Ai GROUP SUBMISSION

27 November 2013

Ai Group Submission to the Productivity Commission Review of the Australian Automotive Manufacturing Industry (Nov 2013)

AUSTRALIAN INDUSTRY GROUP

Contents

Appendixes

This submission was finalised on 27 November 2013.

About Australian Industry Group

The Australian Industry Group (Ai Group) is a peak industry association in Australia which along with its affiliates represents the interests of more than 60,000 businesses in an expanding range of sectors including: manufacturing; engineering; construction; automotive; food; transport; information technology; telecommunications; call centres; labour hire; printing; defence; mining equipment and supplies; airlines; and other industries. The businesses which we represent employ more than 1 million people. Ai Group members operate small, medium and large businesses across a range of industries. Ai Group is closely affiliated with more than 50 other employer groups in Australia alone and directly manages a number of those organisations.

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Executive summary

- The Australian economy is currently growing at a pace that is below its long-term average of around 3%. The RBA and other forecasters expect this slow speed to continue into 2014 and 2015 due to ongoing domestic and international headwinds.
- Australian manufacturing has endured extremely tough trading conditions over the five years since the GFC. As of June 2013, total manufacturing output (value added) was 9.8% lower than at its last peak in June 2008, and just 0.9% higher than during the GFC trough in Q3 2009. Total manufacturing employment is now 14% lower than it was in 2008. In its current condition, the manufacturing industry does not appear to be readily able to 'absorb' tens of thousands of workers who might be displaced from the automotive sector, should automotive production be reduced or removed from Australia by changes to industry policy.
- Limited ability to increase manufacturing employment and investment mean that further shocks to the domestic manufacturing sector (due to changes in policy) could do more damage in this environment than they would if they were implemented at a time when manufacturing - and the broader economy - were more resilient.
- In this fragile economic environment, Government must be wary of inadvertently exacerbating the tough trading conditions faced by businesses across many of our key industrial sectors. Government should avoid implementing short-term or narrowly considered savings measures that may detract from businesses' ability to contribute to Government revenue collections now or at a later date.
- Ai Group believes the funding proposed under the New Car Plan should be allowed to run its course to 2020, in the interests of promoting trust and certainty in industry policy. Policy certainty is especially crucial in programs that are aimed at fostering long-term investment and innovation, such as the current suite of automotive assistance programs. The detail of the Plan should however, be open to revision should that prove appropriate under changed circumstances. Ai Group Members hold a wide range of views on the best way forward on any such revisions.
- As a matter of principle, Ai Group favours industry policies that enhance business growth and productivity and that are open to all businesses, regardless of the sectors in which they operate, their size or their place in the supply chain.

Australian Industry Group participation in this Review

Australian Industry Group (Ai Group) welcomes the opportunity to participate in this latest Review of Automotive Manufacturing in Australia.

Ai Group plans to prepare two submissions to this Review.

In this first submission, we have:

- Set out our broad insights into the current state of the Australian economy
    - We note that the national economy is in a fragile stage right now and that further shocks to the domestic economy (due to changes in policy or other causes) could do more damage in this environment than they would if the economy were more resilient.
- Looked specifically at the current state of Australian manufacturing more broadly.
    - We note that in its current condition, the manufacturing industry does not appear to be readily able to 'absorb' tens of thousands of workers who might be displaced from the automotive sector, should automotive production be reduced or removed from Australia by changes to industry policy.
- Given our preliminary views on the role of automotive production in Australian manufacturing and its future opportunities.
    - Strict time constraints in this Review process have limited the amount of material we have been able to collect from our Members and present in this submission. We have not, for example, been able to examine in detail the linkages between automotive manufacturing and other parts of manufacturing, individual industry assistance programs or issues of geographic distribution, due to these very tight time constraints.
- Included as attachments some of our recent relevant research papers.

In our second submission (due to the Commission in February 2014) and following more detailed discussion at our National Executive and Councils and further consultation with our members, we will set out our response to the Commission's Interim Reports and will provide more detail from our members on the role and future opportunities of automotive manufacturing.

Ai Group has not commissioned any external parties to undertake any research, econometric modelling or data analysis on our behalf for this Review.

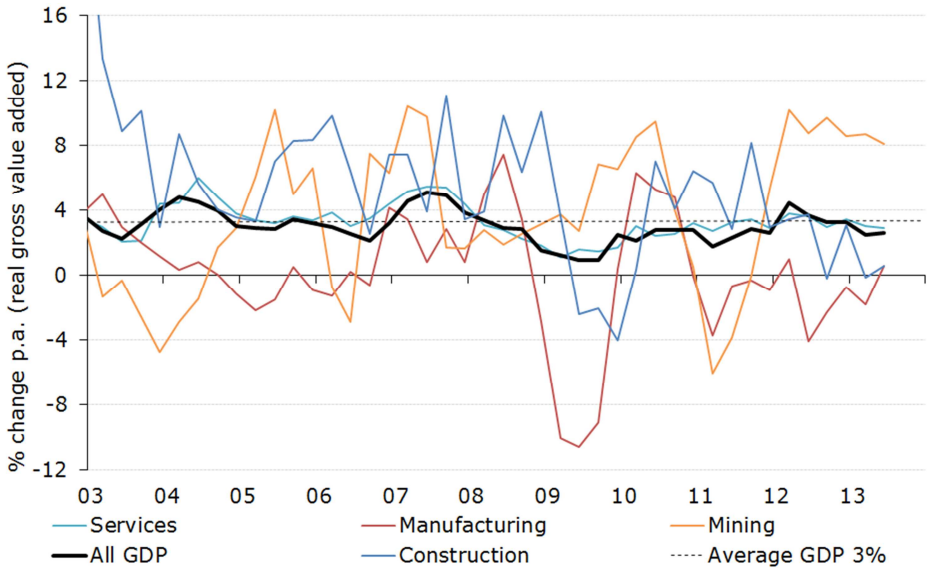
Economic context: the Australian economy

Australian economic growth slowed steadily through 2012 and 2013, with below-average rates of growth in real output (GDP) recorded in both Q1 and Q2 this year. Real GDP grew by 0.6% q/q and 2.6% p.a. in Q2 2013 (inflation adjusted and seasonally adjusted), indicating only a very slight pick-up from Q1 (0.5% q/q and 2.5% p.a. in Q1). Among our six largest industries (in value added terms), three sectors – mining, finance and health – showed strong growth in value-added output in Q1 and Q2 while the other three – construction, manufacturing and professional services – were treading water at best (see charts 1 and 2). These six industries produce almost half of our economic output (around 47%) and account for a similar proportion of total employment (43%).

Construction and manufacturing (our third and fourth largest sectors in terms of value-added output and employment, together accounting for around 15% of GDP and 18% of jobs) have experienced especially difficult trading conditions over an extended period of time, due to a variety of domestic and international factors. Manufacturing has experienced only two quarters of positive annual growth in output since the middle of 2010 (1.0% p.a. in Q1 2012 and 0.6% p.a. in Q2 2013). Meanwhile, construction saw two quarters of contraction in output in 2012-13 (in annual growth terms), despite the apparent boost that this sector was receiving from the mining investment boom during this period. This was because the rise in mining-related engineering construction was not enough to outweigh the falls in commercial and residential construction during the recent lows in their activity cycles. Trends in profits, incomes, employment and investment have followed a similar trajectory over this period in these two key sectors.

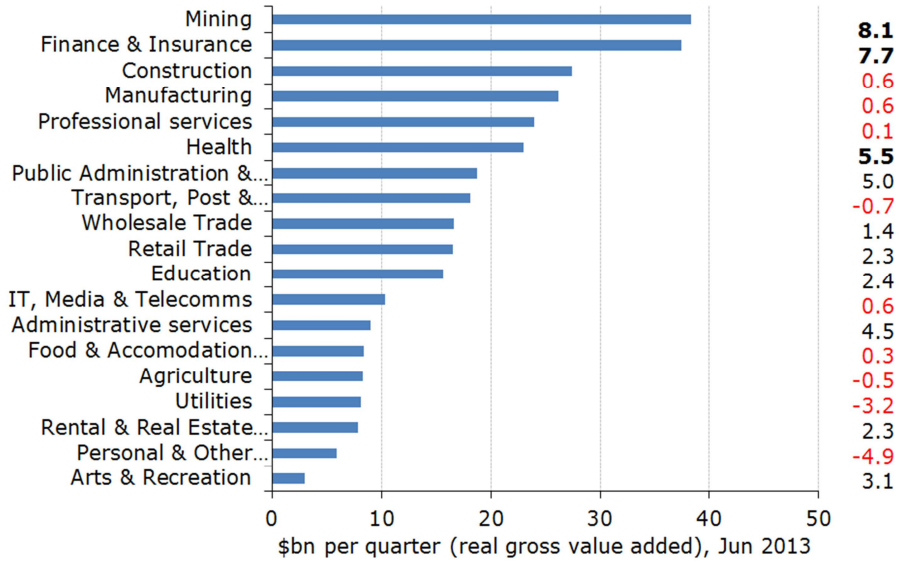
Although the Australian economy continues to perform significantly better than many of our developed-economy peers, these weak rates of national economic growth are of concern. The long-term average rate of growth in real GDP for Australia is around 3.0%, while the population growth rate is around 1.8% p.a. Real GDP growth of 3% or more is widely considered to be a necessary and minimum condition, in order to generate sufficient employment growth to stop unemployment from rising. With GDP growth of just 2.6% p.a. and no strong drivers of local output or employment growth yet emerging to replace the recent (but now declining) support from mining-related projects, we can expect the unemployment rate to keep drifting up, with output and incomes per capita likely to drift sideways at best.

Chart 1: GDP and major industries, annual growth in real output (% p.a.)



Source: ABS, *National Accounts*. June 2013.

Chart 2: Real output by industry, $bn per qtr and annual growth (% p.a.), June 2013



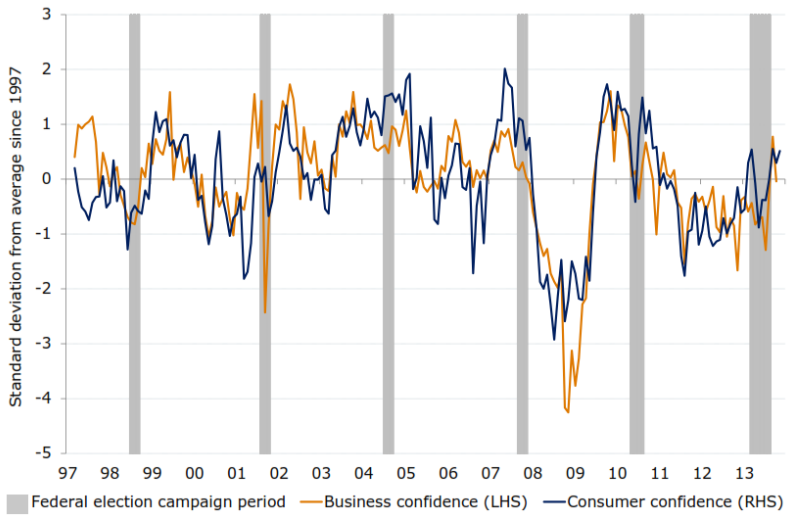
Source: ABS, *National Accounts*. June 2013.

The economic mood has been more positive in the second half of 2013, with several 'real-time' activity indicators showing a lift in local demand since the September federal

election. Real concerns remain however, about the ability of our non-mining sectors to step into the growth gap that is opening up in the wake of the mining investment boom, which has already reached its peak in this cycle. In a recent Statement, RBA Governor Stevens noted that since the election "*there has been an improvement in indicators of household and business sentiment recently, but it is still too soon to judge how persistent this will be*." Of particular significance, Stevens also noted that "*the Australian dollar, while below its level earlier in the year, is still uncomfortably high. A lower level of the exchange rate is likely to be needed to achieve balanced growth in the economy*."

The latest indications of confidence among businesses (the NAB monthly survey) and consumers (Westpac-MI and Roy Morgan) suggest the Australian economy is currently experiencing a fairly normal reaction to a federal election, with a sharp lift in confidence immediately after the election, followed by a moderation in economic expectations some time later. This moderation in mood might be setting in earlier now than in the 2000's, reflecting the weaker state of the economy, compared with the more prosperous, high-growth, pre-GFC period. Business confidence in particular, had already slumped back to its long-term average in October (see chart 3).

Chart 3: Business and consumer confidence in election cycles

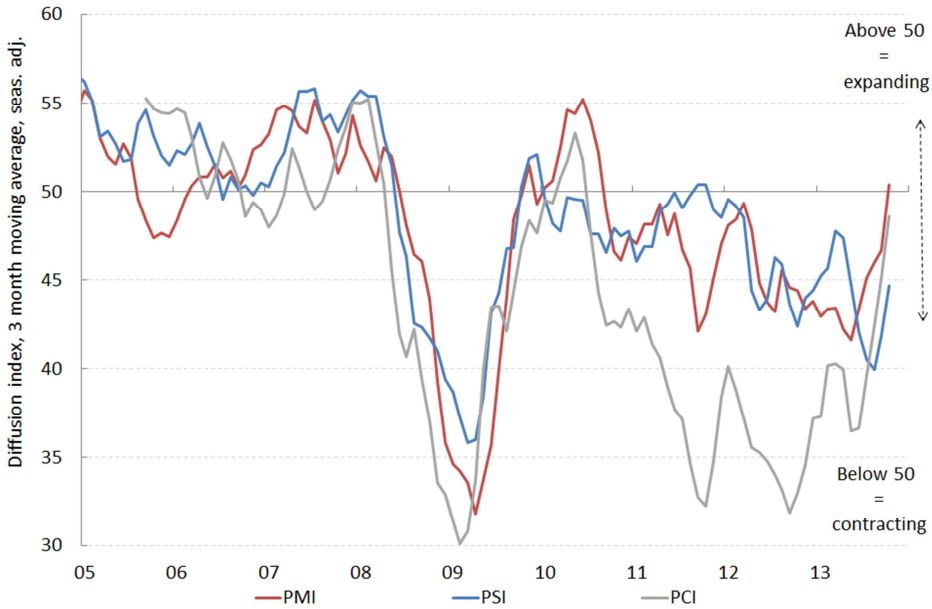


Source: NAB, Westpac-MI and ANZ.

