Ai GROUP SUBMISSION

13 February 2014

Ai Group Second Submission to the Productivity Commission Review of the Australian Automotive Manufacturing Industry (Feb 2014)

AUSTRALIAN INDUSTRY GROUP

Contents

This submission was finalised on 13 February 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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1. Executive summary

The outlook for automotive manufacturing in Australia

- The very recent announcements by GM Holden and Toyota to cease assembling passenger vehicles in Australia by 2017 will cut a swathe through the Australian automotive industry over the next three years. This will have grave repercussions through the rest of the manufacturing sector and indeed, through the entire economy. This situation requires a comprehensive and coordinated response from Federal and State Governments.

- For many of the hundreds of Australian automotive components businesses that supply the three local automotive assemblers (the Tier 1, 2 and 3 businesses that employ around 45,000 people nationally), the outlook is catastrophic. They must transition to other markets, industries or products, or they will shut down for good. Their departure will, in turn, have wide implications for other businesses, contractors and employees up and down the domestic automotive supply chain.

- The end of automotive assembly in Australia will also reduce or remove the ability of automotive assembly and components companies to continue the key role they have long held in the development and diffusion of technological, process and design-led innovation in Australia. The automotive industry has been pivotal in building intellectual capital and in training skilled workers and managers who have taken this expertise and applied it across the economy but particularly in the industrial sector. These important (but largely unquantifiable) spillover benefits from automotive engineering and production to the rest of the economy will be a great loss and will be very difficult to replace. This network of innovation has grown in an organic and informal manner over many years. It will be very difficult to replicate.

The policy challenge for automotive manufacturing in Australia

- The imminent end of automotive assembly presents a serious and immediate policy challenge for Government. The most important task of Government policy now is to establish transitional support for businesses, employees and their communities. This transition assistance needs to be designed and implemented carefully but rapidly and it needs to be closely coordinated so as to ensure easy, timely access for all.

- Ai Group urges State and Federal Governments to immediately direct their attention to actively supporting the affected businesses through this difficult transition process. Successful business transition will be critical to minimizing the financial and human cost of redundancy and the consequent longer-term impact on job opportunities, incomes, families and communities. There are two key dimensions to the response that governments should take to business transition:

  - they should facilitate the transition of affected businesses to alternative markets - whether that be through participation in global automotive supply chains or in other areas; and
  - they should assist with steps to address the chasm that has opened across Australia's broader industrial infrastructure.

- Existing generic jobseeker programs will not be enough to meet these extraordinary circumstances. Additional, carefully designed assistance to redundant automotive workers will be warranted over the next half decade or more, due to the large numbers, geographic concentration and timing of their redundancies. Limited employment growth in other parts of manufacturing over the outlook period is likely to mean that opportunities for equivalent employment for former automotive workers will be limited and extensive re-training may be required.

- Regional adjustment programs to assist local small businesses and other community members will also be required in each of the locations that will be hit the hardest, most notably in and around Adelaide, Melbourne, Geelong and other regional locations.

- Australian automotive manufacturing businesses need a workplace relations system that does not impose unnecessary barriers upon productivity and flexibility and which encourages flexible and innovative workplace arrangements. The need for amendments to be made to the *Fair Work Act* to deliver such a system and to remove unnecessary barriers to competitiveness and adaptability have, if anything, become more pressing given the announcements by GM Holden and Toyota. Industry cannot afford to wait until after a Productivity Commission Inquiry into the *Fair Work Act* and after the next Federal Election before critical changes are made. The inevitable result of any delay or failure to act will be more business closures and greater losses for Australian jobs.

- 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. General industry programs will need to be maintained or strengthened over the next five years, in order to enable Australian industry to weather the fallout from this event and to contribute to a much-needed re-balancing of the Australian economy.

Funding requirements for automotive manufacturing adjustment

- The funding that is currently allocated to the ATS and other components of the New Car Plan should be allowed to run its course to 2020. Government funding approvals and commitments that have already been made must be honoured, in the interests of promoting trust and certainty in industry policy. Clearly, the detail of the ATS and the New Car Plan however, must now be revised in response to these new challenges. Ai Group recommends that the remaining ATS and New Car Plan funds should be redirected to:
    - Assist Tier 1, 2 and 3 automotive companies make the necessary transition to new markets and/or industries, focusing especially on the Tier 2 and 3 companies who are more likely to remain committed to operating in Australia; and
    - Promote longer-term resilience and diversification among business and industry that will extend well beyond the end of Australian automotive assembly from 2017.
- Additional Government funding will be needed to assist with this large adjustment process. As a starting point, Ai Group welcomes the establishment of the $100 million Growth Fund by the Federal, Victorian and South Australian governments.
- The Government is facing a potentially huge budget blowout due to the potential insolvency of many automotive component manufacturers with very generous redundancy schemes unless the *Fair Entitlements Guarantee Act 2012* is amended to reduce the generosity of the scheme or FEG funding is increased very substantially.

