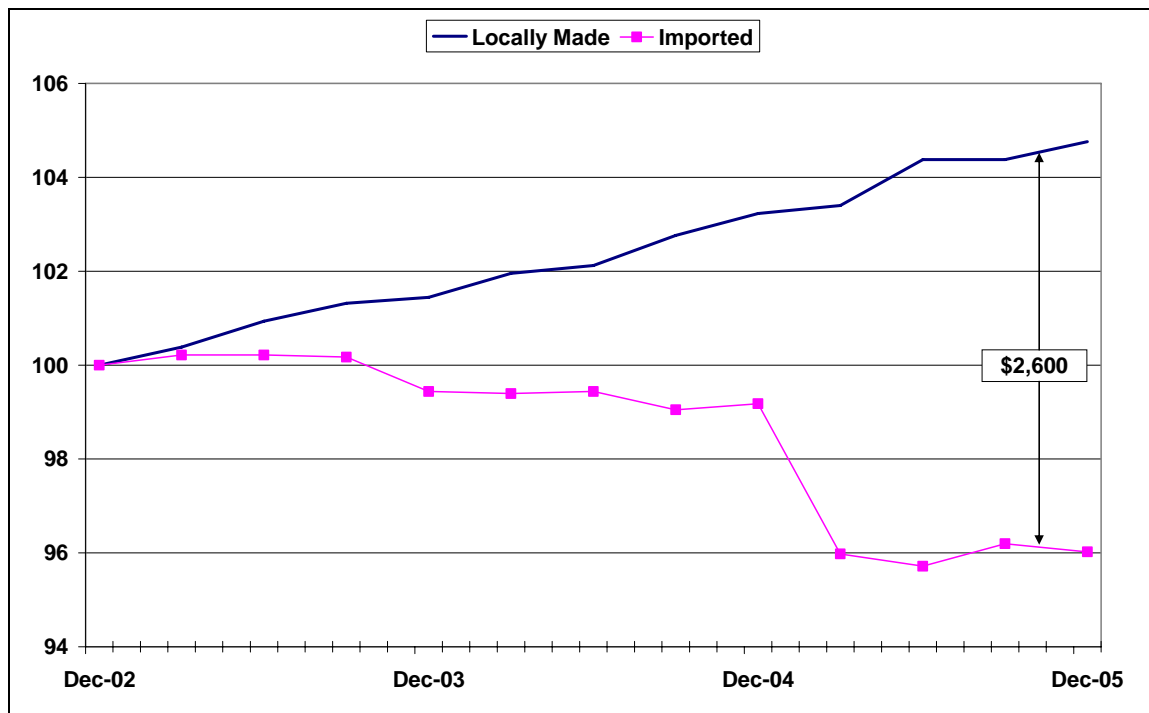
A further indication of the changing competitive balance can be gauged by comparing relative movements in retail price indices. Chart 1, over page, illustrates the extent of the divergence in retail prices for imported and locally produced vehicles over this period.

Since the December quarter 2002, the imported vehicle retail price index has declined by around 4 per cent. Over the same period the locally manufactured price index increased by almost 5 per cent. Thus over this period, there has been an overall deterioration in retail price competitiveness for the locally manufactured vehicles of around 9 per cent.

The impact of this divergence can be readily illustrated if one assumes a common retail price for an imported and an equivalent locally produced vehicle of \$30,000 in the December quarter 2002. Given the percentage changes in the price indexes, by end-2005 the imported vehicle would have opened up a price advantage over the locally produced vehicle of around \$2,600. While a proportion of this change must be attributed to the partial 'pass through' of exchange rate appreciation, some impact must also be attributed to the reduction of tariffs from 15 per

cent to 10 per cent on 1 January 2005. Indeed the significant from Chart 1, it is noticeable that there is a significant step down in import prices in the March quarter 2005, coincident with the change in tariff rates.

Chart 1: Relative Retail Price Changes: Locally Manufactured v Imported Vehicles



Impact on Vehicle Sales

The recent dramatic shift in cost and price competitiveness has only served to exacerbate a long-term trend of declining market share for locally produced vehicles.