These confidence measures confirm the trends emerging from the latest Ai Group's performance indexes: the Australian PMI®, Australian PSI® and Australian PCI®, which

suggest a moderate but not especially strong improvement in local demand and activity in the last quarter of 2013 (see chart 4). For many of our economy's largest industrial sectors, this last quarter of 2013 seems to be offering a partial recovery at best from an extended period of tough trading conditions (due to factors such as the high dollar, weak local demand, shifting global growth patterns and high local costs), rather than new opportunities for outright growth.

Chart 4: Australian PMI®, PSI® and PCI®



Source: Australian Industry Group.

The outlook for the Australian economy is relatively flat for the foreseeable future, because many of the headwinds noted above are likely to remain in play. This fragile trading environment will entail ongoing adjustment from business and industry and will require a strong degree of sensitivity, caution and stability in our economic policy settings. The RBA and other official forecasters expect GDP growth to remain below the long-term average (around 3%) in 2014 and into 2015 (see table 1). In November, the RBA revised down its GDP growth expectations for 2014-15 by about 0.5 percentage points. Below-trend growth is now expected to continue over a longer period than was expected previously, due to a range of factors including: a sharp fall in mining investment (which will subtract from GDP growth); only moderate growth in household spending due to slow employment growth and increased savings; the continued strength of the dollar; and fiscal restraint by federal and state governments. Bright

points in the outlook are resources export volumes (up strongly) and housing construction (recovering).

The RBA does not publish detailed forecasts of employment, but the Australian Treasury expects employment growth to remain extremely weak over the outlook period, improving from less than 1% p.a. currently to just 1.5% p.a. in 2015 and 2016. This is likely to see the unemployment rate rise from its current level of around 5¾% to 6¼% through 2014 and 2015, before improving again in 2016. Workforce participation rates will also be lower. This weak pattern of growth will place increasing pressure on Government and industry to find productivity improvements to drive future growth in our output and incomes.

Table 1: Latest Australian growth forecasts (official sources)

GDP growth, % p.a. (year end)	**2013**	**2014**	**2015**	**2013-14**	**2014-15**	**2015-16**
RBA (November 2013)	2¼	2 - 3	2¾-4¼	2½	2¼-3¼	
Treasury (August 2013)				2½	3	3
IMF (October 2013)	2½	2.8				
CPI rate, % p.a. (year end)	**2013**	**2014**		**2013-14**	**2014-15**	**2015-16**
RBA (November 2013)	2¼	2 - 3	1½ - 2½	2¾	2-3	
Treasury (August 2013)				2½	2	2½
IMF (October 2013)	2.2	2.5				
Employment growth, % p.a. (annual average)				**2013-14**	**2014-15**	**2015-16**
Treasury (August 2013)				1.0	1.5	1.5
Unemployment rate, % (year end)				**2013-14**	**2014-15**	**2015-16**
Treasury (August 2013)				6.25	6.25	5.0
IMF (October 2013)	5.6	6.0				

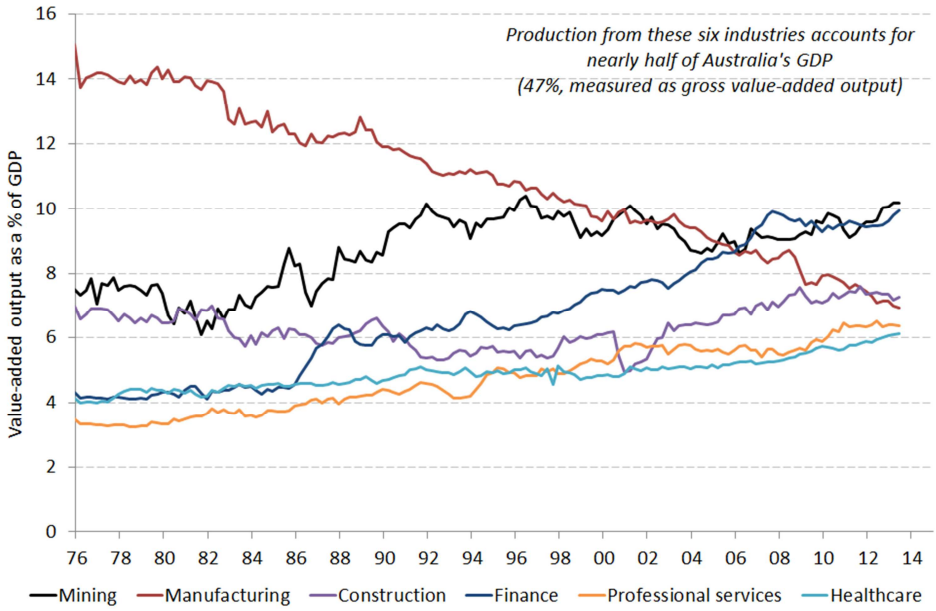
Source: RBA, *Statement of Monetary Policy*, Nov. 2013; Australian Treasury, *Pre-Election Economic and Fiscal Outlook*, Aug. 2013; IMF, *World Economic Outlook*, Oct. 2013.

Recent growth trends in Australian manufacturing

Manufacturing is a large and diverse major industry category in the Australian economy. It currently accounts for around 7% of GDP (gross value added) and around 8% of all employment. It is the fourth largest industry on these two key measures. The shares that manufacturing contributes to export earnings (35% in 2012-13) and investment spending (24% of R&D spending in 2011-12 and 10% of private capital expenditure in 2011-12, but only 6% in 2012-13 due to huge increases in mining investment) are typically higher than its shares of output and employment. This reflects the export-oriented and capital intensive nature of many of the segments within manufacturing.

The shares of manufacturing in total output and employment are important metrics and are particularly popular as a short-hand snapshot of the industry. But they do not give a full and accurate picture of change across the manufacturing sectors or indeed, across the broader economy. While it is true for example, that aggregate manufacturing output has declined since 2008 (see discussion below), this contraction is not the only cause of its loss of share in the economy or in employment. The decline in shares has also been due to much stronger growth in other segments of the economy and especially in the services industries; the finance and insurance industry alone for example, now accounts for almost 10% of output. Mining output accounts for around 10% of total output, as it has done sporadically since 1991. Mining overtook manufacturing as Australia's single largest industry (by output) in 2005. This pattern of broad structural change across the economy is continuing (see chart 5 below and charts 1 and 2 in the previous section).

Chart 5: Industry contributions to GDP, (% share of value added output)



Source: ABS, *National Accounts*. June 2013; Australian Industry Group.

Manufacturing output growth

The disparate industries that make up manufacturing are on quite different growth paths, and have been for some time. In aggregate, manufacturing output (real value added output) reached a peak immediately prior to the GFC disruptions in June 2008. Manufacturing output recovered about half of this loss through 2009 and 2010 but has since declined sporadically again under the weight of some fairly relentless headwinds. By June 2013, manufacturing value added output was 9.8% lower than in June 2008, and just 0.9% higher than during the GFC trough in Q3 2009.

Of most direct relevance to this Review are the growth paths of machinery and equipment (including automotive and all other transport equipment), non-metallic minerals (including glass) and metals products. These three sectors outpaced all GDP growth up until 2008 in terms of value added output growth, but have stalled or gone backwards since at least 2010 (see chart 6). The most recent period of decline since 2010 has been due to a complex mix of domestic and international factors including:

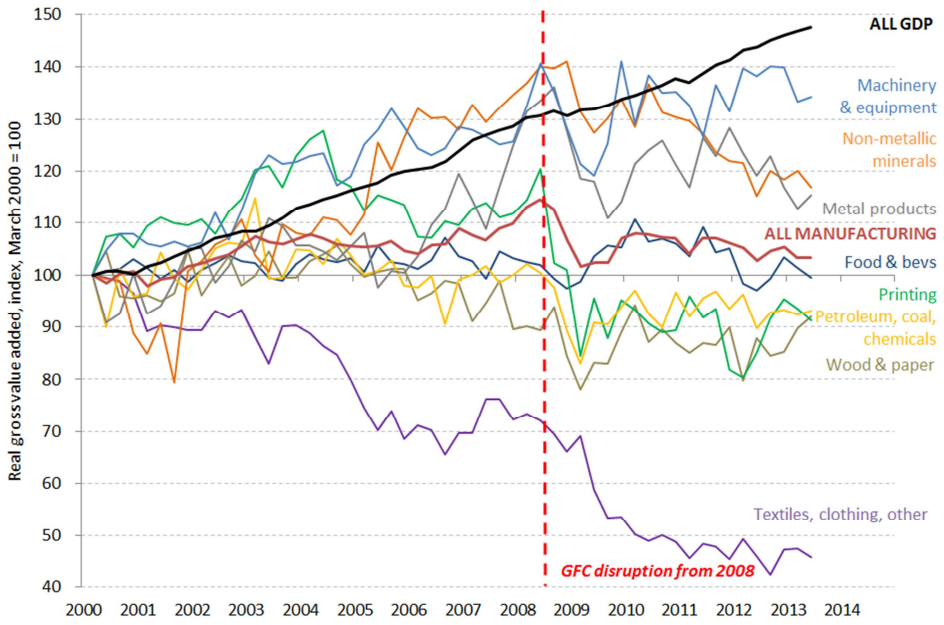
(a) the high Australian dollar and reducing industrial production costs internationally;

(b) disruptions to global demand patterns for manufactured goods since the GFC;

(c) a downturn in domestic construction activity and weaker consumer demand; and

(d) increasing domestic production costs (labour, energy, regulatory and other costs) that have further contributed to an absolute decline in international competitiveness.

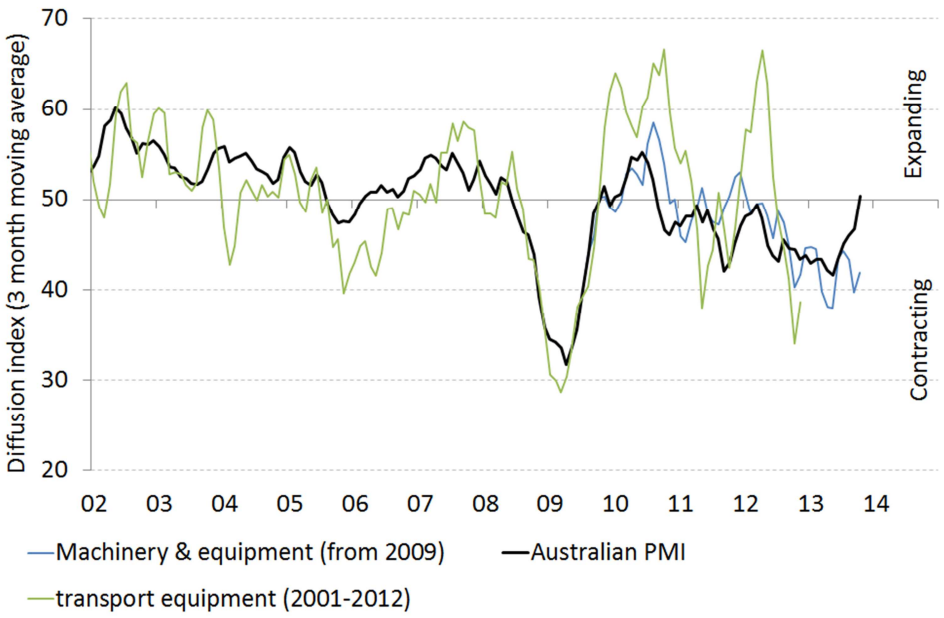
Chart 6: Cumulative change in GDP and manufacturing output, index (Q1 2000 = 100)



Source: ABS, *National Accounts*. June 2013; Australian Industry Group.

Detailed data from the Ai Group's Australian PMI® series confirm that transport equipment manufacturing and machinery and equipment manufacturing (including automotive manufacturing) continued to outperform other manufacturing sectors up until quite recently, with short bursts of recovery in output evident in 2010 and again in 2012. As of late 2013 however, this sector has failed to track back toward the expansion that other manufacturers (led by food and beverages) are experiencing (see chart 7).

Chart 7: Australian PMI® and sectors that include automotive manufacturing

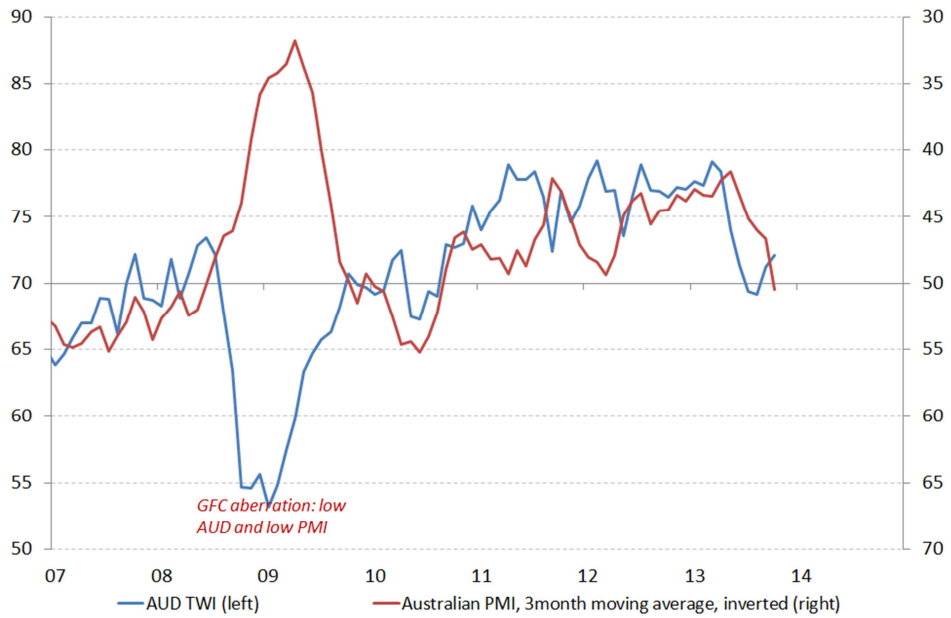


Source: Australian Industry Group.

