Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

INQUIRY INTO AUSTRALIA'S AUTOMOTIVE MANUFACTURING INDUSTRY

MR M. WOODS, Presiding Commissioner
MR P. WEICKHARDT, Commissioner

TRANSCRIPT OF PROCEEDINGS

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MR WOODS: Ladies and gentlemen, welcome to the Adelaide public hearings for the Productivity Commission inquiry into Australian automotive manufacturing industry. I'm Mike Woods, I'm the deputy chairman of the Productivity Commission and the presiding commissioner for the purpose of this inquiry. I'm assisted in this inquiry by Commissioner Philip Weickhardt.

The commission has been requested to undertake an inquiry into public support for Australia's automotive manufacturing industry, including passenger motor vehicle and automotive component production. The commission is required to produce a preliminary findings report, which will be released on 20 December. The commission will also be releasing its draft recommendations in a position paper on 31 January and hold a round table on quantitative analysis on 4 March. The commission will submit its final report to the Australian government on 31 March 2014.

Stakeholders to this inquiry and the commission are all acutely aware of the very short deadlines given to the commission for this inquiry and the limitation that this imposes on the ability to engage stakeholders and the general community in a debate about the future of automotive manufacturing in Australia. Given the time frame, I would like to express our thanks and those of the staff for the promptness of stakeholders in being able to meet with us and make submissions in the time required.

I'd like to acknowledge the courtesy extended to us in our visits and deliberations so far, and for the thoughtful contributions that so many have made already in the course of this inquiry. I would like these hearings to be conducted in a reasonably informal manner and remind participants that a full transcript will be taken and made available to all interested parties. I also remind all observers that they should allow those giving evidence to do so without interruption and at the end of the scheduled hearings today, any person present may make an unscheduled presentation should they indicate, and do so.

To comply with the requirements of the occupational health and safety legislation, you're advised that in the event of an emergency requiring the evacuation of this building, you should follow the green exit signs above the door there to the nearest stairwell. Lifts should not be used. Please follow the instructions of floor wardens. Media will be taking visual footage of this opening statement and also the opening statement of the premier when he arrives. Other than that, there'll be no filming or recording of proceedings. Thank you for that. We will now turn to our first participants from the Australian Workplace Innovation and Social Research Centre, University of Adelaide. Gentlemen, could you please for the purpose of the inquiry give your name, the organisation you represent and the positions that you hold.

ASSOCIATE PROF SPOEHR (WISeR): My name is Associate Professor John Spoehr. I'm executive director of the Australian Workplace Innovation and Social Research Centre at the University of Adelaide.

PROF BURGAN (WISeR): My name is Barry Burgan. I am a professor of business at Torrens University Australia and a visiting research fellow at WISeR at the University of Adelaide.

MR WOODS: Thank you very much and thank you for your submission, which we've had the ability to work through. Do you have an opening statement you wish to make?

ASSOCIATE PROF SPOEHR (WISeR): Yes, just a few general remarks if we can.

MR WOODS: Please.

ASSOCIATE PROF SPOEHR (WISeR): We've been covering the fortunes of the automotive and manufacturing industry here in South Australia for many years and closely observed the events leading up to and the closure of Mitsubishi Automotive Motors here in South Australia, and have in the compilation of our submission been mindful of comparisons between then and now to draw some attention to the very different economic context in which we're operating in at the moment compared to that time when Mitsubishi closed. That has informed the way in which we've undertaken the analysis provided in the report, principally that economic circumstances prevailing at the moment are that much worse than they were at the time of the closure of Mitsubishi.

Since the global financial crisis, we've lost in excess of 30,000 manufacturing jobs here in South Australia, many of those in northern Adelaide where GMH is located, but also in other parts of Adelaide. That is quantitatively a very different circumstance to that which prevailed at the time of Mitsubishi's closure when there were prospects for those who were displaced from the closure of Mitsubishi in the manufacturing industry and in other sectors. We know from that experience that a good number of the workers went on to secure employment, but also a very large number didn't. The reason I raise this at the outset is that our conclusion is that based on analysis of current circumstances, the costs associated with any closure or significant downscaling of the automotive operations of GMH would be very damaging in our view, so much so that they need to be taken into account in assessing financial assistance to the industry.

Our conclusion in relation to the aggregate impact of closure, worst-case scenario, assuming that a large number of component suppliers surrounding Mitsubishi would not be able to function if - sorry, surrounding GMH, would not be able to function if GMH closed, that the losses to the state would be significant, including around about 1.24 billion of GST, around about 13,000 jobs and 72 million per year in state taxation revenue.