There has been a significant reversal in the balance of market share for imported and locally produced vehicles over a period of almost two decades. As Chart 2 shows, the market share of locally produced vehicles has declined from around 70 per cent in the late 1980’s to 26 per cent in 2005. Sales figures for 2006 to date highlight a continuation of this trend with locally produced vehicles accounting for only 21 per cent of all light vehicle sales.

The impact of this trend on the loss of domestic sales for local vehicle manufacturers is difficult to overstate. Chart 3 seeks to quantify the impact of this trend in lost sales over the past two years. Taking 2002-03 as an arbitrary base period, it is estimated that the effective loss in sales rose from an estimated 10,000 units in 2004 to 50,000 units in 2005.

The major proportion of this loss in volume is accounted for by the decline in market share for locally manufactured passenger cars. While the significant loss of passenger car sales is partially offset by the emergence of locally manufactured SUVs, since early 2004, a drop in the market share of locally made light commercial vehicles contributes around 5,000 units to the overall loss of sales in 2005.

Chart 2: Light Vehicle Market Share – Locally Produced v Imported

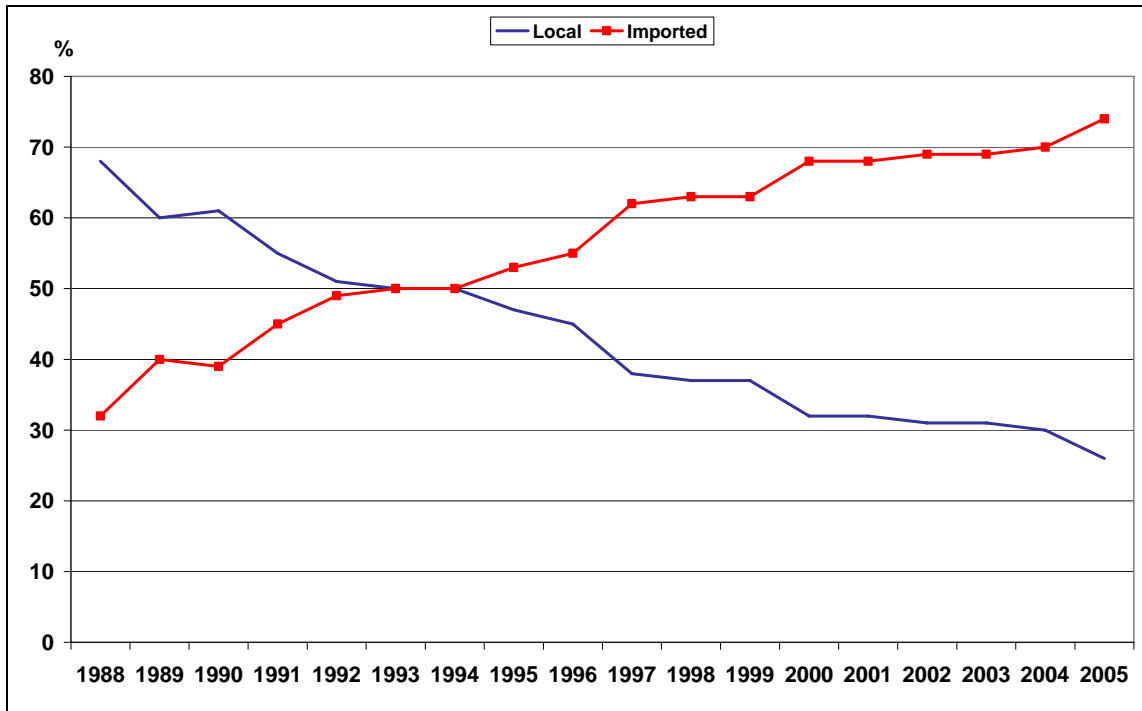
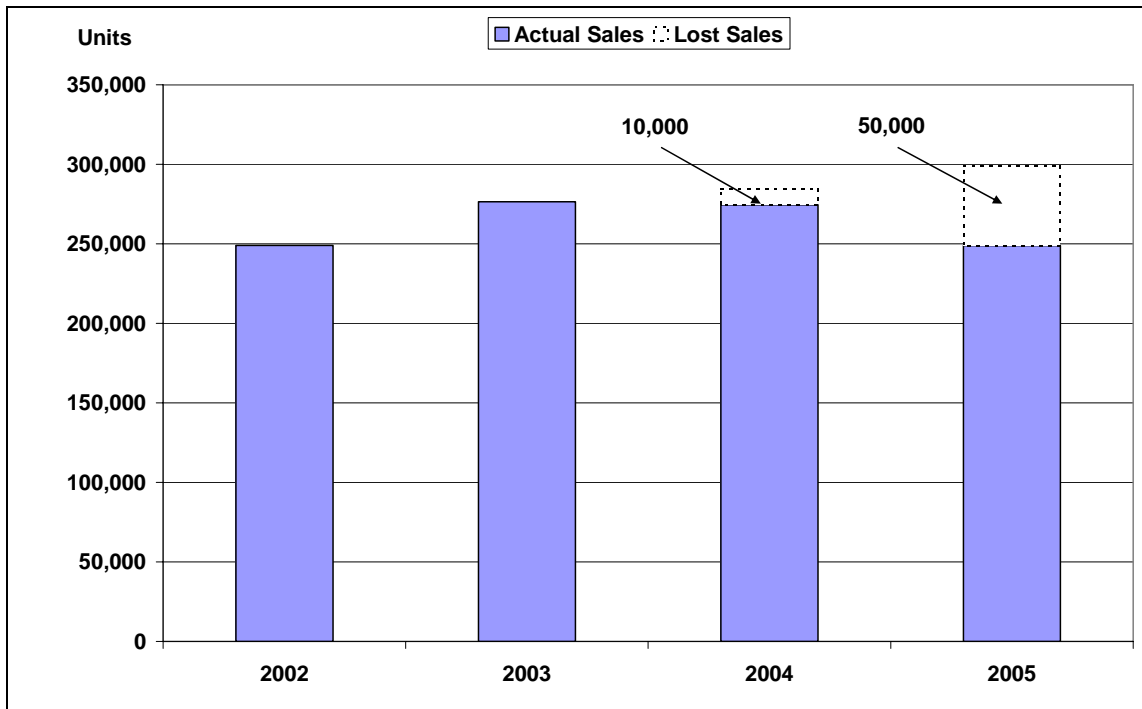