The Ai Group's Australian PMI® turned positive (readings above 50 points indicate net expansion) in September 2013 for the first time since June 2011, followed by another positive result in October. While the positive sentiment effect of the federal election may have had an influence, the history of the Australian PMI® suggests that the recent lowering in trading ranges for the Australian dollar was also a factor. Indeed, the recent history of the relationship between the Australian TWI and the Australian PMI® seems to suggest that an Australian TWI value of 70 or lower is conducive to manufacturing stability or expansion, as indicated by the Australian PMI® (see chart 8).

In both September and October this year, manufacturers reported an increase in activity and new orders but export orders continued to contract. Survey participants in these months noted an increase in local orders and in some sectors such as food and beverages (and to a much lesser extent the machinery and equipment sector) they reported a switch back to local suppliers. This demonstrates the direct and decisive influence of the dollar on manufacturing activity in the domestic context. If further falls in the dollar are sustained, a recovery in export orders may occur also.

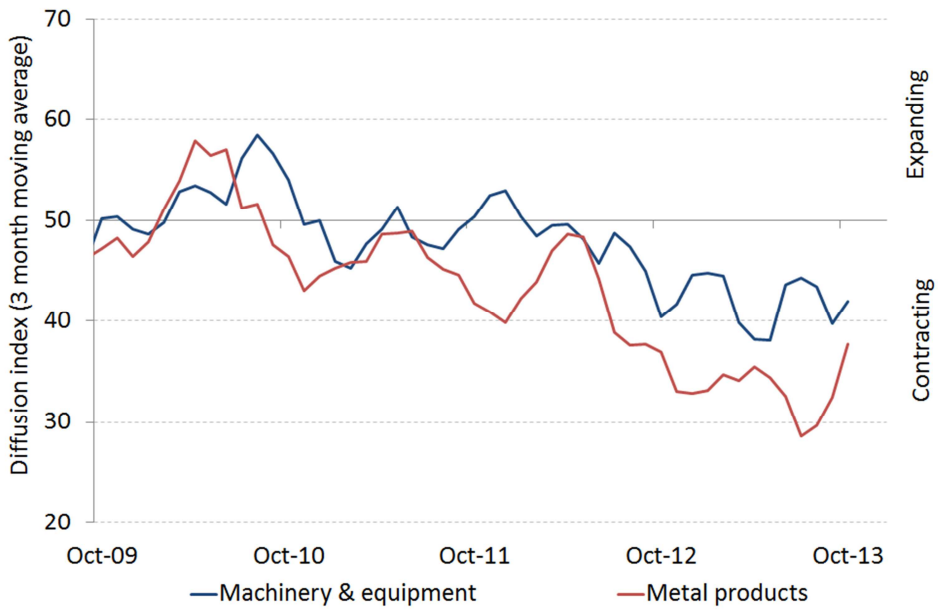
Chart 8: Australian PMI® and Australian TWI



Source: Australian Industry Group and RBA (end of month FX values).

The machinery and equipment sector (including automotive production) however, did not share in this general lift in the Australian PMI® in September and October. Along with metals products, this sector continued to show extreme stress (see chart 9).

Chart 9: Australian PMI® sectors: machinery and equipment and metal products



Source: Australian Industry Group.

Manufacturing employment growth

In the five years since manufacturing employment and output last peaked in early 2008, manufacturing employment has fallen by 14% or more than 150,000 jobs. This is a larger fall in employment – albeit over a longer period of time – than was experienced by manufacturing in the 1990s recession (140,000 or 12% over three years). After the 1990s recession, about a third of those manufacturing job losses were subsequently recovered, with the next big wave of job losses starting from 2008 (see chart 10).

It remains to be seen how many of the more recent losses are recovered. That is, how many of these 150,000 lost jobs are for cyclical reasons rather than structural reasons. Some employment losses have been cyclical and may return when the local construction cycle picks up again (feeding through for example, into increased demand for manufactured building materials and structural steel) and/or when the Australian dollar moderates further. Other job losses are structural and will never return. Manufacturing output has dropped by about 9.8% over the past five years while employment has dropped by about 14%. The gap between these two numbers signifies both a structural loss of jobs and a labour productivity improvement (see discussion below). Structural job losses in manufacturing can occur due to: (1) permanent losses in output (e.g. production moving offshore or being lost to overseas competitors); (2) technological changes that displace labour (most visibly in printing and recorded media and related fields); and (3) productivity improvements among remaining firms that mean less labour is required, but often at a higher skill level. These factors are evident to a greater or lesser degree across the various manufacturing sub-sectors (see chart 11).

Chart 10: Australian manufacturing employment and hours worked

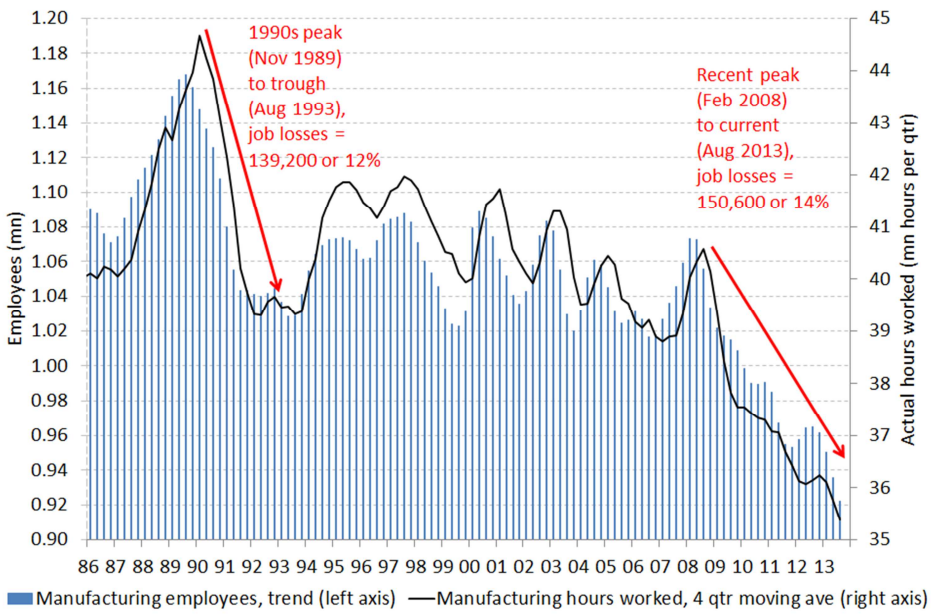
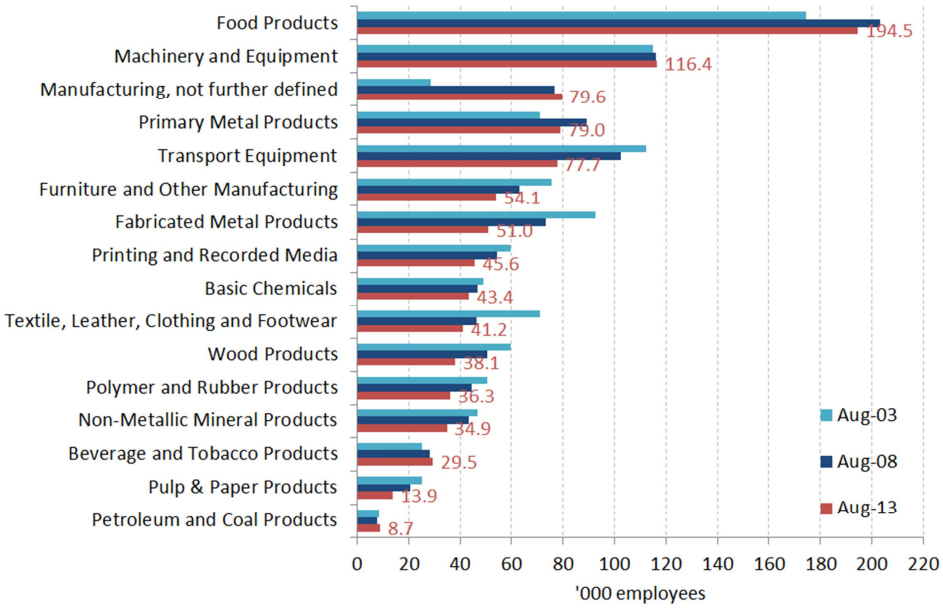


Chart 11: Australian manufacturing employment by sector



Source: ABS, *Australian Labour Force, Detailed Quarterly*. Aug 2013.

Manufacturing employment questions

What are the implications of these job losses from manufacturing for the economy and for society? A big question that arises for policy-makers and for the broader community is: what has happened to the 150,000 people who are no longer working in manufacturing and/ or who never gained entry into this industry? Further research is needed to answer this crucial question, but some clues are provided in ABS labour force data that suggest many, particularly older workers, may have exited the labour market. At the younger end of the labour market, it is likely that the fall in total employment has meant far fewer entry-level and apprenticeship positions have commenced.

The basic demographics of the manufacturing workforce are relevant to this question:

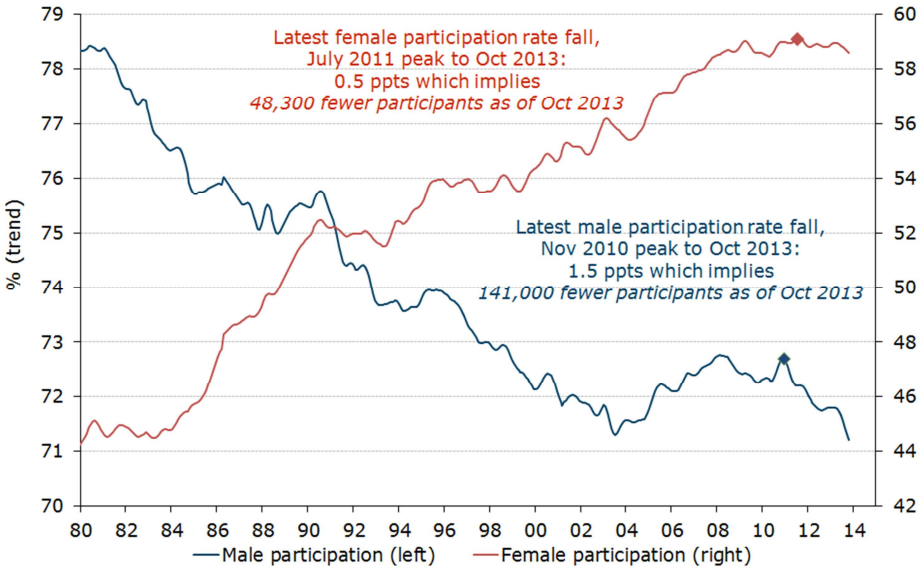
- In August 2012, 9.8% of manufacturing workers were aged 60 years or over and 19% were aged 55 years or over (versus 9% and 17% of all workers). 13% of manufacturing workers were under 25 years old in 2012, versus 16% of all workers;
- In August 2013, 73.3% of manufacturing workers were male. Across the manufacturing sectors, the male proportion of the workforce ranges from a low of 60% in food manufacturing to a high of 90% in primary metals. In transport equipment (including automotive manufacturing) about 87% of workers are male.
- In the 2011 census, 45.2% of manufacturing workers had no formal post-school qualifications, versus 38% of the whole workforce. This statistic alone brings up its own set of questions. In a recent issues paper on the manufacturing workforce for

example, AWPA found that this low level of formal skills means "*a concerted effort will need to be made in the manufacturing sector to raise the base educational standards of its workforce in order to improve productivity and innovation in an increasingly knowledge-based and technologically integrated industry*".[1]

While it is not possible to track exactly where ex-manufacturing workers have gone through ABS or other published data, recent trends in workforce participation suggest that many former manufacturing workers have probably dropped out of the workforce, rather than sought other work. This is one interpretation of the large drop in male workforce participation over the same period (see chart 12). Although some of the drop in male participation is part of a long-term downward trend as a result of the ageing population (older people typically have lower participation rates), this factor cannot explain all of the sharp fall in male participation over a relatively short period of time, nor can it explain the discrepancy between recent male and female participation trends.

This labourforce participation response requires further investigation. The fate of former manufacturing workers is a central question for automotive industry policies, which have often promoted worker retraining and redeployment programs as a key means of enabling the economic transition away from automotive to other production.

Chart 12: national labour force participation rates by sex (trend)



Source: ABS, *Australian Labour Force*. Oct 2013.

[1] Australian Workforce Productivity Agency (AWPA), *Manufacturing Workforce Issues Paper*, Oct 2013.

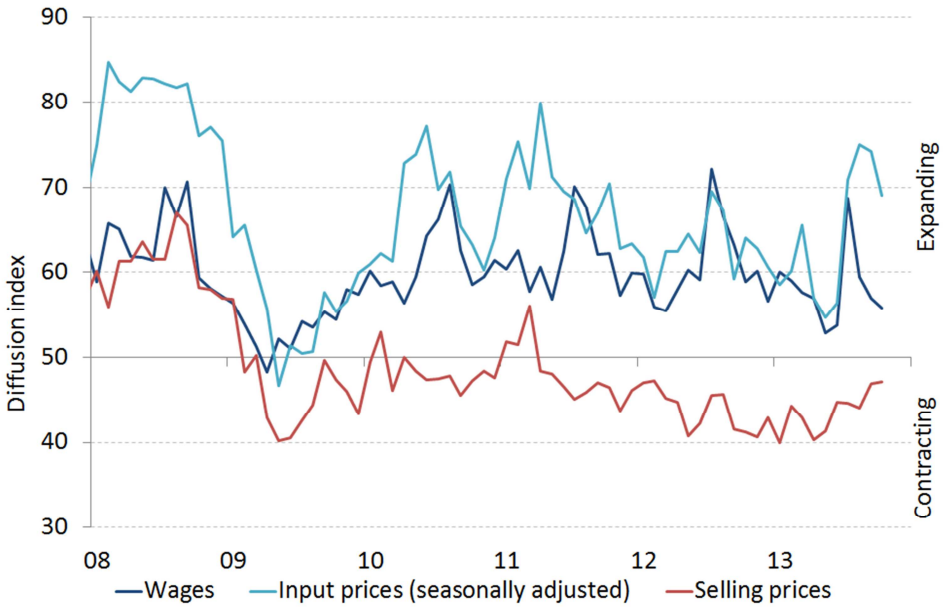
Manufacturing profits and profitability

Ai Group's Australian PMI® has been showing a cost squeeze across manufacturing since around 2009 (see chart 13). This has occurred because wages and input costs have risen relentlessly, but manufacturers have rarely been able to increase their selling prices in response. The inability to pass on rising costs has been due to the tough local and international trading environment and depressed demand among customers. These pricing experiences are corroborated by ABS producer price indexes, which also show zero or negative changes in manufacturing output prices in 2012 and 2013 (chart 14).