We acknowledge that that is a worst-case scenario, but that is based on other information that's been available to us which no doubt will be forwarded to this commission from other parties to the commission's hearings today. But our understanding from those who are very close to the sector are that the expectation is that tier 1 component suppliers would find it very, very difficult to sustain their operations and therefore our estimates in relation to a worst-case scenario are much more realistic in the current environment, in fact we believe that they are quite an honest appraisal of what would be an outcome under the circumstances of a closure of GMH.

MR WOODS: I take it from that you're not actually endorsing those other analyses, but you are drawing them to our attention. Is that correct?

ASSOCIATE PROF SPOEHR (WISeR): Yes, indeed, drawing them to your attention. I think there's significant merit in some of the other analyses, in particular the direct communications with component suppliers here in South Australia, which I think provides useful supplementary information that complements the modelling that's been undertaken.

MR WOODS: This is an update of a 2011 piece of work you did, and you notice the difference between the two years in terms of the economic footprint, if I can describe it as such, by GMH, and the suppliers between 2011 and now, that in fact there has been some reduction of that footprint already.

ASSOCIATE PROF SPOEHR (WISeR): Indeed. Over recent years there has been significant reduction in GMH's overall employment footprint. It is certainly a leaner operation than they were four or five years ago, almost a halving of the workforce over the medium term, so the impact wouldn't be as substantial as it otherwise would have been had those employees been at GMH, but having said that, it's the large component supplier base around GMH that is of great concern.

MR WOODS: Yes, and this inquiry is looking at both the assemblers and the component suppliers to that, and so we take both of those issues into account. The reduction in employment is fairly common across manufacturing more generally, I think you would agree. As productivity increases, the size of the labour force to produce the same level of value added has been decreasing and that's not only Australia but that's common in manufacturing. That would be your view?

ASSOCIATE PROF SPOEHR (WISeR): Yes, that would be my view, and an expectation that the size of the manufacturing workforce in mass manufacturing is likely to decline further as a result of the introduction of new labour-saving technologies, in particular, robotic technologies and additive manufacturing technologies, so the expectation going forward would be for increased productivity based on the introduction of new labour-saving technologies.

MR WOODS: So even if the assemblers were to remain and the suppliers were to maintain their same level of value added, you would expect that there would be some progressive, albeit slower reduction in employment as productivity improves.

ASSOCIATE PROF SPOEHR (WISeR): Indeed, significant pressure on component suppliers to increase the productivity in the face of cheaper imports so, yes, the expectation would be that they would become more productive.

MR WOODS: Do you, in your studies, also look at manufacturing more generally? I know that you're focused on South Australia, but how does this sector operate within total manufacturing in South Australia?

ASSOCIATE PROF SPOEHR (WISeR): It occupies a very central position in South Australian manufacturing and has done so during the post-war period. So the flow-on impacts of existence of the automotive industry here in South Australia are very significant. We have done some work in northern Adelaide to try and understand and quantify what the benefit of the existence of a large manufacturer like Holden is in the region. Looking at the tacit knowledge, that is, that knowledge which is not written down that is shared between engineers in northern Adelaide, the value of that is very high indeed. So the value of tacit knowledge, the value of collaboration exchange of high value manufacturing facilities in the north can't be underestimated.

MR WOODS: Right. Your report does focus on the South Australian economy and specifically Adelaide in terms of the regional impacts, North Adelaide being sort of the stand-out in this particular case. Manufacturing in Australia generally increased its value added at quite a significant rate during the 1990s, and even in the last decade - despite the appreciation of the Australian dollar and reduction in tariffs in certain sectors and import penetration - has maintained its real value. Sure, as a share of the total economy it has been reducing, but that hides the fact that manufacturing in Australia, even in this decade has - I think in fact the current level of real value added is higher than it was at the turn of the century, and productivity has been increasing and the labour force, as we discussed earlier, has been slowly declining, so there is a manufacturing story that is quite a strong story in Australia, and somehow that seems to get overlooked in the context of these specific issues.

The reason I made that comment is that I notice you make comment in your paper that the activity that be lost in South Australia, some of that you would expect to be picked up elsewhere in Australia. Can you elaborate a little more on what those sorts of linkages and flow-throughs might be?