2. 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.

This is the second of two submissions that Ai Group has prepared for this Review. Ai Group appeared at the first round of public hearings for this Inquiry in December 2013.

This second submission is framed in the context of the impending collapse of the Australian automotive manufacturing sector (confirmed since this Inquiry commenced), due to the confirmations by GM Holden in December 2013 and Toyota in February 2014 that they will cease to assemble vehicles in Australia by 2016 and 2017 respectively. These decisions come on top of the end of local production by Ford Australia by 2015. Collectively, these decisions mean all production of complete passenger vehicles will cease in Australia within the next four years.

In our first submission (Nov 2013), Ai Group:

- 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.

- Gave our preliminary views on the role of automotive production in Australian manufacturing and its future opportunities.

- Included as attachments some of our recent relevant research papers.

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 recommendations for generic industry policies and programs are detailed in our recent submissions to the Australian Government for its 2014-15 Budget and to the Federal Minister for Industry, Ian McFarlane, in response to his request for submissions on the automotive sector transition package and the future of Australian manufacturing.

3. Automotive industry policy

The outlook for Australia's automotive industry has deteriorated to the point of impending collapse since this Inquiry commenced in November 2013. The very recent announcements by GM Holden and Toyota to cease assembling passenger vehicles in Australia by 2017 will irreversibly cut a swathe through the industry.

Ai Group is firmly of the view that the end of full passenger vehicle production in Australia by 2017 is going to have grave repercussions throughout the rest of the manufacturing sector and indeed, throughout the entire economy. The size and severity of this shock, and the number of businesses and people that will be affected should not be underestimated, nor brushed aside by policy-makers as just another 'temporary adjustment phase'. As noted by the *Australian Financial Review*:

> There have been several waves of massive restructuring of our economy over the past 30 years. But it is hard to think of one which will be so profound and intense as the restructure we face in the next three years as the car industry – and the components sector which depends upon it – closes down (Laura Tingle, *Policy purity versus pragmatism*, AFR, p. 5, Tues 11 February 2014).

This departure of all of the assembly operations that are so essential to the Australian automotive industry means that most of the draft proposals for automotive industry policy in the PC's Position Paper of January 2014 will need to be re-worked. Ai Group urges the PC to carefully reconsider all of its draft proposals in light of these developments.

The demise of Australian automotive assembly

For many of the hundreds of Australian automotive components businesses that supply the local automotive assemblers (the Tier 1, 2and 3 businesses that employ around 45,000 people nationally), the departure from Australia of Ford, GM Holden and Toyota could be catastrophic. These businesses must transition to other markets, industries or products, or they will shut down for good.

The closure and/or departure from Australia of the assemblers will, in turn, have wide implications for all other businesses, contractors and employees up and down the domestic automotive supply chain, reaching into materials suppliers, machinery and equipment suppliers, maintenance contractors, engineering and design specialists, human resources, training, business and property services providers.

The end of automotive assembly in Australia will also reduce or remove the ability of automotive assembly and components companies to continue the key role they have long held in the development and diffusion of technological, process and design-led innovation in Australia. The automotive industry has been pivotal in building intellectual capital and in training skilled workers and managers who have taken this expertise and applied it across the economy but particularly in the industrial sector. These important (but largely unquantifiable) spillover benefits from automotive engineering and production to the rest of the economy will be a great loss and will be very difficult to replace. This network of innovation has grown in an organic and informal manner over many years. It will be all but impossible to replicate it with structured programs or Government policy directives.

Adjustment policy for the Australian automotive industry

The end of automotive assembly presents a serious policy challenge for Government. Australia's automotive components and assembly businesses, their employees, their suppliers and their associates now have just three years at most to prepare for this massive adjustment.

The most important and immediate task of Government policy is transitional support for businesses, employees and their communities. This transition assistance needs to be designed and implemented carefully but rapidly and it needs to be closely coordinated across all levels and arms of Government so as to ensure easy, timely access for all businesses and individuals who will need it.

Ai Group notes that the PC Position Paper has a very strong focus on assisting individual employees who will be exiting the auto industry in the next few years. Such support for individual employees will be necessary *but not sufficient* in effectively assisting the communities who will be affected. Government programs must also support whole businesses in their quest to re-align their activities to other industries. Support for whole-of-business transitions to other markets and industries has the advantages of:

- building on the established intellectual capital, skills, capital resources, reputations and marketing relationships of existing businesses, instead of starting from scratch with new enterprises that may take years to build back to a similar level of capital;
- reducing the loss of collective intellectual capital, skills and knowledge that occurs when a company ceases to trade. Although individual employees may carry some of that shared knowledge with them to new jobs, in many cases the whole will have been worth more than the sum of the parts;
- reducing the loss of activity and employment in local areas, which is particularly important in locations with high levels of disadvantage and few alternative employment options; and
- minimizing the financial and human cost of redundancy for individual employees.