The same pattern of absorbing cost increases instead of passing them on was evident among manufacturers when the carbon tax was introduced on 1 July 2012. Ai Group research found that about 60% of manufacturing firms had not been able to pass on any of their energy or other cost increases as a result of the carbon tax (see Appendix A).

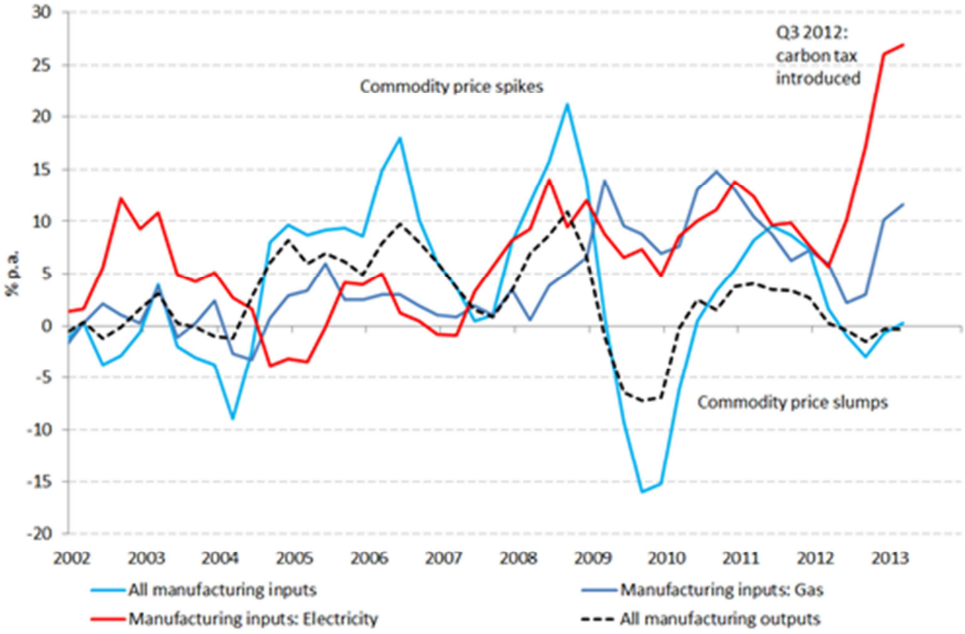
This cost squeeze has been evident across all the manufacturing sectors and over an extended period, with fatal results for many businesses. In aggregate, profit levels are now about the same as they were in 2002 (lower than in the GFC disruption of 2009), in *nominal* dollar terms, while average profit ratios are at an all-time low (see chart 15).

Chart 13: Australian PMI® wages, input prices and selling prices indexes



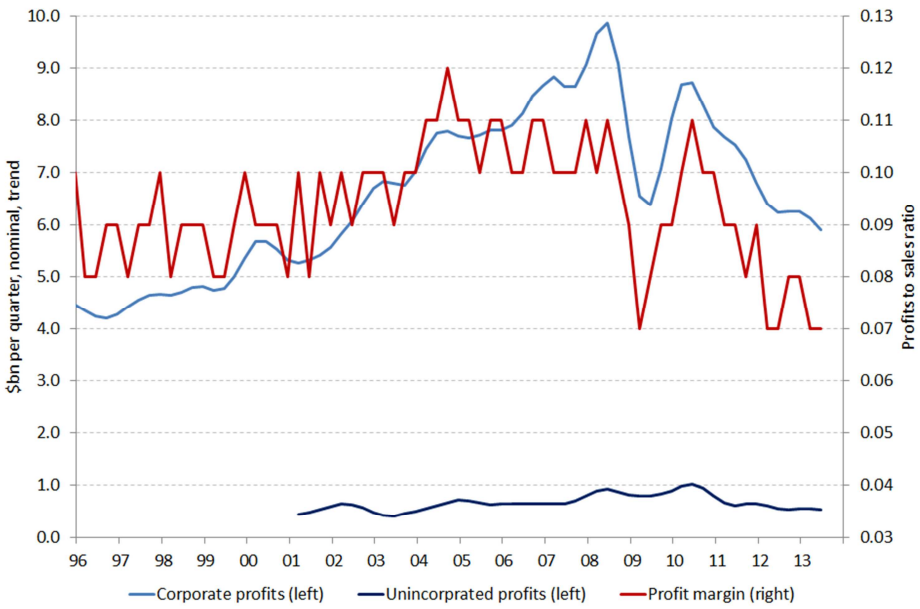
Source: Australian Industry Group.

Chart 14: Producer price index (PPI) increases in manufacturing, % p.a.



Source: ABS, *Producer Price Index*, June 2013

Chart 15: Manufacturing profits (nominal dollars) and profit ratio

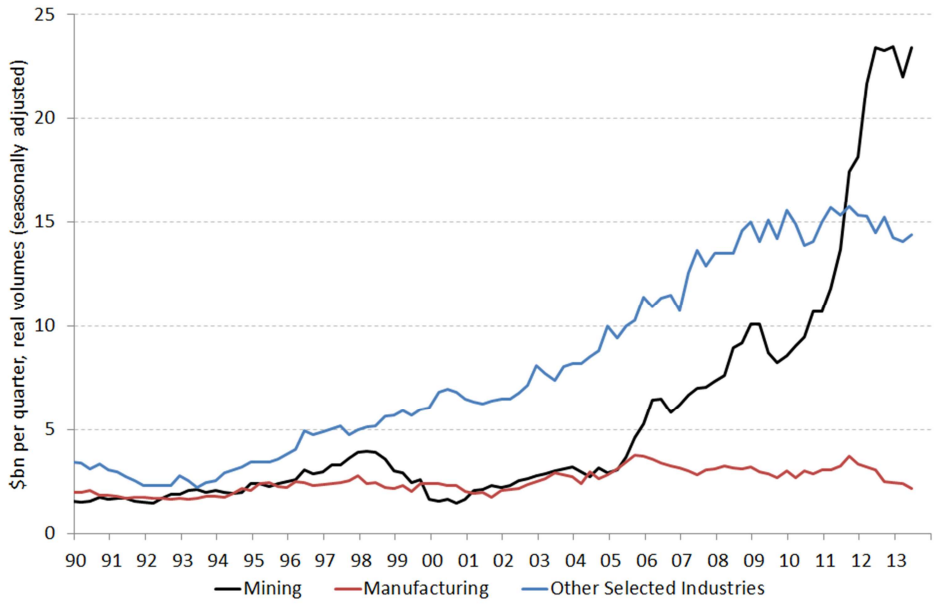


Source: ABS, *Business Indicators*, June 2013

Manufacturing investment

This decisive drop in profits and profitability has, in turn, left many manufacturers unable to support the necessary level of investment required to keep up with global technology changes, let alone to overtake them. Many are continuing to invest, but the aggregate level of investment is problematic. In real terms, manufacturing investment hit a recent peak in Q3 2011, as businesses valiantly tried to lift their capabilities and keep up with global industrial developments. Falling profits have made this level of investment impossible to maintain however, and investment spending has declined in every quarter since, to be down by 40% as of June 2013 (real seasonally adjusted values, see chart 16).

Chart 16: private sector capital expenditure (CAPEX) by major industry category



Source: ABS, *Private Sector Capital Expenditure*, June 2013

Ability to re-invest is crucial for all businesses. Investment in new technologies is especially crucial in manufacturing. Ai Group research conducted in 2013 found that:

- 33% of businesses that invested in new technologies in 2012 reported labour productivity improved compared with 16% of businesses that did not invest.
- Nearly three times as many businesses that intended to invest in new technologies in 2013 expected labour productivity to improve compared with businesses that did not plan to invest (54% and 20% respectively).
- A range of factors affect the productivity gains that businesses realise from technology investment, but workforce skills are the most significant. Employee

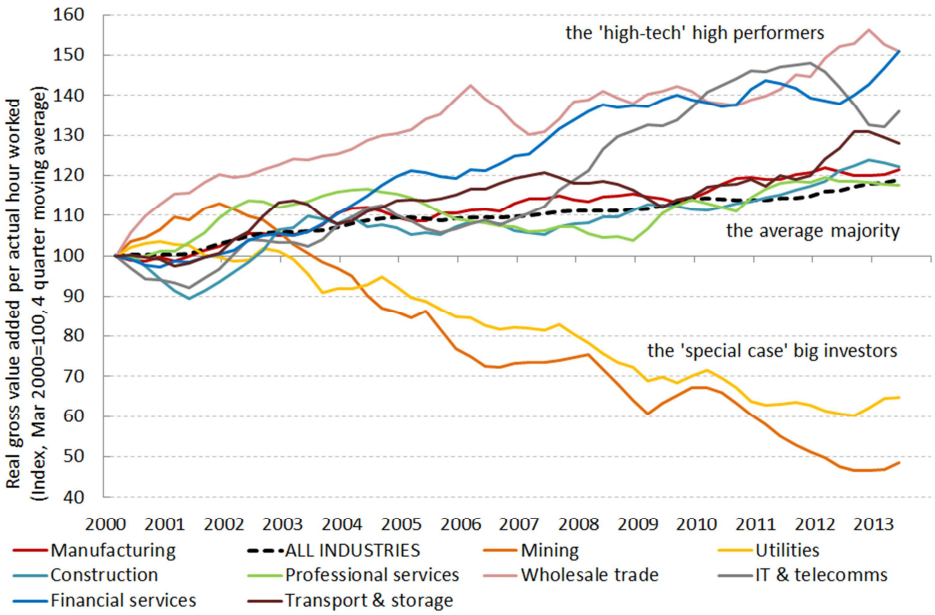
knowledge and skills was the second highest influence on decisions to invest in new technology, cited by over 60% of businesses in the Business Prospects Survey 2013.[2]

Manufacturing productivity

Productivity measurement and analysis is a contentious topic and is the subject of much research, not least by the Productivity Commission. Recent productivity trends in manufacturing can be especially difficult to interpret due to the large number of disparate industries that make up the manufacturing category and the wide range of significant factors that have been affecting these industries over the past decade.

In very broad terms, productivity data calculated by the ABS and/or derived from ABS data sources seem to show that Australian manufacturing has been at least keeping up with the (relatively poor) all-Australian average in terms of labour productivity growth (chart 17), but has been experiencing significant problems in generating productivity growth from its capital inputs (chart 18).

Chart 17: Labour productivity growth by major industry category



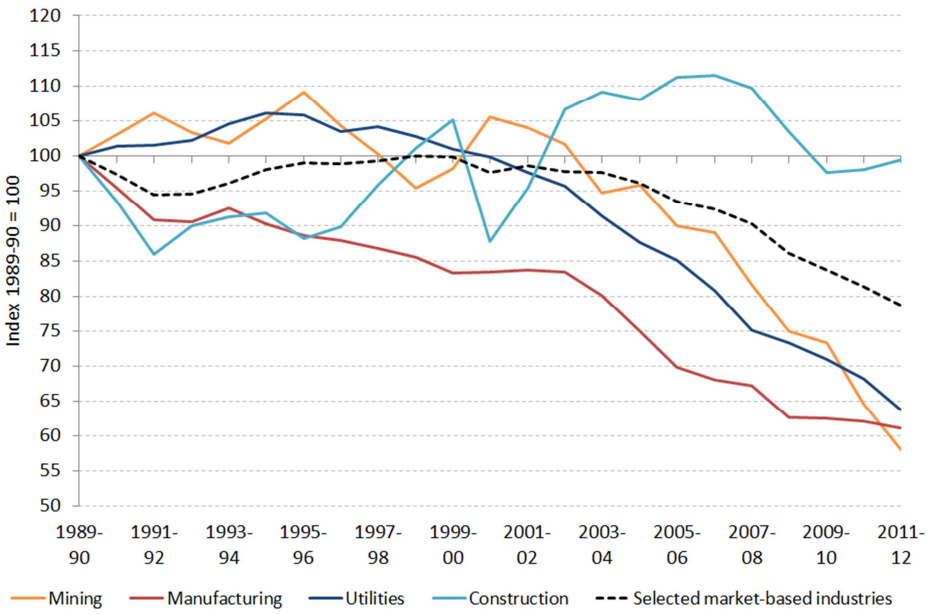
Source: Australian Industry Group calculations derived from ABS *Labour Force Australia, detailed quarterly*, Aug 2013 and ABS *National Accounts*, June 2013.

Ai Group data from the Australian PMI® appears to support the view that problems with capital investment and/or capital utilisation are contributing to productivity problems in manufacturing. Certainly, there appears to be a relationship between falling MFP values

[2] See Appendix B: Ai Group, *National CEO Survey: Ready or Not? Technology Investment and Productivity in Australian Business*, June 2013.