PROF BURGAN (WISeR): The modelling focuses primarily, as you have identified, on the disruption effect to South Australia and the northern region, so therefore it uses a simple economic model that allows us to tease out alternative responses because it is not a given that the existing supply chain would change proportionally with either the closure or changes in production methodologies at Holden. So there are alternative ways in which industry can react, even local industry, but outside of that, the model has been validated in its overall orders of magnitude by reference to national studies which use more complex models that allow for those national interactions. Those national interactions relate not just to supply chain, but also through to the governing parameters that underlie the economic structure which includes exchange rate and interest rates and those sorts of things.

Obviously the freeing up of resources has impacted on prices that changes the mechanisms by which things operate, and so many of the studies will show that a large part of the cost, if you like, of the dislocation which would occur in South Australia would be picked up through benefits elsewhere. However, the purpose of doing this study was to actually identify that dislocation cost as a transaction cost, and what that means particularly for this region.

MR WOODS: Yes. So we just need to keep that in context then. So this is the disruption to the local region, but not the disruption to the national economy; that the disruption to the national economy will be less over time than what is portrayed here in terms of specifically from South Australia.

PROF BURGAN (WISeR): That's correct. It's a regional disruption story.

MR WOODS: Yes, and that needs to be considered and various policy consequences flow from that. One other, before I - - -

ASSOCIATE PROF SPOEHR (WISeR): Sorry, if I could just add to that, yes.

MR WOODS: Yes.

ASSOCIATE PROF SPOEHR (WISeR): I mean, one important parameter of course is what our expectation about reinvestment is following disinvestment, and my expectation would be that lost investment from GMH would not be reinvested in the national context, so that would largely flow to other nations where GMH might consolidate its activities offshore, or simply not invest in any new manufacturing activity offshore, so that's an important rider, I think, in this conversation.

MR WOODS: Does that assume also though that others who might potentially wish to invest in Australia, but see a crowded market in terms of labour force and skills et cetera and are not doing so at the moment, may choose to invest in Australia and to pick up some of that capacity? Is that a possibility? I mean, I understand the GM position that they have competing factories worldwide and why would they come back here again; that's going to different circumstances. In fact they may, but let's put that aside for the moment.

ASSOCIATE PROF SPOEHR (WISeR): No, a fair point. I think the overall dynamic here is the question of the assistance regime in place at the present time in Australia and the extent to which that's attractive to foreign investors and the value of the Australian dollar which I would regard as the principal factor that's eroding the competitiveness of Australian manufacturing, not just auto manufacturing but Australian manufacturing; very difficult to be operating in that environment, to be honest.

MR WOODS: Can I just ask one more before I allow my colleague - sorry, did you want to say something?

PROF BURGAN (WISeR): I was just going to add to that that the other part of the story is, where people look to invest, there's a crowded labour market and crowded capital market in certain regions and in certain industries, so there still is a disruption effect around particular types of skills, retraining issues, relocation issues, all of which carry a substantial community cost.

MR WOODS: Absolutely, and those transactions and those structural adjustment issues we'll get on to in a minute, because they are important in their own right. The one final point I just wanted to clarify for the moment is that your presentation here doesn't assume an alternate use for the public funds that are currently going to support GM, so the amount of funds that GM receive by way of the ATS and other co-investments, I think is the phrase they use, would be free to be either re-released back to taxpayers or redirected to some alternate activity in the economy if that was seen to be of higher value. So your activity, your analysis, doesn't take that into account. Is that right?

ASSOCIATE PROF SPOEHR (WISeR): No, no, but happy to proffer a view on that.

MR WOODS: Yes, please.

ASSOCIATE PROF SPOEHR (WISeR): Yes. I mean, it's a fundamentally important question if we were considering the prospect of Holden closing and it would be my view at least that a very substantial investment would need to be made in industrial diversification to compensate for the loss of Holden, and that's no easy task, and in the short term a very substantial investment required in job-rich or job-ready projects, typically infrastructure projects in the short term that add to the productive capacity of the state. So a combination of those two things would I think require the lion's share of that assistance that might be available should Holden close.

MR WOODS: But you haven't taken that into account - - -

ASSOCIATE PROF SPOEHR (WISeR): No.

MR WOODS: - - - in the sort of worst-case scenarios, but that money can either go back to the economy via the taxpayer, or be directed at specific programs or whatever is the best value.

PROF BURGAN (WISeR): We haven't looked at the alternatives - - -

MR WOODS: Yes, sure.

PROF BURGAN (WISeR): - - - because they are so varied in terms of how they would apply.

MR WOODS: Absolutely.