Transition policy for automotive industry businesses

Ai Group urges State and Federal Governments to immediately direct their attention to actively supporting the affected businesses through this difficult transition process. Successful business transition will be critical to minimizing the financial and human cost of redundancy and the consequent longer-term impact on jobs opportunities, incomes, families and communities. There are two key dimensions to the response that governments should take to business transition:

1. they should facilitate the transition of affected businesses to alternative markets - whether that be through participation in global automotive supply chains or in other areas; and
2. they should assist with steps to address the chasm that has opened across Australia's broader industrial infrastructure.

The automotive industry is characterized by a complex network of Tier 1, 2 and 3 businesses that sub-contract to one another in support of the three large automotive assemblers. The 'Tier 1' companies that contract directly to the assemblers include a mix of larger Australian and multi-national firms that are, for the most part, dedicated solely to supplying the automotive assembly giants. With the exit of auto assembly from Australia, many Tier 1 businesses and operators are likely to exit the Australian market in pursuit of automotive business elsewhere or to simply close down their Australian operations. These Tier 1 firms had been increasing their imported inputs for some time, in response to the high Australian dollar and other factors. For the multinationals among them, the decision to exit entirely will be largely made offshore.

For the smaller Tier 2 and 3 automotive components manufacturers, there is a higher concentration of Australian owned, operated and located companies. Many of these businesses have already started the difficult and complex process of diversifying into other markets, industries and product ranges. A 2008 Ai Group member survey found that 10% of companies who were previously part of the auto components sector (mainly Tier 2 or 3) were no longer supplying solely to the automotive sector, basing their production around other products and sectors. This was due to the downturn in local auto production, but also due to reported difficulties in working with Tier 1 automotive companies, as cost pressures were straining the established supply chain relationships.

Interim results of a survey of our members in November 2013 suggests that this trend has continued, with many companies stepping up their search 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 equipment 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 was 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 is needed 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.

For companies that are part of the auto supply chain, Ai Group believes the focus of adjustment assistance for automotive businesses must be designed so as to ensure:

- strong access, eligibility and relevance for Tier 2 and 3 automotive components manufacturers. These businesses tend to be smaller than the Tier 1 automotive suppliers and many are still conducting all or most of their production in Australia rather than offshore. These smaller firms often find it hard to gain access to the existing suite of Government auto assistance programs, for a variety of reasons. Tier 2 and 3 businesses tend to have a higher level of local production and ownership than their Tier 1 colleagues. Where the Tier 1 automotive businesses are often local branches of international companies who will need to follow the auto assemblers in their moves around the globe, the Tier 2 and 3 businesses are more likely to want to remain viable as Australian producers and to be looking to enter the supply chains of other industries in order to achieve this. Many are already well advanced in this process, but need support to ensure they reach their goals (see discussion below);

- a stronger focus on promoting and supporting exports of auto components, which is the only way to maintain sales levels in what is now a shrinking local market;
- a stronger focus on identifying new applications for auto components makers and on adapting to making new products for other industries;
- a more 'holistic' approach to supporting auto components manufacturers quest to renew themselves from 'end to end', that is, from design to production to sales to services and even to the recycling of their final products; and
- a strategic focus on longer-term benefits to business that will extend beyond the 2020 timeframe for current assistance commitments to the automotive industry.

Identification and transition to other markets and other industries

At a broader, industry level, Ai Group recommends that funds be allocated to market analysis aimed at informing auto businesses with particular sets of capabilities of their domestic and global opportunities for diversification and re-orientation. For example, Australian Industry Groups thinks an opportunity may exist for some automotive part manufacturers to make a relatively quick and inexpensive transition for manufacturers into the global motorcycle after-market parts market. Around 200 million motorcycles are in use worldwide, compared to around 590 million cars. Unlike cars, where 33% of the cars (195 million) are concentrated in the United States and Japan, 58% of motorcycles are in the developing countries of Asia – Southern and Eastern Asia, and the Asia Pacific countries, excluding Japan – while the four largest motorcycle markets in the world are all in Asia: China, India, Indonesia, and Vietnam. The motorcycle is also popular in Brazil's frontier towns. Amid the global economic downturn in 2008, the motorcycle market grew by 6.5%. Recent years have seen an increase in the popularity of motorcycles elsewhere. In the USA, registrations increased by 51% between 2000 and 2005. This is mainly attributed to increasing fuel prices and urban congestion.