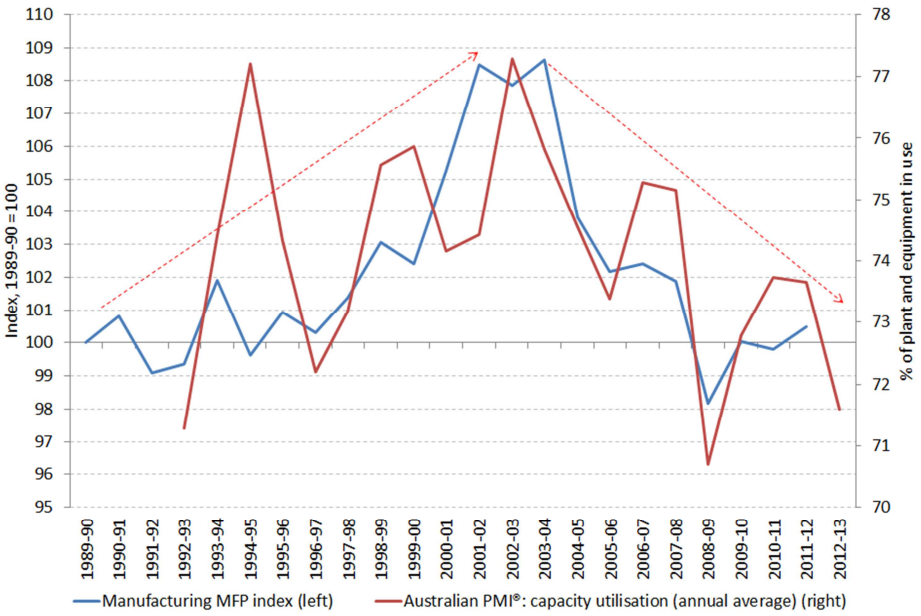
and falling average capacity utilisation ratios that may suggest that under-investment and under-utilisation are pulling productivity levels down across the industry. More research may be required in order to pinpoint exactly where and how this is occurring.

Chart 18: Capital productivity growth by major industry category



Source: ABS *Estimates of Industry multi-factor productivity*, Dec 2012.

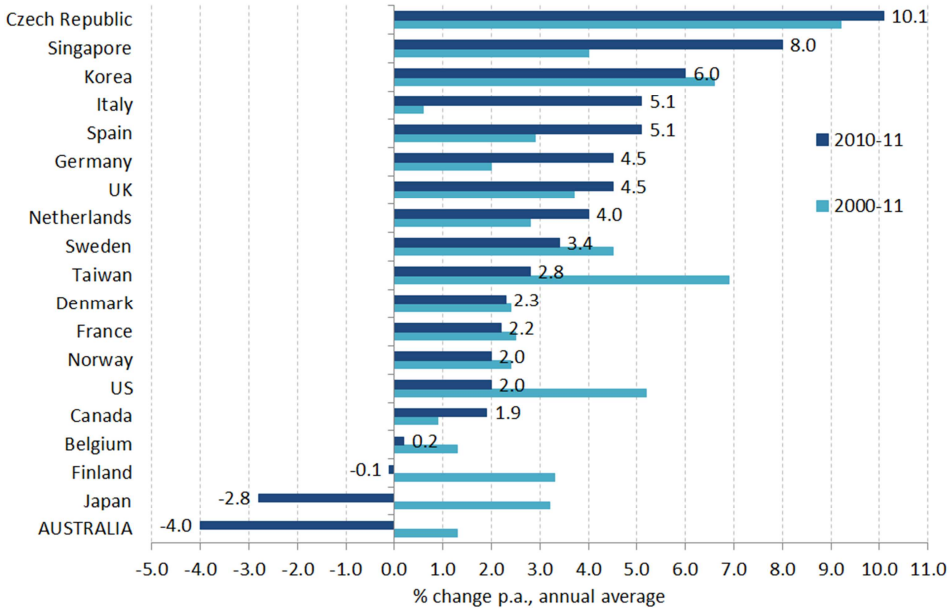
Chart 19: Australian Manufacturing MFP and capacity utilisation



Source: ABS *Estimates of Industry multi-factor productivity*, Dec 2012 and Australian Industry Group.

It is also worth noting that this fall in productivity in manufacturing appears to be a peculiarly Australian problem. Data from the US Bureau of Labor suggest an actual fall in manufacturing MFP in 2010-11 in Australia that was worse than anywhere else, and a lower rate of manufacturing productivity growth over the decade to 2011 (see chart 20).

Chart 20: Changes in manufacturing MFP to 2010-11, selected countries



Source: U.S. Bureau of Labor Statistics, International Labor Comparisons.

Manufacturing competitiveness

International competiveness is a major issue for manufacturing businesses due to the trade-exposed, export-focused nature of many parts of the industry. International business surveys do not rank Australia highly on business competitiveness at present, as Australia has gained a widespread reputation as an expensive place in which to do business. In the annual WEF Global Competitiveness Survey for example, Australia slipped to 21st of 148 countries in 2013-14, from 15th in 2009-10. In the same survey, Australia's labour market efficiency was ranked 54th in 2013-14, with Australian businesses' ability to hire and fire workers flexibly ranked 137th, the flexibility of our wage setting systems ranked 135th and labour productivity ranked 113th[3].

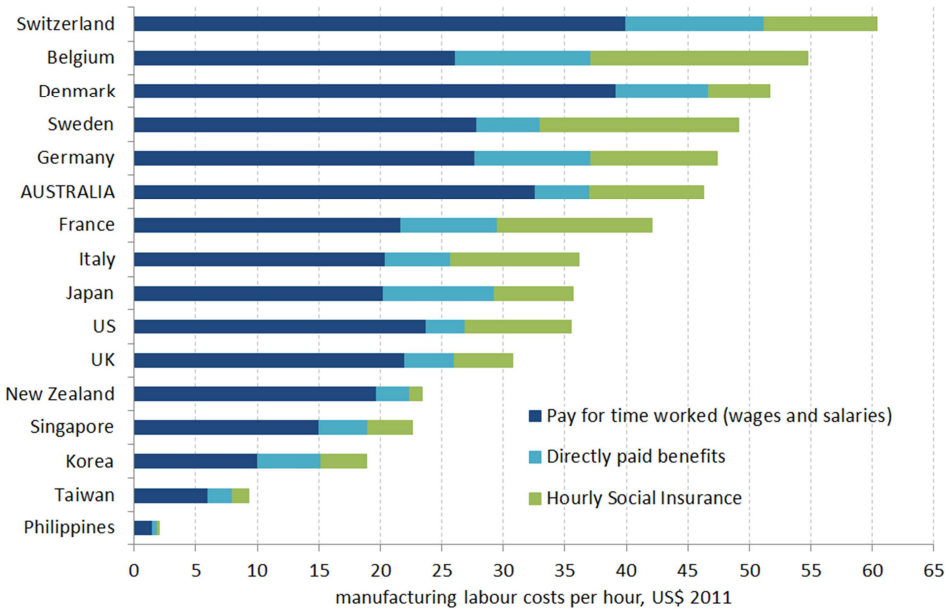
These views were confirmed locally in Ai Group's most recent annual survey of business expectations, which found the two of the most pressing concerns of manufacturing

[3] WEF *Global Competitiveness Report*, 2013-14.

businesses in 2013 were (1) the high Australian dollar and rising international competition and (2) high and rising domestic production costs arising from: wages and labour on-costs; energy costs; regulatory costs and material input costs.[4]

The idea that Australia is a high cost country in which to produce manufactured goods is not a new one. Indeed, this has been the case for many years and pre-dates the current crisis of cost, compounded by the high Australian dollar. Data from the US Bureau of Labor show that as of 2011, Australian manufacturing carried some of the highest total labour costs in the world and the third-highest wage costs. The countries with higher labour costs than Australia include those with very high productivity rates, in terms of value-add per employee per hour (in Germany for example). These data are measured on a purchasing power parity (PPP) basis and do not reflect the extra disadvantage of the high Australian dollar.

Chart 21: Manufacturing labour costs per hour, US$ 2011 (PPP basis)

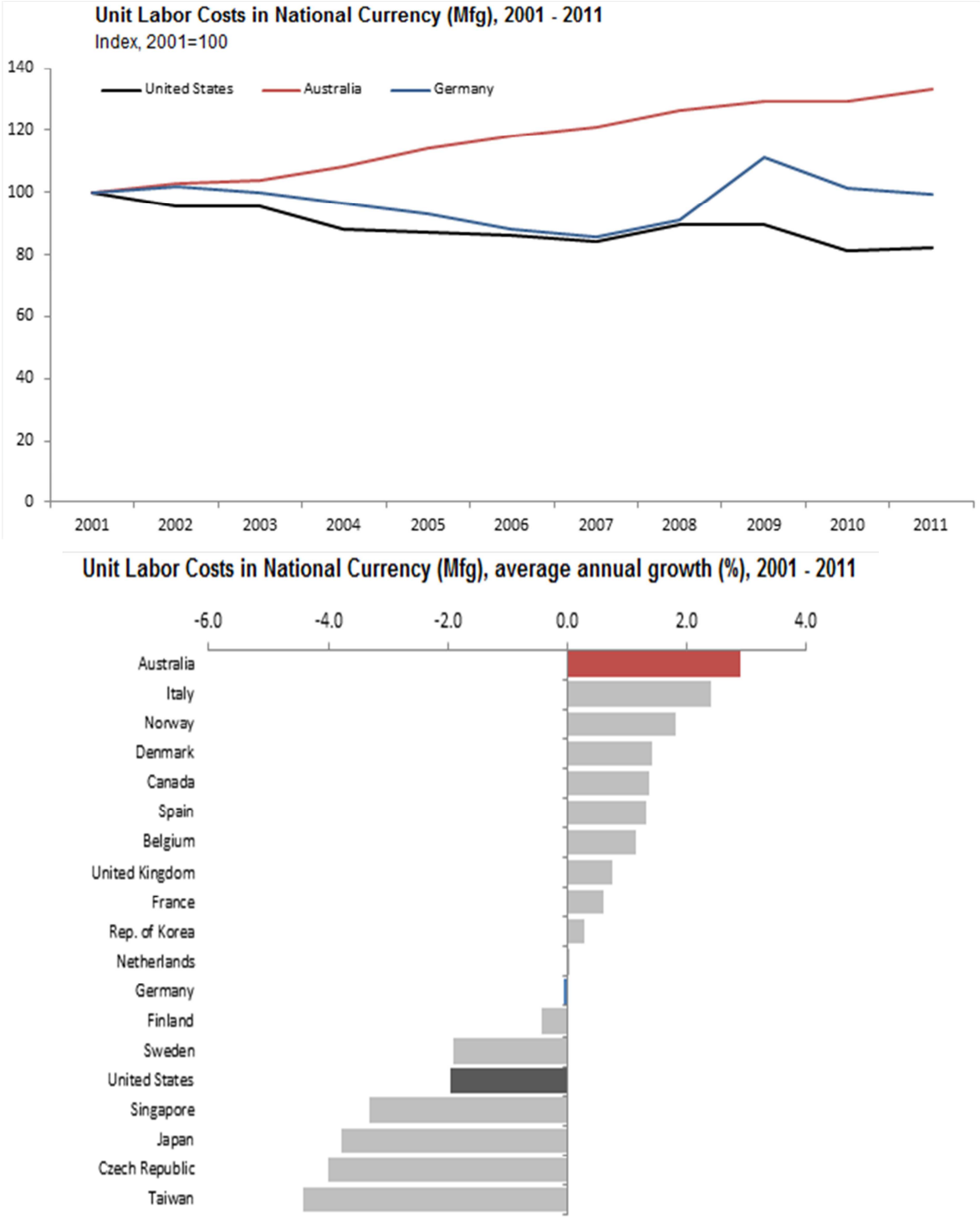


Source: U.S. Bureau of Labor Statistics, International Labor Comparisons.

The US Bureau of Labor also compares international costs on a unit labour cost basis, which helps to take into account the higher productivity rates and value-add among other high-cost countries such as Germany. On a unit labour cost basis and in our own currency, Australian manufacturing had the largest increase in unit labour costs over the decade to 2011, of the 19 developed countries compared by the USBL (see chart 22).

[4] Appendix C: Ai Group, *National CEO Survey: Business prospects in 2013: Australia's Gap Year?* Feb 2013.

Chart 22: Manufacturing unit labour costs growth (index in national currency)



Source: U.S. Bureau of Labor Statistics, International Labor Comparisons.

Role of automotive manufacturing in Australian industry

In this section we present our preliminary views on the place of automotive manufacturing in the broader economy. In our next submission to this inquiry we will look in more detail at this question, following further discussion with and input from our members.

Ai Group has not commissioned any external parties to undertake any research, econometric modelling or data analysis on our behalf for this Review.

Ai Group notes that the FCAI commissioned a major piece of analysis from the Allen Consulting Group on *the Strategic Role of the Australian Automotive Manufacturing Industry* (Sep 2013) and we broadly support the main findings of that Report. With regard to the Allen Consulting Group's Report, Ai Group agrees that:

- Australian automotive manufacturing is "*one of Australia's most advanced industries. It deploys advanced manufacturing techniques, technologies and adds value through the broader economy far beyond its manufacturing core*".
- The trading range for the Australian dollar over the past three years has placed automotive manufacturing under additional pressure and has impeded its efforts to increase its scale through export expansion. This is true also of many other parts of manufacturing that are just as export-focused and/or compete with imports.
- Foreign ownership of the three key automotive assemblers means that if they cease production, all of their foreign direct investment will also cease. It will not be 'redirected' to other industries in Australia, but will simply be lost to Australia altogether. This will be true of some of the foreign owned components suppliers also, with these investment decisions being made offshore and in an international context. This would see billions of dollars withdrawn from Australian investment.
- Spillover benefits from automotive manufacturing that cannot be captured easily in quantitative modelling include: technology transfers through R&D and innovation; lean management techniques and applications; and advanced labour skills and manufacturing techniques.
- The estimated 50,000 people who are directly employed in automotive manufacturing (17,000 by the three assembly firms with the majority working in direct supply chain businesses) are geographically concentrated in locations in Victoria and South Australia that are susceptible to high youth unemployment and socio-economic disadvantage. These locations include Dandenong, Broadmeadows and Geelong in Victoria and Elizabeth in South Australia. Ai Group notes however, that the automotive supply chain also extends into every state in Australia and includes significant operations in regional centres of Victoria, NSW and Queensland.