PROF BURGAN (WISeR): So our emphasis was on the first side of the equation. The other side of the equation about what to do is not part of the analysis. However, John started his discussion with a comment about work we did in this space around Mitsubishi, and an observation from many that the impacts of Mitsubishi's closure has worked its way up quite quickly. So our argument would be, not only as John said, "Well, the economy was quite different then and the issues were quite different then," but an argument might be that labour redirected to some degree, but it's still - you know, it's taken 10 years really to overcome the disruption effect for the region of southern Adelaide around the use of the facilities and the infrastructure that's there. So even in that context it takes time for new investment and new strategies to overcome the transaction cost issue.

MR WOODS: Absolutely. Commissioner?

MR WEICKHARDT: Thank you. You in your submission make the point that almost everyone else has that there are more employees in the supply base than there are in the assembler area. I think Holden's submission to this inquiry shows that their spend on local suppliers has been declining quite rapidly, and indeed reading today's press, quoting a report that we haven't seen but we'd like to see, talks about the fact that Holden's local content is significantly reduced. People even before that event talked about the supply base in Australia being quite fragile, probably has a capacity to service a local manufacturing of about 400,000 vehicles and we're now down to roughly half that.

Given that sort of combination of circumstances, it seems inevitable, even if GM make a decision to stay, that the supplier base is going to be under intense pressure, and therefore there is going to be employment loss in that area. In those circumstances it would be useful for you to talk about the experiences that you have gleaned not only from the Mitsubishi event but of course closures in this industry that have been occurring around the world. So what are the best forms of assistance and adjustment that governments can offer? You make a point that the Mitsubishi closure occurred in a better environment. I think in 2008 it didn't look much better. We were in the heart of the global financial crisis and everyone was very worried. In retrospect it turned out a bit better than that, but there's never a good time for a lot of people to lose jobs.

ASSOCIATE PROF SPOEHR (WISeR): No. They're very good questions. On the question of the component supply base, indeed it's been under enormous pressure for a decade or more really and consolidated when Mitsubishi closed. It is a leader industry I think on the back of the Mitsubishi closure. That implies I think in the current context that they're that much more vulnerable too. We didn't lose the magnitude of jobs that you would otherwise expect in difficult circumstances from the component suppliers. They consolidated but didn't shed as many jobs as was anticipated.

But the position now is very different as we understand from the industry itself and from other submissions that have been provided to the commission. All the indications are that the component supply base is very vulnerable at the moment. Irrespective of whether or not Holden remains in this country or not, it would be my expectation that Holden would seek to source more of its components offshore, and that would lead to contraction of the supply base, and for other component suppliers there would be the necessity of significantly increasing productivity. So that would result I think in further job losses. So I would agree that there is likely to be a contraction of the component supply industry.

I think the variable here will be the nature of any assistance package that might be agreed to with Holden, and the extent to which that requires them to have an active relationship with Australian component suppliers, and the extent to which they're willing to do that as well, or agree to that. So assistance historically can play a role in encouraging the major auto manufacturer to engage with local industry and maintain some crucial parts of its supply chain.

In terms of the second question about what we can learn from international experience, I have done a separate piece of work which I may be able to make available to the commission with permissions from the appropriate organisation, that examines the international experience and Australian experience in relation to assistance packages, and I think it's instructive, for example, to look at the Rover MG example which appears on the face of it to contain many good lessons for Australia in the way in which the package of assistance was structured, both on the labour adjustment side - and importantly it's not just a labour adjustment question, it's about what you do by way of industrial diversification and industrial development, how you might use resources that might be available to foster demand in the economy. So I'd certainly recommend the commission look closely at the Rover MG model, and there's quite a lot published on it. It's regarded as one of the more successful packages in response to a very large-scale closure. It had significant impact, detrimental impact on the region and still has ripple effects to this day.

The big lesson I think from looking at international experience, as I have alluded, is not just to focus on the labour adjustment side, as crucial as that is, but also to look at the investment side: what level of investment is going to be necessary to generate sufficient economic and employment activity post-closure to minimise the impact of any shock on the South Australian and Australian economies? Of course we must remember Victoria is very central to this. In Adelaide it's not just northern Adelaide, it's southern Adelaide and central Adelaide and western Adelaide. All have many GMH employees and component supplier employees based in them, and component suppliers exist across geographical boundaries here in South Australia.

An important part of the learning is also that component suppliers often get left out of the equation in terms of consideration of assistance. So the major manufacturer and the impacts of the major manufacturer's closure are well understood, but the impacts of component supplier reduction or closure on the wider economy are often not thought through. The extent to which you can shore up component suppliers through diversification is a crucial question in the short term because many are already diversifying, for example, into medical devices or other forms of industrial activity. The pressure on them to do so is enormous. So just a few thoughts.