Chart 3: Lost Sales for Local Manufacturers in the Australian Market



Trends in Automotive Production and Trade

Given the growing intensity of competition for sales volume in the domestic market, Australian vehicle manufacturers have increasingly looked to underpin production volumes by seeking out new export opportunities.

Chart 4 shows the path of overall Australian vehicle production volumes, as well the evolving balance between domestic and export sales over the past decade. This chart shows that in aggregate, Australian vehicle producers have successfully increased production volumes from around 300,000 units a year in the mid-1990s to around 400,000 units a year, more recently. This growth is (more than) fully accounted for by an expansion in vehicle exports, while there has been a slight overall decline in the volume of production for the domestic market.

Chart 4: Australian Production of Light Vehicles

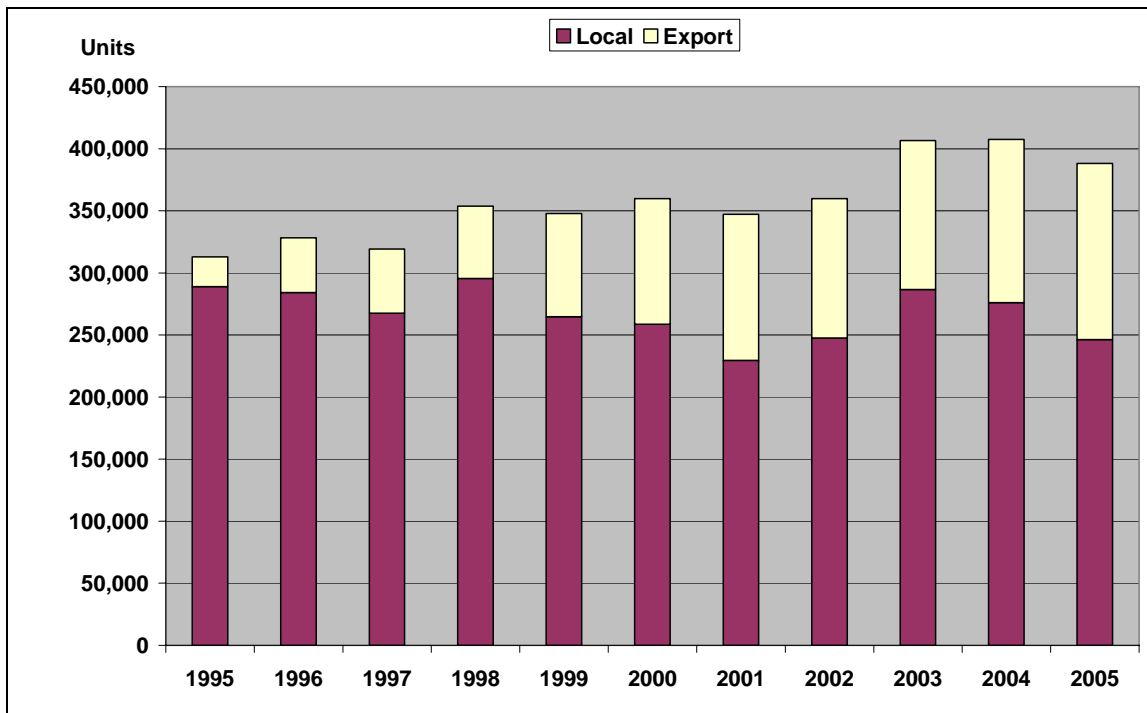


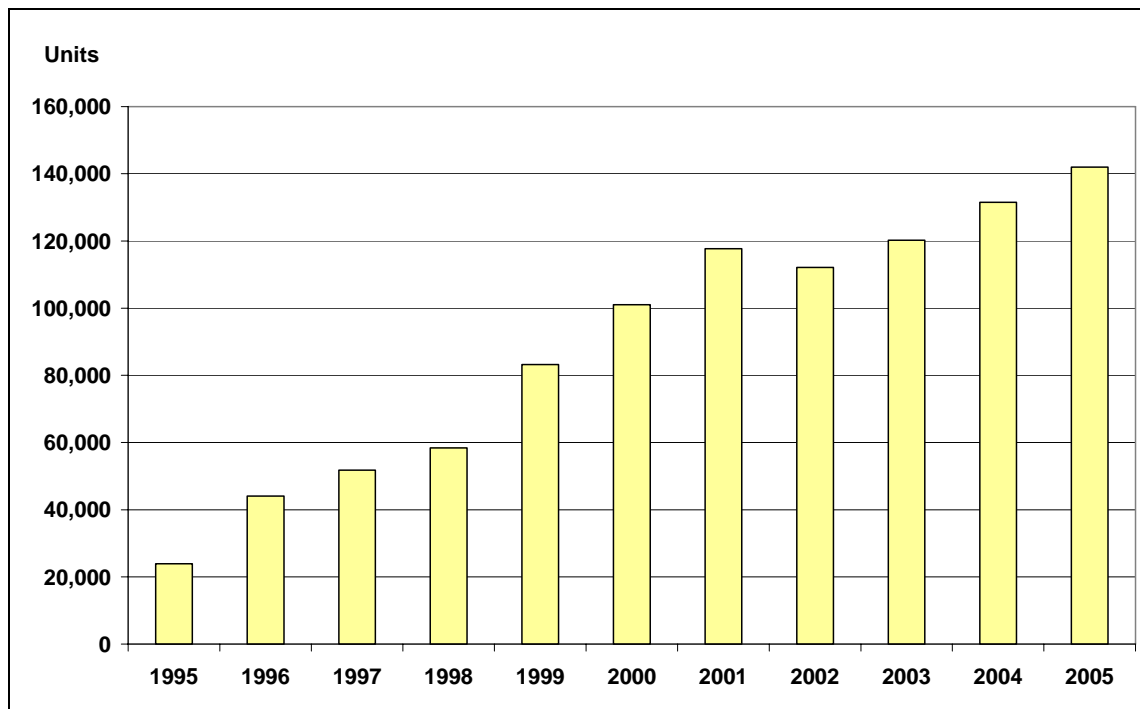
Chart 5, illustrates the extent of the growth in Australian vehicle exports over the past decade. It shows that since 1995, vehicle exports have grown more than fivefold from around 20,000 units a year to a record of 140,106 units in 2005.

