



EUROPEAN UNION

DELEGATION OF THE EUROPEAN COMMISSION TO AUSTRALIA AND NEW ZEALAND

The Ambassador

Canberra, 12 May 2008
CBR.D(2008) 256 – 3.01.01

Dear Mr Bracks,

Please find a submission by the European Commission to the Independent Review of the Australian Automotive Industry.

Should you wish any further clarification of our submission please do not hesitate to contact my office.

A handwritten signature in blue ink, appearing to be 'B. Julien', with a large, sweeping flourish that extends to the left.

Bruno Julien

Mr Steve Bracks
Automotive Review Secretariat
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Canberra, 14 May 2008

SUBMISSION TO THE REVIEW OF THE AUSTRALIAN AUTOMOTIVE INDUSTRY

This paper is intended to be tabled as a formal submission to the independent review of the Australian automotive industry by the European Commission, in its role as representing the European Union in matters pertaining to trade policy. In particular the submission focuses on the operation of the Luxury Car Tax (LCT) and the scheduled tariff reductions.

Luxury Car Tax

It was both a surprise and a considerable disappointment to the European Union that the Australian government announced in the 2008-09 budget handed down on 13 May that it will raise the rate of the LCT from an already high 25% to a punitive 33%. Such a protectionist move can only undermine Australia's credentials internationally as a leader in trade liberalisation.

Non-tariff barrier

From the European Union's perspective the LCT should be seen as a non-tariff barrier, as it is discriminatory in its effect by mainly impacting on imported cars, particularly from Europe; and, as recognised by the Productivity Commission, provides a disguised form of domestic assistance.

Based on data provided by VFACTS, around 90% of cars affected by the LCT are imported and over 50% are from the European Union – with around 66,000 vehicles in 2007 subject to the LCT, of which around 60,000 were imported and 36,000 were from the EU.

The imposition of the LCT leads to a distortion in the domestic vehicle market and curtails the development of the luxury car segment.

The review's own discussion paper acknowledges that the bulk of LCT is collected on the sale of imported vehicles and it is of note that the review observes that '*the LCT may benefit the local industry*' (emphasis added). The European Commission contends that it is questionable whether in the longer term the LCT does provide real benefit to the local industry and it certainly does not benefit Australian consumers.

LCT is a tax on safety, environmental performance and security

Importantly, from a domestic perspective the imposition of the LCT has adverse impacts on the safety, environmental performance and security of the overall vehicle fleet. Luxury vehicles generally offer superior safety, environmental and security features either as standard fittings or as optional extras. Where these superior features contribute to increasing the price of the vehicle above the Luxury Tax Threshold (LTT) of \$A57,123, the tax effectively now acts as a fine of \$A330 for every \$A1,100 of expenditure above the LTT and results in consumers being penalised for purchasing a safer, cleaner and more secure vehicle.

Examples of these superior features include:

Safety – electronic stability program (ESP) enhanced systems, collision warning with brake support, speed dependent and electric/electronic steering systems, continuously controlled chassis concept (Four-C), blind spot information system (BLIS), active or advanced bi-xenon

light sensors, water repellent side windows, electronic lane assist scanning, advanced cruise control with speed and braking functions, air bag systems including curtains, body and knee protection from side impacts, two phase or size sensing for the driver and passenger;

Environmental – adaptive cruise control (ACC), more advanced fuel efficient engines which are smaller in size but are assisted by compression methods (turbo or supercharging) to give better performance and leaner fuel economy, hybrid engines and biofuel engines, advanced diesel technologies, LPG; and

Security – remote control alarm, laminated side windows, lockable wheel bolts, deadlocks, panic switches, tracking devices.

In addition, by reducing the proportion of 'luxury' cars with advanced features on the Australian market, the LCT reduces the potential for consumer pressure for the inclusion of safety and other advanced features in models in the remainder of the market.

The LCT impedes innovation

The luxury car segment is also important for innovation in the industry since it provides a means to test advanced technology which can subsequently be adopted in other segments of the market through a trickle down effect. The LCT is therefore an impost on innovation and high technology cars and hampers the introduction of premium quality and safety to standard family cars. Impeding this driver for innovation must have consequences on the long-term competitiveness of the Australian auto industry in world-wide markets.