MR WEICKHARDT: Thank you.

MR WOODS: Unfortunately our time is up, but we do want to pursue with you your other research in those areas, and we are conversant with the Rover example and with what Ford is currently doing in Melbourne. So if we can - - -

ASSOCIATE PROF SPOEHR (WISeR): Happy to.

MR WOODS: - - - take whatever material we can and thank you very much for your presentation.

ASSOCIATE PROF SPOEHR (WISeR): Our pleasure. Thanks for the opportunity. If I could just table a number of documents. One is a profile of the northern region which has just been prepared using 2011 census in terms of contextual material that might be useful, and the other are summaries of that report as well.

MR WOODS: Thank you very much.

ASSOCIATE PROF SPOEHR (WISeR): Thank you.

PROF BURGAN (WISeR): Thank you.

MR WOODS: Thank you, ladies and gentlemen. Our next participants are the South Australian government, headed by the premier. Premier and staff, could each of you please for the record state your name and your position.

MR WEATHERILL (SAG): Jay Weatherill, premier and treasurer of South Australia.

MR HALLION (DPC): Jim Hallion, chief executive of the Department of Premier and Cabinet.

MR PIRO (DMITRE): Len Piro, group executive director for manufacturing innovation, Department of Manufacturing, Innovation, Trade, Resources and Energy.

MS BIERBAUM (DPC): Christine Bierbaum, executive director state development, Department of Premier and Cabinet.

MR HOCKING (DPC): Stuart Hocking, executive director, economic analysis division, Department of Premier and Cabinet.

MR WOODS: Thank you. Premier, do you have an opening statement you wish to make?

MR WEATHERILL (SAG): I do, thank you, commissioner. Thanks for the opportunity to appear at this public hearing, and as you can see, we do have officers from the South Australian public sector, and we would be more than happy to answer any questions you may have on our submission that has been lodged. I do want to speak generally to that submission, but make a few opening remarks.

First about the process itself: the South Australian government believes that the Commonwealth government should proceed with investment in the car industry as a matter of urgency. That obviously has implications for the process that they have asked you to undertake. Our principal concern is that the Productivity Commission inquiry has a schedule that you have been asked to meet by the Commonwealth government that doesn't accord with the time frame that has been put in place by the car manufacturers, in particular General Motors. So with an appreciation of the difficulties that the commission faces in terms of time and resources, it's the South Australian government's request that the Productivity Commission makes an interim report as comprehensive as possible to put the Commonwealth in the position to make the earliest possible decision.

Despite these concerns we appreciate the opportunity to put to the commission why the industry should continue to receive assistance from the Commonwealth and from state governments. As we have described in our submission, earlier this year the South Australian government published an economic statement where we set out the long-term economic outlook for the future of our state's economy, as well as the opportunities and the challenges that arise from that outlook, and we have a copy of that economic statement here for your information.

In that statement we identified that the economies that best dealt with external shocks and changes in global circumstances are those with a diverse economic base. This has been consistent across history and was most evident in the most recent global financial crisis. It's likely that manufacturing will not grow as fast as other sectors in our state's economy. However, an advanced manufacturing industry which competes principally on the basis of value, not just on the basis of the lowest cost, should continue to be part of our state's economic base.

It's obvious in the interests of South Australians that we build a resilient economy. However, it's also in the interests of the nation. The economic history of Australia is cyclical of gold rushes and busts, of bumper crops and drought, of the construction of factories and post-industrial decline. Counter-cyclical measures which deal with the excesses of the boom time and the harshness of busts help ensure that each state of the federation is resilient in the face of changing global circumstances.

In securing a manufacturing base which we believe is essential for that resilience, car making is a cornerstone of manufacturing. Automotive manufacturing involves some of the most advanced processes and technologies of any industrial supply chain in the world. The benefits to the manufacturing industry more broadly which flow from the automotive sector includes technology transfer, investment in research and development, and the creation of a more skilled workforce.

It is true that as the Productivity Commission found in its last report that these spillover effects are significant, they're also difficult to quantify, but they are pervasive across the South Australian manufacturing industry and we would submit that just because they are difficult to quantify, they should not be ignored and efforts should be made to grapple with the nature and extent of those spillover benefits.