While this is an outstanding record of achievement, the export competitiveness of local manufacturers has been adversely affected by the appreciation of the \$A against key currencies in recent times. Equally, Australian vehicle exports continue to be narrowly concentrated in a limited number of key markets (Middle Eastern markets such as Saudi Arabia, UAE, Kuwait, Oman, Qatar and Bahrain account for more than 55 per cent of the value of vehicle exports).

Notwithstanding the prospects for implementation of possible further free trade agreements (FTAs), Australian automotive exports continue to face significant (non-tariff) market access barriers in the Asia Pacific region. While the implications of the recent suspension of WTO

Doha Development Agenda negotiations are yet to be fully understood, this is only likely to limit the prospects for future improvements in market access for Australian automotive exporters.

Chart 5: Australian Vehicle Exports



Summary of Key Points

The competitive environment facing Australian automotive manufacturers has become significantly tougher over the past two or three years.

As a result of significant loss of cost and price competitiveness, Australian vehicle manufacturers have lost a significant volume of sales in the domestic market and face increased competitive pressure in existing and potential export markets.

The loss of sales for local manufacturers in the Australian market is estimated to be 50,000 units in 2005 alone.

While declining local market share has been offset by increased export sales over the past decade, export competitiveness has been undermined by the sustained strength of the \$A over the past one or two years.

Australian vehicle exports are heavily concentrated in a limited number of key markets (particularly the Persian Gulf). While FTAs currently under negotiation may offer opportunities for an expansion of trade, Australian automotive exporters continue to face significant barriers to trade, particularly in Asia Pacific markets.

B. POLICY IMPLICATIONS

The Australian automotive industry has engaged in significant structural reform, driven by a changing global industry and an evolving policy environment over a period of more than two decades.

Over this period, the Australian economy as whole has faced an extensive agenda for economic reform, implemented with the objectives of encouraging stronger productivity growth, increased investment attractiveness, enhanced employment opportunities and higher growth in living standards.

In recent years, the Australian vehicle market has been boosted by strong consumer demand, underpinned by solid growth in employment and incomes, and booming asset prices (property and shares). At the same time vehicle affordability has been enhanced by low and stable interest rates and by national reform of indirect tax arrangements, implemented by the Commonwealth Government.

Going forward, key policy settings and an ongoing agenda for economic reform will play a vital role in underpinning the competitive position of the Australian automotive industry.

Supportive Industry Policy

The most recent review of policy arrangements for the Australian automotive industry was completed in December 2002. The outcome of this review has continued and significantly reinforced industry policy arrangements directed at the dual objectives of progressively opening the Australian automotive market to a greater degree of international competition, while ensuring that Australia remains an attractive and competitive location for international investment. The key elements of the policy arrangements announced by the Government in December 2002 include:

- A further reduction in tariffs on passenger cars and key automotive components from 10 per cent to 5 per cent from 1 January 2010. The Government indicated that it would undertake a further inquiry in 2008 to determine whether changes are warranted to these legislated tariff reductions in view of conditions in the international trade environment.
- A 10 year program of budgetary assistance to the industry, worth an estimated \$4.2 billion, through the ongoing Automotive Competitiveness and Investment Scheme (ACIS). This comprises an estimated \$1.2 billion in uncapped ACIS credits over the period, along with capped ACIS assistance of over the period 2006-2010, with phase out arrangements for this capped assistance of \$1.0 billion over the period 2010-15.

FCAI has acknowledged that current industry policy arrangements play an important role in augmenting the broader economic policy settings and reform agenda, providing valued support for the ongoing renewal of investment in automotive manufacturing and the evolving international competitiveness of the Australian automotive industry.

Moreover, it is also acknowledged that the Australian Government has adopted a flexible approach to the industry policy arrangements announced in December 2002. Where

circumstances have warranted, the Government has demonstrated that it is prepared to provide further support to secure additional global investment in the Australian industry, as illustrated by the recent announcement by the Prime Minister of Australian Government financial assistance, worth a total of \$52.5 million to Ford Australia for two strategic projects (5 May 2006). It is noted that the Victorian Government has also committed financial support to Ford Australia for these projects.