An example currently is the resistance by the domestic industry to calls by fleet operators to have stability controls and curtain airbags as standard features. This resistance has also led the Victorian Government to introduce as part of its *Road Safety Strategy: First Action Plan 2008–2010* a requirement for registration that all new vehicles manufactured after 31 December 2010 be fitted with electronic stability control and all new vehicles manufactured after 31 December 2011 be fitted with head protecting technology (such as side curtain airbags) should a national system not be in place at this time.

The indexing methodology has led to the LCT becoming more onerous over time

With the proportion of all vehicles subject to the LCT increasing from 4% in 2000 to 6.5% in 2007, it is clear that the indexing methodology is not reflecting the true movement in the price of cars. When vehicles imported from the EU are considered, almost 30% of all vehicles were subject to the LCT in 2007.

The current indexing methodology (increase in the Consumer Price Index Motor Vehicle Index in the year to the preceding March quarter) explicitly excludes price changes resulting from the adjustment of prices for 'quality' improvements in vehicles – quality in these terms can be broadly seen as positive changes in specifications.

Given technological advances and improved quality is one of the key drivers of the automotive sector, the index bears no resemblance to the real change in prices. Therefore the current indexing methodology is becoming progressively inappropriate over time. Since the luxury car segment is the leader for improved specifications its prices tend to increase by more than the average price of vehicles. Therefore the current indexing methodology based on the average movement in prices is also inappropriate.

There are many alternative methodologies which could be used to index the LTT which could be considered more appropriate than the current methodology, including the construction of a specific luxury vehicle price index including quality changes or as a second best option the Australian Automotive Intelligence Report car price index.

Given the inadequate indexing of the LTT in the past and the apparent arbitrary way it was set when it was last seriously reviewed (i.e. when the Goods and Services Tax was introduced¹), the current LTT would need to be considerably increased to be recalibrated at a level analogous to the level it was introduced at.

As an indication of the order of magnitude required to recalibrate the LTT, the affordability of vehicles caught by the LTT has dropped significantly since the GST was introduced – from 66 weeks of earnings in 2000 to just 55 weeks in 2007. Put another way, the threshold should have increased by 37.7% since 2000 to maintain constant affordability, when in practice it has only increased by 3.6%. On this basis, the threshold should be at least \$A75,920; but if the initial Tax Reform Plan threshold proposal of \$A60,000 is used the threshold should be \$A82,620.

Conclusion

For all of the above reasons, the European Commission contends that the Luxury Car Tax should be abolished immediately as being detrimental to the Australian automotive industry as well as discriminatory in its application and urges the independent review of the Australian automotive industry to recommend that the LCT be abolished.

Should this be considered as impractical within the parameters of this review, the European Commission contends that the LCT should be phased out over a reasonably short period of time by the progressive application of (a) substantial increases in the Luxury Tax threshold, starting at \$A80,000 at least; and, (b) significant cuts in the punitive 33% tax rate, with the rate cut to 15% at least from the outset.

Tariff reductions

Regarding the scheduled reduction in the customs duty on passenger motor vehicles and certain related componentry from 10% to 5% in 2010, it is similarly a surprise and a disappointment to the European Union that the question of postponing or even abandoning the reduction in tariffs should even be considered as part of the review.

The European Commission is aware that there are calls from the Australian domestic automotive industry for continued protection but observes that the industry has known since at least 2002 that the reductions were going to occur and have been given more than enough opportunity and industry support to restructure and prepare for the new conditions post 2010.

Should such protectionist moves gain any traction, this would again send a negative message to Australia's trading partners and undermine both Australia's international credentials and moves for further global trade liberalisation.

The European Commission therefore urges the inquiry to resist pressure from domestic interests for any deferral in the legislated tariff reductions.

¹ In the initial Tax Reform Plan proposals the threshold was to be set at \$A60,000 but was actually introduced at \$A55,134.