At almost every manufacturing workplace that I visit across the state, I meet workers that have been trained in the automotive sector, and the really powerful example that's just occurred recently here in South Australia is concerning Spring Gully. It's a local food manufacturer which had struck tough times; a four-generation family. It looked like it was about to go under, and interestingly the consultant that was brought in to actually assist them to restructure their manufacturing processes was a former automotive operations manager, and indeed as they have now chosen their new operations manager for Spring Gully, they've turned to a former automotive manufacturing operations manager once again. So this technology transfer is absolutely crucial.

Food is one of the sectors in the manufacturing sector which is a growing element of our manufacturing sector, but it's the skills and capabilities which are transferred from the automotive sector which are absolutely vital to permit those opportunities to be realised. These management skills are apparent in many of South Australia's leading business. Seeley International, an airconditioning manufacturer, has a managing director with auto industry experience and relies heavily on lean manufacturing techniques from the car industry. Codan, a major exporter of advanced communications equipment for the defence and resources sector, applies lean manufacturing techniques including Kaizen and Just In Time to deliver customised solutions to clients.

Thermo Fisher Scientific is a supplier to the resources sector which has consolidated from three sites to one site in Adelaide, based around lean principles and improved product flow, allowing its volumes to double within 12 months and reducing costs, drawing directly on the skills and capabilities that came into its business from the automotive sector. Siemens is working with consultants from the automotive sector to design the layout of their new facility at the Tonsley site later this year. Tonsley of course is the former site of Mitsubishi Motors, and it's now being re-imagined as an advanced manufacturing site.

The skilled workforces built by the automotive industry are also vital for attracting other work. One of South Australia's key advantages in winning defence contracts and mining services work is that we have a ready-made workforce which is capable of working to the precise standards required on those projects. Innovation businesses rely on the automotive sector. SAGE Automotive in Adelaide's southern suburbs grew a high-tech business out of their automotive work and now provides equipment to industries as diverse as food, resources and infrastructure.

SMR Automotive is a company which makes automotive mirrors in Lonsdale. They developed a new mirror coding technology out of the University of South Australia in conjunction with that institution which is now best practice across the auto industry and is now being used to develop medical devices, and also in the cleantech sector. Just last week I met with representatives from businesses which rely upon high quality steel for which the car industry is a lead purchaser and for whom it could be much more expensive to procure a loan, so the notion of a critical mass of certain inventories drives a number of these businesses. We also hear very clear expressions from executives in steel-making companies that they are different companies because of the fact they have to supply into the automotive sector, the exacting time lines, the exacting standards, and the management practices they come in contact with reflect back. So in a sense, the productivity gains from the automotive sector are transmitted through the process of being a supplier to the automotive industry. So the challenges that the automotive manufacturing industries face include those shared by many export-exposed sectors, but also a set of pressures unique to the automotive sector.

Now, the Productivity Commission last conducted a major inquiry into the car industry in 2002. Since that time, the Australian economy has been transformed by the effects of the mining boom, which has driven a once in a generation increase in our terms of trade, and unprecedented investment in the resources sector and a steep rise in the value of the Australian dollar.

In our submission to the last Productivity Commission review in the automotive sector, the South Australian government highlighted that the car industry was heavily exposed to a significant increase in the relative value of the Australian dollar. This risk has been realised to the scale that nobody would have even contemplated back in 2002. On Friday, 13 December 2002, the day the Productivity Commission's last report into the car industry was released, the Australian dollar was valued at just over 56 US cents. The dollar peaked in 2011 at around 110 US cents. So over the past two years or so, Australian economic growth has cooled and the terms of trade have started to soften. Nationally, economic growth remains below trend and a declining terms of trade is reducing growth in national incomes. Nominal GDP growth in 2012-13 was the lowest since the early 1990s recession. Today, driven by these factors, the dollar is valued at around 91 cents US, which is 19 cents less than the peak.

However, the Reserve Bank governor, Glenn Stevens, has indicated that the dollar is currently above levels which we'd expect to see in the medium term. In addition to the challenges of the high Australian dollar, Australia has one of the most competitive automotive markets in the world. Australia has 67 brands competing for 1.1 million sales; this compares to the United States which has 51 brands competing for 12 million sales and the United Kingdom which has 54 brands competing for 2.3 million sales.

The South Australian government does not believe that any changes to tariffs should be contemplated as part of an assistance package to the car industry. However, it must be considered that trade barriers in overseas markets restrict the ability of the Australian automotive industry to compete. This includes the imposition of tariffs many multiples higher than those imposed on cars imported to Australia, but also non-tariff barriers, even in countries with which Australia has free trade agreements.