FCAI believes that it is important that the Australian Government maintain the flexibility to respond to finetune and augment existing policy arrangements to meet the changing competitive circumstances facing the Australian automotive industry.

Recognising the evolving competitive climate facing the Australian automotive industry the Minister for Industry, Tourism and Resources, in November 2005, convened the Automotive Industry Strategic Group (AISG), comprising chief executives of the four Australian-based vehicle manufacturers and senior representatives of the automotive component manufacturing sector. Relevant state ministers have also invited to attend AISG meetings. The AISG has provided a useful forum for industry to canvass emerging challenges facing the industry and an opportunity to

A key initiative emerging from AISG has been the proposal to undertake a Supplier Development Program. The program will draw on \$7.2 million in funding provided for under the existing \$150 million ACIS Motor Vehicle Producers R&D Scheme. It is proposed that the program will focus on supplier development initiatives to be implemented by motor vehicle producers (MVPs). The MVPs will work with component suppliers to identify priority areas for capability development, over and above existing development activities, and nominate projects for funding. MVPs have endorsed this proposal and will be bringing forward supplier development project proposals over coming months, for implementation under this program in 2007.

FCAI also welcomes the recent announcement by Minister Macfarlane that the Australian Government will be undertaking consultations with a range of stakeholders to assist in preparations for the development of a new Industry Statement to be finalised early in 2007. FCAI sees this process as a valuable opportunity to renew existing industry policy settings and will be seeking to contribute relevant input through forthcoming Roundtable meetings which the Minister is convening for this purpose. FCAI believes that the forthcoming Industry Statement provides an ideal opportunity to ensure that future strategies for industry investment and innovation are effective in maximising Australia's potential as a location for international investment and R&D.

Enhanced Market Access

The Australian automotive industry continues to work actively with the Australian Government to pursue increased market access for automotive exporters.

The recent suspension of WTO Doha Development Agenda negotiations diminishes the prospects for far reaching reform of international trade barriers which may have been of benefit to manufacturing exporters, including those in the Australian automotive industry. It is noted that FCAI had expressed concerns to the Australian Government that modalities under

consideration for non-agricultural products would have potentially provided developing countries (which nonetheless are home to advanced automotive manufacturing industries) with excessive flexibility to exclude a proportion of tariff items from the full impact of any agreed tariff reduction formula.

FCAI has endorsed the Australian Government's approach of pursuing free trade agreements (FTAs) with key trading partners where such an outcome offers broad mutual net economic and trade benefits.

To this end, FCAI has supported the implementation of recent FTAs with Thailand and the United States. FCAI has also endorsed current FTA negotiations underway with ASEAN, Malaysia and China. However, we note that the Australian automotive industry's support for any final agreements which may result from these negotiations is contingent on the ability to comprehensively address a broad agenda of trade-related issues, including the removal of all significant obstacles to improved market access for Australian automotive exporters.

Summary of Key Points

The Australian automotive industry has been the focus of dedicated policy arrangements for more than two decades. These policy arrangements have been implemented with the dual objectives of supporting ongoing global investment in the industry, while progressively opening the Australian vehicle market to increased international competition.

The post-2005 review of policy arrangements was completed in December 2002. A key outcome of this review was the decision by the Australian Government to extend ACIS from 2006 until 2015. It has been acknowledged that this provides an extended period of competitive support for the industry, which will help underpin renewed investment in the Australian industry.

The Australian Government has legislated to reduce tariffs on passenger cars and key automotive components from 10 per cent to 5 per cent from 1 January 2010. It is noted that the Government proposes to review these legislated tariff reductions in 2008, in the light of changes in the international trade environment.

To this end, it is essential that the Australian Government continue to actively pursue enhanced market access opportunities of tangible benefit to automotive exporters (particularly with ASEAN).

FCAI urges the Australian Government to maintain a flexible approach to policy arrangements for the Australian automotive industry to ensure that they remain responsive to recent significant changes in the competitive environment, including the impact of the resources boom.

Contact Information

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