Interaction with automotive and other transport manufacturing sectors

Around 77,000 people are directly employed in transport equipment manufacturing in Australia (ABS, Aug 2013), with an estimated 50,000 employed in automotive manufacturing, mainly in the Tier 1 and Tier 2 businesses that supply the three big automotive assemblers. This is equivalent to around 5% of all current manufacturing jobs. Businesses in the automotive supply chain have various levels of engagement with the assemblers to whom they are contracted, depending upon their place in the chain. The Tier 2 firms are generally smaller and more specialized. They contract to the Tier 1 firms rather than to the assemblers directly and therefore have a more limited and indirect relationship with the big three automotive companies. Tier 2 businesses have indicated that they have limited access to automotive industry programs as well as to the big firms themselves, so the benefits flowing through to them in terms of transfers of knowledge, skills, technology and innovation is more limited than for the Tier 1 firms.

At all stages in the automotive supply chain, the level of import penetration has been steadily increasing as businesses look to reduce their costs and respond to the higher Australian dollar. Our Members in this industry note that import penetration has noticeably increased over the last two years. Cost pressures are relentless and this can strain the relationships between businesses in the chain. Some Members indicated that these cost pressures – and the resulting pressure on relationships – have worsened of late, as the dollar has risen and profit margins have fallen across the sector.

This pyramid-like structure is important in considering the design and application of industry support measures for this sector, since not all benefits will automatically 'trickle down' from the top layers to those smaller firms near the base. Some Ai Group Members are of the view that this means we are not getting the full benefit that such assistance measures could be providing, since "*The real technical advances come from material suppliers to the automobile industry and other industries (e.g. steel alloys, plastic components, paints, batteries etc) [and so] The Australian Government should support strategic and technical material-based industries*" Richard Flook, Managing Director, Shinagawa Refractories Australasia P/L, Nov 2013.

The other 27,000 transport manufacturing workers make trucks, trains, buses, caravans and other related equipment. Many businesses that make components and other inputs supply more than one transport production line, although some supply parts into only one type of finished product exclusively (e.g. cars, trucks or trains but not all of them).

Australia's expertise in automotive manufacturing is not limited to the manufacture of petrol and alternative fuel cars, but includes the manufacture of trucks (except off-highway trucks) and buses. Feedback from Ai Group members indicates that businesses in, or supplying components to, these sectors are generally faring much better than businesses manufacturing cars, and see themselves as quite distinct from car manufacturers and suppliers to the car industry. Many of these businesses operate in

areas of niche competitive advantage, as the following quote by Ronald Grasso, Director, External Affairs and Institutional Relations at IVECO a truck manufacturing company indicates: "*the customisable nature of the industry and its inherent manufacturing flexibility, provides it with a distinct advantage. Because just about every truck that comes off our line is individualised to meet specific customer requirements, there is (to a degree) a natural hedge against the rudimental (cost) basis for comparison against low-cost regional economies that occurs within the mass-production/global platform, car industry*."

These non-passenger vehicle production sectors tend to operate their own supply chains and are relatively distinct from car manufacturers and suppliers, although there is some overlap in their supply chains. Outside the supply chains however, there is considerable interaction with the passenger vehicle sector, including the regular interchange of personnel and skills.

These other automotive transport sectors receive far less attention than the passenger vehicle sector due to their smaller size and lower export capabilities. A separate study of Australia's strengths and opportunities for growth in these categories may be warranted. An overview of the Truck Manufacturing Sector is provided in the box below.

However, even in non-passenger automotive and vehicle manufacturing, not every business we spoke to had benefited from contact with automotive people, technologies, knowledge or skills or had experienced examples of successful transfers of automotive technologies, innovations or management practices to other sectors or applications. This is mainly because their supply chains are not always fully integrated or close to the automotive suppliers, despite operating in adjacent sectors that might have some obvious synergies. For example, Darren Laidler, the Managing Director of Transglaze, a company specialising in manufacturing glass components for public transport vehicles, commented that the mass transit supply chain operates in a manner that is mutually exclusive from the automotive supply chains, despite the fact that they are often considered to be part of the automotive supply chain and are making similar componentry. He said, *"In my experience, most OEM suppliers to the auto industry are very much in survival mode and fight to sustain themselves, even in good times, this leaves very little opportunity or resource to cleverly ally with other industry sectors and transfer technology.*" He felt that some of the more popular and publicized automotive innovations and management practices (e.g., the Toyota Lean System) were difficult to apply and had limited application in smaller companies, particularly in smaller Tier 2 and 3 OEMs.

Similarly in the truck manufacturing sector, the supply chain overlaps with automotive production but is largely separate from it, with only an estimated 10% to 20% of local components manufacturers in the truck supply chain also supplying parts for passenger vehicle production.

Australian Truck Manufacturing: our other automotive manufacturing sector

Australian automotive manufacturing is bigger than just cars and car assembly plants. It also includes SUVs, light commercial vehicles, recreational vehicles (caravans and motor homes), trailers, passenger buses, coaches, heavy commercial vehicles and trucks.

The Australian truck industry designs and manufactures trucks at three key locations:

- Volvo and Mack trucks and WACOL, Qld (2,300 units p.a.)
- Kenworth trucks at Bayswater, Vic (2,400 units p.a.)
- IVECO trucks at Dandenong, Vic (900 units p.a.)

These three plants produce about half of the heavy-duty trucks sold in Australia and almost all specialist vehicles for Australia's mining industry and outback road trains.

They require multiple levels of design input, thousands of large and small components and hundreds of local and international suppliers. Local assembly has a high labour content and includes engineering, testing and other high-skilled labour content.

Some of the larger locally produced components include cabins, fuel tanks, chassis frames, harnesses, sleeper cabins, wheel guards, turntables, truck bodies and specialist equipment. By value, local content in trucks assembled in Australia is typically higher than that achieved in most Australian passenger cars (with the exception of the V6 Ford Falcon). While some components suppliers also supply the passenger vehicle market, most suppliers (up to 80%) are specialists who work into the truck assembly chain only.

Unlike passenger cars, truck assembly is done in two distinct stages and can be done by different operators:

- Stage 1: the truck manufacturer builds the basic truck or 'truck chassis'. This first stage is applicable to around half of all trucks sold in Australia and is done at one of the three manufacturing sites listed above.
- Stage 2: the truck or another manufacturer fits the specialist equipment required by the purchaser to the chassis (e.g. a tipper, dump mechanism, refrigerated van, towing bars, turntable, concrete mixer, curtain sides for freight or other parts). This second value-add stage applies to over 95% of trucks sold in Australia, even if the basic truck or chassis has been imported. This stage is a broad-based industry with hundreds of second-stage truck fitters around Australia specializing in various components and applications. In most cases, vehicles (imported or local) will not be road-worthy until this second stage is completed.

Significant R&D is carried out by manufacturers at both stages.

Primary R&D is carried out to develop and test cab trucks and to ensure that imported designs will operate in Australian conditions, particularly with regard to meeting

Australian heating, cooling and emissions standards. R&D testing can take up to three years per model. Iveco for example, employs 40 R&D engineers on site in Dandenong, with the other manufacturers employing similar numbers.

Secondary R&D applies to the development, manufacture and testing of vehicles and components to meet unique requirements and applications, including in the mining, utilities, construction, defence, emergency services and agricultural industries. Australia leads the world in the design and construction of road trains, with local production of vehicles that can pull up to 10 trailers of 300 tonnes GCM. This requires additional power sources to supplement the prime mover and is a unique Australian design, superior in technology to anywhere else.

Source: Truck Industries Council, *TIC Overview*, July 2013.

Interaction with manufacturers outside automotive and transport manufacturing sectors

Outside of the transport manufacturing sectors, businesses in sectors as diverse as polymer products and non-transport equipment manufacturing commented that they had employed people and/or adopted practices and procedures (e.g., in lean manufacturing) developed by the automotive sector. Some referred to the local automotive sector as a model to improve their own manufacturing operations and performance. For example, the following quotes cite the automotive sector as a valuable source of engineering and/or management expertise.

"Lots of our processes are locally developed with automation suppliers, and they are becoming harder and harder to find …. so people out there ready to take on innovative projects from the engineering perspective is reducing as well." Adelaide focus group on technology and productivity, February 2013.

"…a lot of these companies rely on the automotive industry to feed them, especially machinery and equipment manufacturers on the technology side of things. And many of us came out of that industry, as do the people who come and work for us." Adelaide focus group on technology and productivity, February 2013.

"My current purchasing officer came from a long history with a company that used to supply parts to Holden, Ford & Mitsubishi. The skills he developed in that role and his involvement in the automotive supply chain have been invaluable for my company & have enabled us to develop in many areas at a pace far swifter than we would have possibly been able to without that experience to fall back on. This includes skills in advanced quality management, training, document management and control, knowledge of the ISO 9001 quality assurance system and associated auditing processes and establishing and maintaining on time delivery." Ian Melville, MD, G&O Kert machining specialists.

"To compete Setec relies upon commercial relationships, quality and innovation to continue to prosper and grow. Setec has experienced limited exposure to the practices, disciplines and structures of the Australian automotive industry. We have however had some exposure from staff we have recruited from the auto industry who are well trained across big international industry processes with Lean, Six Sigma practices, to local manufacturers of automotive parts with whom we share machinery manufacturing challenges and assist both ways." David Bayliss, SETEC Industries, custom-designed electronic power supplies, Nov 2013.

"The global automotive industry is a bit like New York, in that if you can make it here you can make it anywhere. It is so competitive that only the very best survive. This means the skills in styling, CAE, product engineering, testing and development, manufacturing engineering, purchasing, supply chain management, distribution, etc, are leading edge. These skills get distributed across Australia as people's careers move on – into mining, defence, banking, research, retail, government, etc. It is why those countries which have an automotive industry fight so hard to keep it, and those smart ones without it are fighting for one" Mark De Wit, MD and CEO, Futuris Automotive Australia, Nov 2013.

Edward Banks, MD at Crib Point Engineering, commented that technology spillovers, for example in electronics and robotics, from the major car manufacturers were important, particularly for component manufacturers like his company: "*The automotive sector has raised the standard. Once one company has their technology, everyone has to have it [to be competitive]*." He is concerned about the potential for such 'best practice' skills to be lost if the automotive sector does not continue to operate in Australia.

"A country must try to maintain the balance between comparative advantages for today and tomorrow. Australia is the second highest costly country in the world to manufacture anything and I personally know that too well. However the car industry plays its part in ensuring there is some knowledge retained here about making cars that has flow on effects not only to parts manufacturers but to other manufacturers in automation and lean manufacturing methodologies and we shouldn't easily let the industry fall as a result." Mike Tristram, CEO, Trisco Foods P/L, Nov 2013.

Businesses in sectors that used to be heavily engaged in the automotive manufacturing sector were also finding that the skills of their staff in automotive product manufacturing are being used to good effect in other sectors and supply chains.

Opportunities for Australian automotive manufacturing

Australian manufacturing has experienced significant contraction over the past five years, as documented above. Before the GFC however, the automotive sector and many other key manufacturing segments were growing in a sustainable and balanced manner that included strong technological innovation and expanding export options. This previous period of growth, in our very recent past, demonstrates that the current trend toward contraction is not locked in and should not be regarded as a foregone conclusion.

This has important implications for the future development path of our broader economy. The mining-boom has positioned Australia to take greater advantage of our tremendous natural resource endowment. At the same time, the greater reliance on commodity exports will expose us to significant risks including commodity price risk and risks associated with the growing pains of emerging economies. In order to achieve a more balanced (and hence less vulnerable) economy, growth and employment opportunities in non-mining sectors of the economy, including in manufacturing, must be tapped. But how best to achieve this?

Many of the growth impediments that beset Australian automotive manufacturers and their suppliers also affect manufacturing and other businesses more broadly. Their problems can be summarized in the phrase "**Australia is a high cost country in which to do business, to manufacture or to supply services**". This lack of cost competitiveness, when compared to our international peers and when compared to our productivity performance, is at the root of many of the comments and concerns that Ai Group hears from our Members, right across the economy. In our *CEO Survey of Business Prospects* for 2013 for example, two of the three main concerns were about our international cost competitiveness, in the form of (1) the effects of the high Australian dollar and falling international production costs and (2) rising business operating costs within Australia (the third major concern was about flat local demand).

Economic policy settings that support automotive and other manufacturing

The level of the Australian dollar is largely a function of global market forces and is not something on which policy-makers can or should intervene, except in emergency circumstances. That said, the RBA has repeatedly stated that despite falling in 2013, the Australian dollar remains higher than the RBA would like, for the purposes of 'rebalancing the economy'. Similarly, the IMF recently concluded that as of November 2013, the Australian dollar is still about 10% 'over-valued', relative to where fundamental supports such as commodity prices, the terms of trade, interest rate differentials and the relative state of our economy suggest it should be. This implies the trading range for the dollar should be around 80 to 85 US cents instead of 90 to 95 cents. If it could be sustained, such a drop would provide a large and instant boost to

Australian automotive and other manufacturers' cost competitiveness. Indeed, the benefit of the dollar's fall to date is already evident in the Australian PMI® (see chart 8).

Many auto manufacturers see the dollar as their single biggest hurdle. For example, Futuris Automotive cites the dollar as "*the single biggest issue impacting on the health and viability of the Australian Automotive Sector*", pointing to a $10,000 difference in the price of a $30,000 imported vehicle if the dollar were $US0.72 versus $ US1.00.