The Australian Industry Group submitted to a previous Productivity Commission inquiry that Thailand's restructuring of motor vehicle excise tax applies the new excise rates on a non-discriminatory basis to all exporters. However, the fact that the rates escalate according to engine size disadvantages Australia; up to 80 per cent sales tax for the Ford Territory, pushing its sales price to almost $100,000 in Thailand. Without a change to the current arrangements in Thailand, pursuing an export market there is pointless.

The other factor that has undermined the Australian automotive industry has been the prevailing uncertainty in the policy environment. The introduction of the Green Car Innovation Fund was a boon for the industry, resulting in the attraction of the Toyota Camry Hybrid. Its withdrawal without warning in 2011 affected industry confidence. However, the most significant uncertainty was created by the $500 million reduction in the Automotive Transformation Scheme that has been announced by the current government.

This reduction undermines the business models for the current vehicles for the industry and creates sovereign risk for future co-investments. Of course, co-investment in the car industry imposes costs on taxpayers and consequently for the economy as a whole. We believe that the commission should assess whether the net present value of the benefits from supporting the sector outweigh the present value of the costs of that support, taking full account of the avoided costs associated with the industry's closure.

The amount of assistance received by the Australian automotive sector is low compared with other competing countries, who often have high non-tariff barriers. The level of protection to the automotive industry and manufacturing more broadly is lower than commonly believed. The effective rate of combined assistance to the motor vehicle manufacturing is 8.5 per cent, down from 12.3 per cent in 2006-07. The Productivity Commission has previously stated that any further gains in allocative efficiency from further reductions in automotive assistance would be small compared to the economic and social costs of adjustment.

Importantly, reductions to assistance would not deliver cheaper cars to consumers and other businesses. On the other hand, if the car industry was lost, not only would the jobs of Holden and Toyota plant workers be lost, but also those across the component sectors and through the rest of the economy. In South Australia, a report by Burgan and Spoehr found that depending on the buoyancy of the economy when the plant closes, total losses in the short term could range up to $1.24 billion dollars of GSP, 13,200 jobs and $72 million per year to the state's taxation base.

The loss of the car industry would also severely affect businesses and consumer confidence in South Australia. The northern suburbs of Adelaide, where Holden's plant and most of its suppliers are located and which is highly dependent on the manufacturing sector for employment, would be most affected by the closure. The City of Playford would be profoundly affected. It already has an unemployment rate that is much above the national average and the average for the rest of Adelaide. It has a far lower average income and much higher dependence on government assistance. If Holden were to close, there is little doubt that its loss would exacerbate the problems which this region already faces in terms of long-term unemployment and regionalised disadvantage. The profound economic shock which the loss of the car industry would cause would mean very significant investment levels by all levels of government would be required in order to ensure that the City of Playford did not decline further.

This investment would go far beyond the costs which would inevitably be borne by government through additional welfare costs and would need to underpin an economic transformation of the area. On this balance, the South Australian government believes that it's clear that our internationally modest levels of assistance to the car industry far outweigh the costs that would result to government and to the economy if the car industry was lost. Further assistance would secure the benefits for our manufacturing sector as a whole, underpinning a diverse economy, and we have ambitions to ensure that those growing sectors of our economy, the things that have been identified as growing faster than the national average, areas like our gas sector, like our food and beverage sector, all of those sectors have opportunities for manufacturing to add further value to those sectors, but our capacity to realise that needs the skills and capabilities within our economy to come from the automotive sector.

In a sense, having a car industry in your economy is like having a training college in your economy, where skills are transferred to businesses, where capabilities as people move through that sector to those businesses are shared across the whole of your economy, and what you're in touch with is that part of the manufacturing supply chain which essentially takes new technologies, but then its scale turns them into something which allows them to create essentially a mass-produced product. Now, that capability is rare; it only exists in a few major industries internationally. If you want that in your economy, the evidence is across the world that you have to pay for it, and we believe that that investment is an investment in capability about the sort of economy you want. If you want an economy where you simply dig things up and grow things and put them on ships, that's one thing. But if you believe that a diverse and balanced and resilient economy requires you to add value to things, then you need a manufacturing base.

If you want to be connected to the skills and capabilities which are at the cutting edge, you have to have a cutting edge sector, and the sector which does that, to take proven technologies and then take them at scale is the car industry, and that's why we support the car industry for this nation and for this state. I'd be more than happy to answer any further questions that the commission may have, or any of my team.