In contrast to the automotive parts sector, there is a low level of government protection for after-market motorcycle parts internationally. Businesses can access the mass market concentrated in Asia, while significant opportunities also exist for Australian business to penetrate the high value, high margin, low volume market in places like the US, UK and the EU. These markets tend to concentrate on customising, personalising and restoration, coupled with a higher willingness to think and act about matters pertaining to safety. Hence suspension, brakes, steering, lights, and so on are more frequently looked at and there is an opportunity for a high degree of specialization.

Ai Group has developed a pilot project in the Hume and Riverina districts, and believes the transition could be relatively smooth for businesses. Many parts manufacturers have the equipment and knowledge to quickly transition with only minor re-tooling required. Ai Group has applied to Industry Minister Ian Macfarlane for a $300,000 grant to fund a thorough analysis of the international motorcycle market and to scope out the opportunities for Australian business. After thorough research is undertaken, we will then propose to employ an adviser to work with five local firms in the Hume and Riverina areas to make this transition.

We envisage this project will have two parts. The initial stage will be to conduct market research and opportunity identification, which we envisage will take around six months. Then, an adviser will work with the manufactures to make the transition in the workshop and create a brand with the goal of penetrating the market after one year. The lessons learned from the implementation of this project will aid similar initiatives to identify opportunities for other manufacturers throughout Australia.

Transition policy for automotive industry employees

Even before the announced closure of local assembly by Toyota, the PC had understandably found that employment losses in automotive manufacturing are likely to be large and geographically concentrated over the next few years. If anything, these job losses look to be happening faster and earlier than even these announcements had anticipated. Job losses as a result of plant closures by Ford and GM Holden will not occur only in 2016 and 2017 when their assembly plants finally close, they are already happening now. Ford for example, will shed another 300 workers as of June 2014, when it will reduce production of Falcon and Ford Territory vehicles from 133 to 80 units per day (Ford Australia Media Announcement, 6 Feb 2013). This round of job losses will happen in Geelong and Broadmeadows in Victoria, both of which are already locations of socio-economic disadvantage and relatively high unemployment.

Given the number and geographic distribution of the job losses expected by the PC over the next decade in automotive manufacturing, Ai Group is surprised and disappointed to see the PC question the suitability or desirability of specialist transition assistance for redundant automotive employees in its Position Paper (e.g. Draft Findings 5.1, 5.2, 5.3 and 5.4 and draft proposal 5.1).

In our first submission, Ai Group set out the challenges that we see ahead for redundant automotive workers seeking alternative employment. While some segments of manufacturing are indeed doing relatively better, and are growing their outputs, few if any areas of manufacturing are expected to expand their workforce significantly over the coming decade (see pages 10-24 of our first submission). This is because the growth sectors in Australian manufacturing at present tend to be in segments that are smaller, higher-value, more capital intensive and require more specialised or high-skill workers than may have been the case in the past. Managerial, engineering and technical professionals with automotive production experience are often highly regarded and sought after by the growth segments of manufacturing (and this is an important avenue for unquantifiable ‘spillover’ benefits from automotive to other parts of manufacturing), but new opportunities are likely to be limited due to the low-growth outlook facing the Australian economy (see our first submission for our views on the outlook for the Australian economy). Such professional employment opportunities are unlikely to match the increasing supply of industrial professionals coming into the market, as they exit the auto industry in increasing numbers over the coming years.

For the automotive production workers with lower levels of skills and qualifications, it is very likely that they will miss out on alternative work unless they can undertake intensive, carefully designed assistance. As the PC has noted, many of the auto industry’s production workers are lower skilled, are older, and are in disadvantaged locations, so their job options will be limited. Language, literacy and numeracy skills may also create a barrier for some of them. Ai Group agrees with the PC that these characteristics probably apply to many other unemployed jobseekers also. This is why, for example, Ai Group strongly advocates access to properly designed and implemented Workplace English Language and Literacy (WELL) programs across all industries (see details below)..

For all of these reasons, existing generic jobseeker programs will not be enough to meet these extraordinary circumstances. Additional, carefully designed assistance to redundant automotive workers will be warranted over the next half decade or more, due to the large numbers, geographic concentration and timing of their redundancies. Limited employment growth in other parts of manufacturing over the outlook period is likely to mean that opportunities for equivalent employment for former automotive workers will be limited and extensive re-training may be required.

Regional adjustment programs to assist local small businesses and other community members will also be required in each of the locations that will be hit the hardest, most notably in and around Adelaide, Melbourne, Geelong and other regional locations.