Since the dollar cannot be influenced easily or directly through policy measures, the weight of policy attention must be directed toward the suite of problems that contribute to high business operating costs in Australia, over and above the effects of the dollar. With regard to business operating costs in Australia, Ai Group can identify several areas that are paramount to Australian manufacturers, and from which Government policy has strong potential to provide relief:

- **Rising unit labour costs and weak labour productivity growth.** The US Bureau of Labor Statistics found that in 2011, Australian manufacturing had the third highest hourly wage rates and among the strongest rises in unit labour costs globally (see charts 21 and 22). Manufacturing unit labour costs have risen sharply is Australia in recent years due to unchecked wage contagion from other sectors (primarily mining) combined with poor productivity growth. In our annual survey of CEO business expectations, 9% of manufacturers said that wage pressures were a business impediment in 2013, while a further 8% noted skill shortages as an impediment. Productivity needs a radical improvement. It must be top of mind in all IR, skills, innovation, investment and other industry-related policy; [5]
- **Rising energy costs** including gas and electricity prices that are difficult if not impossible to pass on to customers (see chart 14). Low energy costs were once a comparative advantage for Australian manufacturers, but this is no longer the case. Instead, manufacturers have faced stiff rises in electricity costs over the past five years, due to regulatory, market-based and investment cost increases in utilities. Almost 10% of manufacturers said that energy costs were a growth impediment in their business in 2013.[6] These businesses now face the prospect of potentially larger rises again in gas pricing.
- **Business regulation and regulatory costs** have been rising steadily, particularly in the areas of energy, environment and planning regulation. Duplication and lack of harmonization between state and federal governments is an area that has received

[5] Ai Group, *National CEO Survey: Business prospects in 2013: Australia's Gap Year?*, Feb 2013

[6] Ai Group, *National CEO Survey: Business prospects in 2013: Australia's Gap Year?*, Feb 2013

much attention but it still requires concerted action. Business regulation was identified as a major growth impediment by 9% of manufacturers in 2013. [7]

- **Domestic transport costs** for freight and materials are regarded as extremely high by international standards, and not just because of Australia's large distances. Port costs, labour costs in the transport sector, and inadequate transport infrastructure are frequently cited as exacerbating our relatively high internal freight costs.
- **Construction costs** for new or extended sites and facilities are also very high. This is due to some of the factors already cited above, including labour and regulatory costs. Ai Group notes that costs of construction on major projects has already been identified as a high priority policy area by the Federal Government and a separate Review is currently being undertaken by the Productivity Commission on this topic.

In terms of priorities, these policy areas are currently of equal importance to Australian business (across all industries). For manufacturers however, 'reforms to industrial relations to boost productivity' was recently nominated as their number one policy priority by 31.3% of manufacturers, followed by 'reducing company tax and implementing tax reform' (number one policy priority for 21.7%) and 'reducing red tape and regulatory duplication' (number one for 15.7% of manufacturers).[8]

In assessing the potential benefits for manufacturing businesses if these policy areas were to be adequately addressed, the recent trend toward 'onshoring' among US manufacturers – including automotive manufacturers – provides a potent example of what can be achieved when significant local cost and productivity impediments are addressed. After many years of contraction, manufacturing activity in the US is currently enjoying something of a renaissance, as a number of larger manufacturers have brought some of their offshore production back to the US again. This process has been dubbed 'onshoring' and has included some of the major US automotive manufacturers. This raises the question of whether a similar 'onshoring' path could be explored in Australia. US manufacturers who have discussed their onshoring have said it is being enabled by[9]:

- Reduced unit labour costs including lower real wages and on-costs for manufacturing workers, largely in response to rising local unemployment and recession. In many cases, renewed labour agreements also assisted in boosting local employment. This was contrasted with rising industrial labour costs in popular 'offshoring' countries such as China, which has seen skilled industrial wages but also skills and productivity (and in some cases unit labour costs) rise strongly;

[7] Ai Group, *National CEO Survey: Business prospects in 2013: Australia's Gap Year?*, Feb 2013

[8] Ai Group, *Ai Group Survey: Policy priorities for the next Australian Government*, July 2013.

[9] Various articles about US 'onshoring' in *The Economist*, 2012 and 2013.

- Reduced energy costs due to huge new supplies of oil and gas from unconventional sources (including but not limited to gas 'fracking'). This has revolutionized the US energy sector and significantly reduced energy costs across the country;
- Adoption of new technologies and production techniques, such as the integration of product design, development and quality control into production lines, such that products can be produced in smaller runs and tailored or customized more easily;
- Direct support for new and refurbished industrial facilities from US state and local government agencies including fast-track planning approvals, grants for expansions, tax breaks, R&D grants and loans, and assistance with skills and retraining programs;
- A sustained and significant reduction in the value of the US dollar against major trading partners in Asia, which has fundamentally altered the maths of trading;
- Increasing global freight costs, which make local production slightly more attractive.

In order for this 'onshoring' trend to be duplicated in Australia, these factors that the US manufacturers have cited would need to be present in Australia. But as noted in our list of impediments above, few if any of these cost factors are currently heading in the right direction in Australia, and seem unlikely to do so without direct policy support. Australia has been lucky to be spared the recession suffered by the US for example, but this has seen our real labour and other costs rise. These cost impediments need policy action.

General assistance measures that support manufacturing

Ai Group and many of our members recognise the importance of maintaining the automotive industry in Australia. But as documented in this submission, the automotive sector is not the only industrial sector that is struggling in the current operating environment. The Government, in reviewing assistance to the automotive sector, needs to be mindful also of assistance provided across the economy.

As a general principle, Ai Group believes that where there is a case for government intervention, industry programs aimed at lifting the productivity and competitiveness of industry (e.g., through innovation, global supply chains, improved production techniques or skills enhancement) should be available to all businesses, regardless of the sectors in which they operate, their size or their place in the supply chain. This minimises the likelihood of market distortions that can arise from sectoral support measures or from Government 'picking winners' (either in terms of sectors or in terms of stages in a particular supply chain).

One of our Queensland Members summarized the benefits of such programs over sector-specific arrangements thus:

"I'd like to see other manufacturers who like me are in the space of trying to recreate ourselves for the next generation of manufacturing in looking to find more innovative solutions for the future, as well as innovative business processes. I'd like to see more

funding in this space. Therefore I'm a big advocate of expanding the EMDG scheme and the R&D tax incentive scheme." Mike Tristram, CEO, Trisco Foods P/L, Nov 2013.

General assistance measures that are of benefit to all manufacturing sectors including automotive manufacturing and that Ai Group supports include:

- **Research and Development Tax Incentive.** The remodeled R&D Tax Incentive with its changed eligibility rules is still in trial mode and Ai Group urges all parties to commit to a rapid response to any flaws that emerge from the initial period of its operation. The additional proposed change in the R&D Tax Incentive to deny access to larger businesses was poorly thought out and would leave a substantial hole at the epicentre of Australia's innovation system. The proposed change has not been legislated and Ai Group urges that the proposed change not be proceeded with under the new Government.
- **Enterprise Connect and Researchers in Business.** Transitioning businesses and communities to competitive industries requires provision of effective and tailored support at both the enterprise and regional level. This is a particular focus of the following core elements of the Enterprise Connect service offering:
  - Holistic Business Reviews for eligible participants, and subsequent matched grant-based assistance to implement the priority recommendations determined from the Business Reviews. 83% of Enterprise Connect clients have improved productivity or efficiency as a result of participation in the program.
  - Researchers in Business Researchers (RiB) help to break down the cultural divide between industry and the public research sector and accelerate the adoption of new ideas and technologies. Facilitators connect businesses with researchers that have specific expertise relevant to the needs of the business, including in the areas of: product, process and marketing innovation. Businesses that have used the program rate the experience very highly as a way of lifting their productivity and improving their opportunities.
  - Innovative Regions Facilitators work collaboratively with regional businesses, researchers, local governments and communities to build business capability and entrepreneurial capacity and stimulate regional economic development.

  Research underway at the present time suggests that the Enterprise Connect program is having a positive and sustained impact on the performance of participating businesses, including in comparison to a control group of non-participating businesses.
- **TradeStart.** TradeStart is a national program funded through the Australian Trade Commission (Austrade) with advisers placed in strategically important host organisations such as industry associations and economic development agencies. Experienced advisers work one on one with existing and potential exporters providing them with customised assistance to develop new export markets. The

program is flexible and practical and as the host organisations are paid once a threshold number of exporters have made export sales, extremely effective. This program has been running for twenty years and the current four year contract is due to expire 30 June 2013.

- **Export Market Development Grants (EMDG).** Ai Group remains supportive of the EMDG and welcomes the recent addition of $50 million to the program. Competiveness isn't just about the cost of the final product; it also includes maintaining market profile and brand awareness. The EMDG assists SMES to hold their own on the world stage.

- **Skills Connect Funding**. Skills Connect representatives can assist employers identify appropriate training solutions and can provide guidance on the best approaches to developing and lodging a proposal for funding support.

- **National Workforce Development Fund.** Advisers can work with businesses, free of charge, to assist in determining your workforce needs by:
    - providing your business with direction on emerging skill, labour and technology trends in the industry
    - help employers determine the current level of knowledge and skills required in the workforce
    - assist in identifying skills gaps that limit business growth
    - work with employers to find solutions and opportunities to develop your workforce.

- **Workplace English Language and Literacy Program (WELL).** this program has been in existence for over 20 years to help organisations train workers in English language, literacy and numeracy skills. The program assists existing employees to undertake training essential to retaining their employment and progressing in the workplace. It also focuses on helping Indigenous Employment Program (IEP) participants who need language, literacy and numeracy training and foundation skills. Funding support is a co-contribution model.

- **Investing In Experience (Skills Recognition & Training).** This 'Investing in Experience (Skills Recognition & Training)' program commenced on 1 July 2012, and invites employers to apply for grants of up to $4,400 to assist their mature age workers (aged 50 years and over) to get qualifications that match their skills. Through a skills assessment and, if needed gap training, a mature age worker can attain a nationally recognised qualification at the Certificate III to Advanced Diploma level.

- **Australian Apprenticeships Incentives Program**. the Australian Government provides a range of support through the Australian Apprenticeships Incentives

Program to encourage the continued training and development of a highly skilled Australian workforce. The Program links into the industries and occupations traditionally associated with the apprenticeship system. In addition, the Program targets a broad range of traineeships and apprenticeships in new and emerging industries especially where future skills shortages are projected.

- **Apprentice Kickstart Commencement/Retention Incentive**. This incentive sits within the Australian Apprenticeships Incentives Program. It is provided to small and medium enterprises and eligible Group Training Organisations to increase the number of Australian Apprenticeship commencements in skills shortage areas of the building and construction industries and in skills shortage engineering trades.

Industrial relations policy in support of automotive and other manufacturing

Australian automotive manufacturers need a workplace relations system that does not impose unnecessary barriers upon productivity and flexibility and which encourages flexible and innovative workplace arrangements. Australian automotive manufacturers, like other manufacturers, must not be faced with unnecessary workplace relations barriers that affect their competitiveness and adaptability. If unnecessary barriers continue to be imposed upon automotive manufacturers, the inevitable result will be more business closures, more off-shoring and less Australian jobs.

Some important changes need to be made to the *Fair Work Act 2009* to remove barriers to flexibility and productivity including:

- More tightly defining the issues which can be the subject of bargaining claims;
- Implementing a more effective framework for Individual Flexibility Arrangements,
- Fixing the general protections laws which are creating major risks, uncertainties and costs for employers, and inhibiting management decision-making; and
- Implementing more workable transfer of business laws to ensure that businesses are able to restructure to remain competitive.

Despite the obvious challenges facing Australian automotive manufacturers, unions relentlessly push enterprise bargaining claims which restrict flexibility, often under the banner of “job security”. Such claims include:

- Restrictions on the use of labour hire;
- Restrictions on the use of independent contractors;
- Restrictions on casual employment;
- Restrictions on outsourcing;
- Claims for very generous redundancy packages which restrict the ability of companies to restructure to remain competitive;

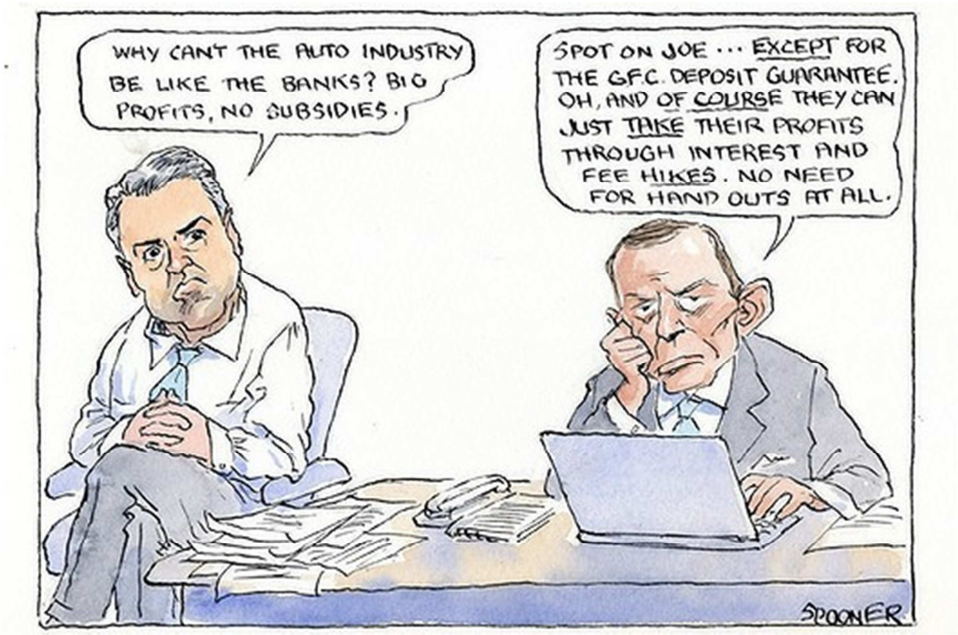
- Union rights to be involved in management decision-making;
- A prohibition on flexible arrangements being agreed upon between an employer and an individual employee.

Union enterprise bargaining claims and the responses to those claims inhibit the ability of automotive manufacturing businesses to be responsive and adaptable to market changes. Further, changes in wages and conditions in the automotive sector can spill over into other industries and sectors. In the real world the only true job security for workers comes from ensuring that businesses remain profitable and competitive. Flexibility is critical if this is to be achieved.

The "permitted matters" for bargaining under s.172 of the *Fair Work Act 2009* need to be more tightly defined and the "unlawful terms" in s.194 need to be extended. Any matter which is not a "permitted matter" should be an "unlawful term" and unable to be included in an agreement. This will ensure that bargaining is focussed on matters which genuinely pertain to the employment relationship, rather than on matters which seriously impede the ability of employers to manage their businesses in a productive manner. For example, up to 2009, enterprise agreements were not permitted to contain provisions which imposed restrictions on contractors and labour hire. This prohibition needs to be reinstated within the list of "unlawful terms" in the Act.

Australia's workplace relations system needs to be as flexible and productive as possible, whilst ensuring fairness for both employees and employers.

Specific assistance measures to the automotive manufacturing sector



Source: John Spooner, www.theage.com.au/comment/workers-autodafe-20131112-2xeeg.html.

Australian automotive manufacturing suffers under the weight of a widespread perception that it is unique among Australian industries with regard to the size and scope of the assistance it receives from Government. Much of this perception seems to be related to the high visibility of assistance to automotive manufacturing when compared with assistance to other industries. The Productivity Commission's annual *Trade and Assistance Review* for example, confirms that a range of Australian industries inside and outside manufacturing receive special assistance of a similar level to automotive manufacturing (an estimated $1,117mn in combined assistance in 2011-12), including utilities ($1,000mn) and financial services ($927mn) (see table 2).

Productivity Commission data show that the highest effective rates of assistance — net assistance per dollar of value added — is for the TCF and motor vehicle industries, although by 2011-12, effective rates of assistance to these sectors had dropped by around 25 per cent from 2006-07 levels. The effective rate of assistance for these industries was around seven and nine per cent respectively in 2011-12, compared to the average for manufacturing of around four per cent. Assistance to automotive manufacturing is also more visible, because more of it is provided through expenditure programs rather than through tariff assistance or tax concessions (table 2). This visibility of assistance is commendable from a policy design perspective, but it leaves the industry more vulnerable to criticism of its assistance than other industries.

Table 2: Combined Government assistance to major industries, 2011-12

	Tariffs			Budgetary (a)		
$ million (nominal)	Output	Input penalty	Net tariff assistance	Outlays	Tax concessions	Net combined assistance
Mining	1	-208.5	-207.5	400.9	299.5	493
Sheep, cattle & grain farming	0.2	-17.2	-17.1	212.9	355	551
All Primary production	209.5	-73.4	136.1	891.2	548.3	1,576
Food, beverages and tobacco	1,698.5	-486.4	1,212.1	44.6	61.3	1,318
Metal and fabricated products	1,780.4	-423.6	1,356.8	220.4	45.5	1,623
Motor vehicle and parts	785.2	-289.2	496.1	579.9	40.9	1,117
Machinery and equipment	641.7	-193.4	448.3	120.2	62.4	631
Petroleum, coal and chemicals	991.5	-288.5	703.1	177.7	46.1	927
Textile, clothing and footwear	295.6	-60.4	235.3	53.4	6.6	295
Wood and paper products	720.6	-145.8	574.8	8.4	9.6	593
Electricity, gas, water and waste	–	-77.6	-77.6	1,050.8	26.6	1,000
Financial and insurance services	–	-10	-10	69.7	845.1	905

(a) Allocated funds only.
Source: Productivity Commission, *Trade and Assistance Review*, 2011-12.

In international comparisons, Australian automotive industry assistance is generally more transparent than in other automotive manufacturing countries, including the United States and much of Europe. On some measures, the level of assistance may be lower than in other economies (see for example, Allen Consulting Group, Sep 2013).

The terms of reference for this Review recognize that having an automotive industry is desirable. However, there are various possibilities regarding the future size, scope and shape of the industry that are worth exploring. The balance between automotive assistance and assistance to other industries also needs to be considered, as does the balance between general assistance programs that are open to all businesses and programs that are carefully targeted to just a few (for example, programs that are only open to larger firms or those at a particular stage in the supply chain). This balance is important to ensure that:

- investments are targeted to build on our existing strengths in automotive and transport manufacturing, where we can be competitive overseas;
- opportunities for knowledge and skills transfers, as highlighted in the previous section, are maintained. In this context, it may be beneficial for some automotive assistance programs to be reconfigured so as to provide a better boost to the innovation or skills links between sectors and between suppliers. This might help to encourage more spillovers, rather than directly supporting production; and

- valuable knowledge that is at risk of being lost from the automotive sector is not lost from Australia, but is re-directed into other sectors within the Australian manufacturing industry and other industrial sectors (e.g. mining and transport).

As a general principle, Ai Group strongly believes that Government measures and policies that have been committed should not be discontinued prematurely without very good reason. The current assistance arrangements for the automotive industry were put in place with a time frame to 2020, although some components of the Plan have already ceased or were ended early (see Table 3).

The remaining committed timetable should be honoured, in the interests of ensuring trust and certainty in industry policy. Policy stability is especially crucial to programs such as these, that are aimed at fostering long-term investment and innovation. Long-term certainty is all the more important when applied to automotive production, due to the very long lead-times in its investment, planning and decision-making cycle. The three Australian-based automotive assemblers plus around 150 Australian-based parts suppliers have already made key long-term investment decisions on the basis of the current funding and programming arrangements out to at least 2020.

This is not to say that the detailed components of the **New Car Plan for A Greener Future** or the **Automotive Transformation Scheme (ATS)** (Table 3) are immutable, but changes to these core programs at this late stage in their implementation must be very strongly justified and very carefully designed and implemented.

Table 3: A New Car Plan for a Greener Future: major components, dates and funding

Program	Start date	End date	$mn
Automotive Transformation Scheme	1 Jan 2011	31 Dec 2020	$3,000
Automotive New Markets Initiative	2012-13	4 years	
- automotive new markets program			30
- business capability support program			
- automotive envoy			
- automotive supplier advocate			
Automotive Industry Structural Adjustment Program	31 Mar 2012	30 Jun 2017	15.6
Automotive Supply Chain Development Program	30 Jun 2009	30 Jun 2013	20
Green Car Innovation Fund		Jan 2011	500
LPG vehicle enhancement scheme			10.5
Automotive Market Access Program	Jul 2009	Jun 2012	6.3

Source: Allen Consulting Group, *The Strategic Role of the Australian Automotive Manufacturing Industry,* Sep 2013.

There is a range of views among Ai Group members regarding the detail of the programs provided to support the automotive sector. For our second report to this inquiry we will

seek more detailed input from across our membership. Here we present a snapshot of the input we have received to date.

Many of our automotive industry members believe that a Review and amendment to the current New Car Plan is now justified, because this Plan was designed and established prior to the GFC but has now been "*overshadowed by the strengthening Australian dollar, the upholding of high Tariffs in offshore markets and the significantly increased co-investment made by Governments in support of other automotive production countries as a result of the GFC*." (Mark De Wit, Futuris Automotive Australia, Nov 2013). In particular, Members say the Plan needs to have:

- a stronger focus on promoting and supporting exports, which are the only way to increase demand in a relatively small and mature market like Australia; and
- a more 'holistic' approach to supporting the sector from 'end to end', that is, from design to production to sales to services and even to recycling of auto products.

Others in the automotive supply chain said that assistance programs should be more directly accessible to smaller 'Tier 2' businesses in the automotive supply chain that are still conducting all or most of their production in Australia rather than offshore. Many Tier 1 firms have increased their imported content in response to the high dollar and intense cost pressures in the industry. In some cases, this has caused friction with their remaining local suppliers. The Tier 2 firms are finding it harder to compete for business, but they said they are also finding it harder to gain access to the Government programs that are available to help improve their own productivity and long-term viability. These firms want to remain viable as Australian producers and are now looking to enter the supply chains of other industries in order to achieve this (see discussion below).

The views above are echoed by Mike Tristram, CEO of Trico Foods P/L, who recognises the value of retaining an automotive industry in Australia, but believes that the industry should only continue to receive government support if it can move to a position of greater profitability and ultimately become viable in its own right:

"The car industry plays its part in ensuring there is some knowledge retained here that has flow on effects not only to parts manufacturers, but also to other manufacturers, in automation and lean manufacturing methodologies, and we shouldn't easily let the industry fall as a result. However, like any business in this country, it needs to have strategies in place to find itself "eventually" globally competitive. If the Government is to continue to support these manufacturers, it must look only to support these companies to transition and find more niche and differentiation options that can be profitable. It[the Government] needs to determine if these companies are situated both culturally, and have the mix of skills and abilities, to be able to move into this [niche and profitable] space. Otherwise, they shouldn't put the money forward."

The Ai Group agrees that industry policies and programs need to be strategic and to focus on longer-term benefits, particularly beyond the 2020 timeframe for current assistance commitments to the automotive industry.

At the same time, some of our members think the automotive sector receives a disproportionate level of Government support relative to other manufacturing sectors; that automotive sector support is provided to the exclusion of support to other sectors; or that support for the automotive sector comes at the expense of other sectors. This view is illustrated by the following quotes:

"*We are currently facing hard times. For the first time in 30 years of business we have had to ask staff to work short weeks in the hope that work will pick up. Will the government give me "free funding" to keep me manufacturing in Australia?*" Andrew Melvelle, CEO of Melvelle Equipment, rail and mining equipment manufacturing.

"*Supporting the industry adds to the cost of running our business by making vehicles and parts more expensive*." Graeme Dossetor, MD at Australian Food Ingredient Suppliers (AFIS) Pty Limited

"Within the Public Transport Sector manufacturing supply stream we see none of the charitable benefits afforded to car manufacturers, and yet despite this, we are globally competitive, perhaps because we have no false sense of security. We live in hope that a clear distinction can be made between Auto and Mass Transit, as to date all effects of the auto industry have been negative to our industry sector." Darren Laidler, Managing Director of Transglaze, a public transport component manufacturer.

"What Australia needs is long term policies, leadership and support for industries which can stand alone and prosper without continued Government support. There are many examples worldwide where governments have developed policies, structures and incentives, which are holistic instead of one dimensional, that have built worldwide industry leaders. For example Germany now leads the world as one of the most innovative, technologically advanced and largest manufacturers worldwide of products such as solar inverters and panels … [Germany had] a competitive edge with local proximity markets, industry skills and government support … they turned this into an unassailable and formidable position in the renewable energy market. There are many well cited examples of holistic policies similar to this, either industry or product based or others where a particular culture gives rise to industry. e.g. manufacturing – free trade zones in Penang, now a leading supplier of worldwide electronics or innovation and entrepreneurship coming from Silicon Valley." David Bayliss, SETEC Industries, Nov 2013.

There also appears to be less community support for automotive assistance than has previously been the case. Despite a renewal of the national automotive fleet over the past decade (although the pace of renewal has eased in most recent years), the industry is smaller; there is less domestic consumer demand for locally-made cars; and exports

have retreated. The scale of domestic production is considerably below international levels which continue to grow.

Assisting businesses to adapt in response to reduced local automotive production

A 2008 Ai Group member survey found that 10% of companies who were previously part of the components sector (mainly Tier 2 or 3) were no longer supplying to the automotive sector, basing their production around other products and sectors. This was due to the downturn in automotive production, but also to difficulties in working with Tier 1 automotive companies as cost pressures are straining supply chain relationships.

Interim results of a survey of our members in November 2013 suggests that this trend continues with many companies continuing to look for opportunities outside of the automotive sector, a reflection of the challenging environment facing component suppliers. Many of these businesses had moved to take up opportunities in the mining and healthcare industries. An example is Crib Point Engineering, which serviced the automotive sector for roughly 30 years, but has done no work for the automotive sector since the GFC as there is very little work available and increasing uncertainty regarding payment. "*We are lucky we are a broad-based engineering company, so have been able to pick up work in other sectors, such as mining, to make up for the work we no longer do for the automotive industry*", Edward Banks their MD said.

Other businesses had not successfully managed to adapt their business, sometimes because they were not strategic enough, but often because of factors that were out of their control, such as the high cost of labour and raw materials in Australia. In the case of the latter, the businesses often already have a diverse customer base, are productive, lean and have maintained investment in new technology. As the following quote from a manufacturing business in Ballarat in regional Victoria indicates, the consequences of failing to, or being unable to structurally adjust can be dire: "*We weren't investing in line with a long-term strategy…we were aimed primarily at the automotive industry in Australia, which we were originally in, and it's been in decline…So as a result, we had no strategy, we had markets that were in decline…We went from an operation that ran six days a week with 400 people to what we are today, which is considerably smaller and we did it almost overnight*."

Further support for structural adjustment may be useful to ensure that skills and knowledge built up in the automotive sector are not lost from Australia; that problems of high local unemployment are minimised; and that innovations (technological and otherwise) that are developed by the automotive sector continue to provide spillover benefits in other sectors. However, structural adjustment assistance will not be the panacea for all those businesses currently grappling with diminished supply from the automotive sector, and the manner in which adjustment assistance is provided needs careful evaluation.

Trade policy in support of automotive production and all manufacturing

In relation to trade policy, Ai Group believes that Australia's free trade agreements (FTAs) should be used to greater effect in support of exports of Australian manufactured products. Automotive exports and manufactured exports more generally must be better promoted and supported in the context of bilateral trade agreements currently being negotiated, including FTAs with Japan, Korea China, India and Indonesia as well as the Trans-Pacific Partnership Agreement.

As an example of arrangements in current FTAs that are inappropriate or not supportive of Australian industrial exports, the Allen Consulting Group (2013) cites the case of Thailand:

"Ford Australia has exported the Ford Territory to Thailand, but the Thai Government imposes a non-tariff duty, making the Territory's price in Thailand an unattractive $100,000, which is far above the price of a comparable locally made product. This, it should be noted, is after the conclusion of an apparently trade liberalising agreement between Australia and Thailand." (p. vii)

Lindsay Guscott from the Production Stamping Company, a small component manufacturing company with a diversified customer base of businesses inside and outside the automotive sector, said the key problem for them was their lack of cost competitiveness against imports. He wants to see stronger anti-dumping policies:

"We watch our once very broad customer base slowly but surely source from offshore suppliers. We already have a diverse customer base, we are productive, we are lean and we have always invested in smart, new technologies, but we have no chance of being able to compete with a country that has access to cheap raw materials (something we do not have). Most of the components that we have lost are now sourced from China, finished and delivered for the cost of raw material here. If we as a country do not address this issue then manufacturing will disappear regardless of how much money is spent to support it. If we are able to quote on work at the same raw material cost then the length of the supply chain, risk with delays, ability to change order quantities or introduce design changes would make us a viable option. We don't want government money. What we want is for the government to treat this as a form of dumping and introduce measures that make it a less attractive option for sourcing components – ie, to level out the advantage so we compete toe to toe."