Ai Group believes a sound and well developed skills package is vital for affected automotive industry workers to ensure they are able to transition to businesses that will have an ongoing and sustainable role in Australia's manufacturing future. Ai Group commends the Federal and state government's commitment to assist automotive workers. However, we would stress that the retraining package must be developed with a considered view to targeting future business and employment opportunities for the automotive manufacturing sector and its supply chain. Government must consult with the automotive supply industry to ensure that workers are retrained into relevant qualifications that will meet the needs of business and provide employment. Once this information is provided, we would encourage the program to draw on the expertise of the existing Enterprise Connect program and the Manufacturing Workforce Development Advisers, who are able to assist companies in transition and map out future careers and identify the skills gap before training begins. These advisers could also assist in brokering training opportunities for workers, as this is a confusing exercise for the uninitiated.

Ai Group would encourage any skills package to include English literacy and numeracy training, which is in many cases will need to be the first step in helping retrenched workers into new jobs. We would encourage priority access for these workers into the already successful Commonwealth-funded program known as the WELL Program mentioned above, but would ask that the employer contribution be waived.

Many automotive sector employees will require Recognition of Prior Learning before they transition to new roles. We stress the importance of ensuring RTOs are fully-funded to conduct assessments given the reduction of funding for RTOs to provide these services in recent years.

Regardless of the final form of skills packages, it will draw on both federal and state initiatives. We feel there is a need for the broad program to be managed and coordinated centrally so both employees and employers know what services are available and how and where they are able to access them as well as to provide employment opportunities.

In many cases, employees will need to reskill and so will need to complete a qualification at a level they may have already attained in a different area. We would encourage that any assistance allows them to do so. We welcome any reward payments for completion of training and brokerage of sustainable employment linked to the training. We encourage an incentive for employers to take on these workers, similar to payment schemes to encourage employment of older workers or the Victorian Employment Start-Up of Business – however encouraging employment of retrenched workers form the automotive manufacturing sector.

Funding availability for automotive industry adjustment

Ai Group believes that all of the funding that is currently allocated to the ATS and other components of the New Car Plan should remain available to the auto industry until 2020. Government funding approvals and commitments that have already been made must be honoured, in the interests of promoting trust and certainty in industry policy.

In light of the imminent shut-down of this industry, Ai Group agrees with the PC that Government needs to examine whether the $500 million removed from the ATS in last December's MYEFO will "*result in adjustment costs greater than the savings benefits*" (PC Position Paper, Information Request 3.1, p. 86). The PC notes that ATS underspending is now worth an estimated $380 million, as a result of the end of assembly operations by Ford and GM Holden. This means that total ATS expenditure will be $230 million lower than previously estimated, rather than the full $500 million lower, to the end of 2020. These numbers will need to be revised again in 2014, to take into account the departure of Toyota (and potentially a number of Tier 1 auto suppliers) before the scheduled end date of this funding allocation. Ai Group recommends that all funding that is left unallocated as a result of industry departures is redirected into transition assistance for the auto supply businesses and former employees that need it.

Regardless of the total amount of funds which is ultimately made available however, the design and implementation of the ATS and the New Car Plan must clearly be revised immediately, in response to the new situation. Ai Group recommends that in very broad terms, the remaining ATS and New Car Plan funds should be immediately redirected to:

1. assist Tier 1, 2 and 3 automotive companies make the necessary transition to new markets and/or industries, focusing especially on the Tier 2 and 3 companies who are more likely to remain committed to operating in Australia; and

2. promote longer-term resilience and diversification among business and industry that will extend well beyond the end of Australian automotive assembly from 2017.

Industry Growth Fund

Additional Government funding will be needed to assist with this very large adjustment process. As a starting point, Ai Group welcomes the establishment of the $100 million 'Growth Fund' by the Federal, Victorian and South Australian governments. This will be required to assist the economies of Victoria and South Australia adapt to the future reality of a much smaller automotive manufacturing sector.

This Growth Fund was announced prior to the announcement by Toyota that it will cease manufacturing in Australia by 2017. Ai Group expects that this Fund will need to be broadened in size and scope to meet the adjustment task that now lies ahead.

The detail of the Growth Fund is still being developed by the Federal Minister of Industry and Ai Group is an active participant in that development process. We have a number of suggestions for policies in relation to the design of this Growth Fund. Some of these proposals could be scaled up to meet the adjustment needs of the industry. We welcome the opportunity to provide further input on the redesign or refocus of funds.

Our suggestions for appropriate programs within the Growth Fund are:

- At a firm level, for funds to be allocated to providing tailored strategic advice for firms along the automotive supply chain. A sensible way to implement this would be to add to the existing allocations for Enterprise Connect and add to that program a specific and additional focus on businesses in this supply chain. A similar dedicated extension of the Export Markets Development Grants (EMDG) program could also be considered;

- This tailored business advice should be complemented by a facility to provide suitable businesses with soft loans for projects backed by a solid business case. The detailed knowledge of particular businesses generated in the process of preparing tailored strategic advice would assist in targeting this program and magnifying its effectiveness;

- At a broader, industry level, for funds to be allocated to market analysis aimed at informing businesses with particular sets of capabilities of domestic and global opportunities for diversification and re-orientation. One example of this is a proposal for market analysis to inform businesses of opportunities in the global motorcycle after-parts market (see details below); and

- A skills package for automotive employees. This should be designed in close consultation with the businesses in the supply chain and should dovetail with the directions businesses pursue in adjusting to the changes in their industry.

Both the Commonwealth and state governments will need to keep an open mind about whether further financial injections are needed to the Growth Fund to address the challenges in the years ahead. It is also important for the National Industry Investment and Competitiveness Agenda (announced in Dec. 2013) to be adequately resourced, if the necessary long-term repositioning of Australian industry is to be achieved.

Fair Entitlements Guarantee (FEG)

The Australian Government provides assistance to people owed outstanding employee entitlements following the insolvency or bankruptcy of employers. This help is available through the Fair Entitlements Guarantee (FEG) which replaced the General Employee Entitlements and Redundancy Scheme (GEERS) from December 2012.

When the FEG was implemented by the Labor Government in 2012, Ai Group expressed great concern about the risks associated with implementing such a generous level of redundancy entitlement protection. The following extract from the submission which Ai Group made to the Labor Government in May 2011 is relevant:

> *"Ai Group has been at the forefront of the public debate about the protection of employees' entitlements over the past decade and we have worked hard to ensure that mechanisms to protect entitlements are fair on both employees and employers, and are workable. We appreciate being consulted about the FEG even though we continue to hold substantial concerns about various aspects of the scheme.*
>
> *The Federal Budget Papers had a lot to say about the restructuring of the Australian Economy which is in train due to the mining boom, and the impacts upon sectors such as manufacturing. As this restructuring gathers pace over the next few years, corporate failures will unfortunately most likely be part of the picture. In this environment, the increase in the level of redundancy pay protection to a maximum of four weeks per year of service constitutes in our view a very serious risk.*

Our concerns include:

- *The Government's estimate of the additional cost appears to be very optimistic.*

- *The collapse of even one large company could lead to a major funding shortfall.*
- *It is inequitable for a publicly funded scheme to pay generous compensation to the employees of one insolvent company and much less to those working for another company. Generous over-award redundancy packages tend to operate in large unionised workplaces. However, a much larger number of employees work in other enterprises.*
- *Implementing a maximum redundancy entitlement of four weeks per year of service with no cap (other than the salary cap) will lead to union claims for such redundancy benefits to be included within enterprise agreements, with a consequent increase in disputation and reduction in the ability of companies to restructure to remain competitive.*

If the increased level of redundancy pay protection proves to be unworkable, we are very concerned that there would be calls for business to make up the shortfall. Employer funding for the FEG would operate as a tax on employment and would lead to the 99.99% of employers who do not become insolvent and fail to pay employee entitlements, funding the obligations of failed companies.

Ai Group supports the maintenance of the existing 16 week limit on redundancy pay protection. (Ai Group, 2011)

The 2013-14 Budget Papers contain an estimated expenditure on the FEG, of $192 million for the year. This allocation is to cover entitlements across all industries.

There is a significant risk of insolvencies amongst Tier 1, Tier 2 and Tier 3 suppliers to the automotive industry. Manu automotive component companies have generous redundancy entitlements in their enterprise agreements of up to four weeks per year of service with no cap on payments.

The financial risk can be seen from the following hypothetical but realistic example:

> *5,000 automotive component employees earn an average of $75,000 per year. Their employers become insolvent and are unable to pay entitlements. The companies have redundancy provisions in their enterprise agreements which provide entitlements of four weeks per year of service. The average service of each employee is 10 years.*

FEG liability for the total redundancy entitlements of these employees would be:

5,000 employees x ($75,000 / 52) x 4 weeks x 10 years = over <u>$288 million</u>

Clearly, the Government is facing a potentially large budget blowout due to the potential insolvency of many automotive component manufacturers with very generous redundancy schemes unless the *Fair Entitlements Guarantee Act 2012* is amended to reduce the generosity of the scheme or FEG funding is increased very substantially.

Industrial relations requirements for automotive industry restructuring

In Ai Group's first submission to this inquiry, we argued that Australian automotive manufacturing businesses need a workplace relations system that does not impose unnecessary barriers upon productivity and flexibility and which encourages flexible and innovative workplace arrangements. The need for amendments to be made to the *Fair Work Act* to deliver such a system and to remove unnecessary barriers to competitiveness and adaptability have, if anything, become more pressing given the announcements by GM Holden and Toyota.

Industry cannot afford to wait until after a Productivity Commission Inquiry into the *Fair Work Act* and after the next Federal Election before critical changes are made. The inevitable result of delay or failure to act will be more business closures and less Australian jobs.

Ai Group agrees with the Commission's Draft Finding 2.3:

> *"The broader policy environment in which the automotive manufacturing industry operates directly affects the productivity and competitiveness of automotive manufacturers, and the capacity for firms and individuals to respond to changing market and competitive conditions. In particular, workplace arrangements are limiting efforts to promote workplace flexibility and increase productivity in some cases."*

The essential changes which need to be made to the *Fair Work Act* to remove barriers to flexibility and productivity include:

- 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.

Union enterprise bargaining claims often result in the imposition of provisions which inhibit the ability of automotive manufacturing businesses to be responsive and adaptable to market changes. 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* 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.

In addition, the decision of Justice Bromberg in *Marmara v Toyota Motor Corporation Australia Limited* [2013] FCA 1351 needs to be overturned through a legislative amendment to reinforce the rights of parties to discuss and agree to variations to their enterprise agreements. It is not in anyone’s interests for an employer to be unable to put proposed variations to an enterprise agreement to its employees to consider, with the employees able to freely decide whether or not they support the proposed variations.

The Federal Court case centres around the meaning of a No Extra Claims provision in Toyota’s enterprise agreement. No extra claims clauses can be traced back to the agreement reached between MTIA (one of Ai Group’s predecessor organisations) and the Metal Trades Federation of Unions in 1981 to implement significant wage increases and a 38 hour week, after a protracted industrial battle over the metal unions’ 35 hour week campaign. The original No Extra Claims clause in the MTIA / MTFU Agreement, which subsequently became a standard feature of National Wage Case decisions, imposed an obligation on **unions** not to make extra claims during a specified period. Over the years, unions (particularly the AMWU in Victoria) have sought to impose obligations on employers under the clauses. Ai Group has urged employers to reject these union claims because when a No Extra Claims clause is drafted to apply to an employer, the unions have often argued that the clause prevents the employer from introducing more productive work processes and other workplace changes. Despite Ai Group’s advice, many employers have reluctantly included such clauses in their agreements as a result of pressure from unions.

A further important issue which needs to be addressed is the very high bar which the *Fair Work Act* and decisions of the Fair Work Commission (FWC) have placed on applications to vary an enterprise agreement after its nominal expiry date. Many employers in the automotive components industry are saddled with agreements made in far less challenging times. Of course, when agreements reach their nominal expiry date employers typically seek to reach agreement with their employees on the terms of a replacement agreement. However, if agreement is not able to be reached employers need to be able to apply to the FWC to have enterprise agreements which impose significant barriers to productivity or competitiveness terminated, given that agreements continue to operate indefinitely until replaced or terminated.

Under section 225 and 226 of the *Fair Work Act*, an employer can apply to the FWC to have an agreement terminated after its nominal expiry date but the FWC is given very broad discretion in deciding whether to terminate the agreement. The reality is that over the years very few applications by employers to terminate agreements have succeeded without the consent of the relevant union/s and employees.

Subsection 226(b) of the *Fair Work Act* should be amended by adding the underlined wording below:

(b) the FWC considers that it is appropriate to terminate the agreement taking into account all the circumstances including:

- (i) the views of the employees, each employer, and each employee organisation (if any), covered by the agreement;
- (ii) the circumstances of those employees, employers and organisations including the likely effect that the termination will have on each of them;
- <u>(iii) whether the agreement is having a substantial negative impact on the productivity or competitiveness of an employer covered by the agreement; and</u>
- <u>(iv) whether the agreement is having an adverse effect on the survival or revival of an employer covered by the agreement.</u>

Australia's workplace relations system needs to be as flexible and productive as possible, whilst ensuring fairness for both employees and employers. The *Fair Work Act* needs to be amended without delay to address the issues discussed above.

4. Manufacturing and general industry policy

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.

General industry programs will need to be maintained or strengthened over the next five years, in order to enable Australian industry to weather the fallout from this event and to contribute to a much-needed re-balancing of the Australian economy.

The role of manufacturing in creating a balanced Australian economy

Ai Group sees an important role for manufacturing into the future to ensure Australia has a diverse and balanced economy that is less reliant on the resources sector for growth and to take advantage of the considerable opportunities presented by the rapid growth in incomes in the emerging economies in the Asian region. For manufacturing to contribute in these ways, a new culture of ideas and co-operation within industry, between businesses and Australia's research organisations and with governments is needed to foster new ideas and businesses for Australia.

Policy and strategy for a stronger manufacturing sector

The Australian manufacturing sector needs to be excellently-managed, competitive, innovative, globally engaged and equipped with a skilled workforce in order to make sustainable and competitive contributions to the growth, balance and resilience of the Australian economy. It also needs efficient internal transport infrastructure, well-functioning energy markets and access to finance. It needs taxation, workplace relations and regulatory arrangements that achieve domestic policy objectives as efficiently as possible; it needs close relationships with a more business-facing publicly funded research sector; and it needs access to regional and global markets and strong collaboration with government agencies in searching for and developing opportunities abroad.

There are no silver bullets: moving towards these objectives is no easy task. Both business and governments have important roles to play. However, we are not starting from scratch.

- We have many businesses that are competing successfully in both the domestic and international markets.

- We have good infrastructure and a strong capacity to lift its quality.

- We have strong ambitions and we are making important headway into the task of lifting the skills of our present and future workforces and the quality of our managers.

- In taxation, workplace relation and regulation more generally we have an awareness of shortcomings and in some cases we have initiatives in train that have the objective of addressing some of these shortcomings.

- We have very strong research and scientific capabilities that, while underappreciated and insufficiently orientated towards lifting commercial outcomes, have the potential to build on current success stories, learn from international experiences and lift the competitive performance of domestic businesses on a much broader scale.

- We have a range of existing programs and agencies dedicated to improving the innovative performance of business, building business capabilities and improving access to commercial opportunities in both the domestic and international markets.

Against this background, Ai Group welcomes the Federal Government's announcement in December 2013 that it would develop a blueprint for the manufacturing sector, called the National Industry Investment and Competitiveness Agenda, through which it aims to build opportunities for new industrial directions and to ensure Australia develops the capabilities to take advantage of these opportunities.

It is imperative that any changes within the sector be led by businesses themselves and not by governments picking winners. Nevertheless, governments have key roles to play in getting the broader policies right and in encouraging industry to innovate and lift productivity through improved business practices.

At the level of broad, economy-wide policy directions, governments need to take the lead in pursuing measures that ensure a stable macroeconomic environment and promote growth and productivity. Prominent candidates include: reform of industrial relations arrangements to promote flexibility and workplace productivity; facilitation of greater levels of investment in upgrading Australia's infrastructure; lifting the efficiency and reliability of Australia's taxation arrangements; reducing regulatory burdens; and improving the operation of energy markets to reduce costs and certainty of supply.

In relation to industry policy, we encourage the Government to develop a coherent framework of policies that are aimed at businesses regardless of sector or size to encourage sustainable growth. These policies should:

- Encourage business innovation – including by ensuring all Australian businesses have access to Research and Development Tax Incentives; by encouraging and removing obstacles to collaboration between business and public sector researchers (including through the Researcher-in-Business (RiB) program); by ensuring that incentives in research organisations give due weight to researcher collaboration with business; and by lifting engagement between SMEs and research organisations – for example by implementing an innovation voucher scheme for SMEs;

- Expand upon the Manufacturing and Food Centres of Excellence to establish a network of applied research and knowledge dissemination centres, akin to the UK's Technology Strategy Board's Catapults program;

- Establish a new national venture capital fund that has a broad investment mandate to kick-start the development of a broader, self-sustaining domestic venture capital market, which would be crucial to spearhead innovation and R&D efforts in Australian industry;

- Strengthen business capabilities: including for SMEs through proven federal and state government programs like Enterprise Connect in which business advisors work with businesses to review and improve their businesses to build their competitive advantages;

- Support businesses give greater focus to improving their workplace cultures and practices to better engage their workforces in the process of business improvement;

- Adopt targeted taxation measures to encourage capital investment by industry;

- Ensure strong industry consultation and focus in skills and higher education policies to ensure businesses have access to high quality new entrants into the workforce; are able to find the skilled workers they need to develop new products and chase new opportunities; and can help lift the skills of the existing workforce;

- Assist businesses investigate export and investment opportunities and participate in global supply chains to boost sales opportunities and reduce costs of domestic operations; and,

- Have in place major project procurement arrangements that ensure that Australian suppliers have full and fair access to the business opportunities presented by these projects.

Free Trade Agreements for a stronger manufacturing sector

The Korea-Australia free trade agreement (KAFTA) is a mixed blessing for Australian industry and particularly for the remaining years of Australian automotive manufacturing. It will eliminate Australian tariffs on imports of Korean-made motor vehicles, automotive parts and steel products. This will further reduce the relative competitiveness of locally made cars in the Australian auto market.

On the other hand, the KAFTA will eliminate tariffs of up to 13% on exports of Australian motor vehicle parts such as gear boxes and engines to Korea, which is Australia's third largest market. Korean import tariffs will also be lowered on other existing Australian manufactured goods, such as floating structures (tanks, coffer-dams, landing stages, buoys and beacons), electrical switchboards, and pharmaceuticals, including vitamins.

Services exports will also be facilitated by KAFTA, including engineering, accountancy, legal, environmental, education, health, aged care - a whole raft of areas which will provide the basis for potentially enormous trade returns in the years ahead.

We can expect the KAFTA to be a blueprint for the imminent FTA with Japan. Tariffs on Japanese cars imported into Australia will likely be eliminated in this process.