MR WOODS: Thank you, premier. I'll just wait till the cameras leave. Thank you for that opening statement. In the time left I thought it might be useful if we just focus on the recommendations as a way of cutting through a number of the issues. I realise that that may leave untouched one or two things, but it may in the time available get us to some of the key points.

I think recommendation 1, the idea of multilateral agreements - trade is not something that we particularly need to debate. We won't quibble over whether there are things like free trade agreements or preferential trade agreements. That's a debate that is not for today.

Your second recommendation again is very broadly based and there's a lot that's potentially in it in terms of skills and development and micro-economic reform generally. I'm not sure that we'd make a lot of progress in unpacking that today, but perhaps your officials could elaborate on some of that in any subsequent material or in a further submission.

It does take me though to recommendation 3, and there you talk about the Australian government providing policy certainty for the auto industry. I notice in some of your opening remarks you referred to some recent events that have reduced that certainty. I would have thought though that having a legislated ATS, putting aside a particular recent event, which sets out a 10-year plan is a model for policy certainty.

Do you have any comments on, or your officials, the issue of whether a 10-year plan does give the industry - and I'm talking about both the assemblers and the suppliers - an opportunity to look into the future and to see what changes need to be made and what the outcomes might be at the end of that 10-year period? Do you have any views, or your officials, on whether a 10-year plan is heading towards what you're envisaging?

MR WEATHERILL (SAG): I think we'd be broadly supportive of that. I mean, the ATS seems to run in five-year blocks. It doesn't necessarily deal with capital expenditure though, it deals with the underlying level of subsidy for the sector. Certainly we think the longer and the more stable the arrangements are, the more likely it is that we'll provide an environment in which the automotive sector will feel more inclined to invest.

If you've got a business model and it's been assumed on a certain level of funding and that funding had an expressed term, some people might call that sovereign risk, if that were to be whipped out from underneath you. So a 10-year period of certainty and the mechanism for doing that we are certainly open to talking about.

MR WOODS: Okay.

MR WEICKHARDT: Can I just piggyback on that, because I'm sort of intrigued by the aspiration for policy certainty, and indeed our terms of reference ask us to consider how this industry could be sustainable and viable.

It seems to me this is a challenging dream, because for a global company, investment decisions are part of a consideration of relativities. "Do I invest in Australia or do I invest elsewhere?" We don't control what governments or companies or unions agree to overseas. Even if the government set out a 10-year or a 20-year plan which might look good today, how do we avoid that situation in another five years looking quite different? Indeed, almost every one of the plans has been put in place in Australia since 1988. Like the Button plan said, "This is a long-term plan and it will be the last plan." We never got to a last plan, and it seems to me that's because the world changes around us.

The question is, do you expose yourself to an almost blank cheque by saying, "I must have an automotive industry here, whatever it takes," and how can you justify a blank cheque? Our government doesn't have a bank account for a blank cheque.

MR WEATHERILL (SAG): I suppose we put the caveat on our remarks about reasonableness. Obviously there is a point at which the level of investment is not something that can be sustained, so there has to be a point. Certainty travels as far as we can make it travel, having regard to the realities of the decision-making of other autonomous units.

For instance, if we create the environment which permits as much certainty as we can create and other people make other decisions, then you're in the world of retrieving your investment. That becomes the remedy. Obviously you can't force people to make cars if they're not going to make cars having regard to their business plan, but what we can do is retrieve perhaps some of the investments that governments have made. We've always insisted as part of any of our arrangements that there are clawback positions if the obligations or the expectations of any agreement aren't met.

MR WOODS: Taking the lead from my colleague as to where we go, if we could bring together recommendations 4, 6 and 7, because they deal with basically an extension of this issue. Recommendation 4 is talking about avoiding further reductions in assistance, recommendation 6 talks about continuing assistance to secure a sustainable auto industry and recommendation 7 then summarises those into a series of points: continue the ATS, co-invest, reinstate the 500 million and continue tariffs. That's the sort of summary, I guess, of all three of those recommendations.

At one level, the ATS provides a reasonable but not obviously complete level of certainty of a pathway to transition, but at the same time we have a submission from General Motors which concludes by stating that for an auto industry to be in

Australia would require adequate levels of ongoing public assistance. That to me is at odds with what the ATS does, which is by 2021 winds down its production and R and D assistance.

So we have a disjuncture in aspirations. We have the ATS saying, "This is a plan, this is a transition pathway, and at the end of it you're on your own," and we have General Motors talking about adequate levels of ongoing public assistance. So how should we at the commission reconcile those two things and what are your views on that?

MR WEATHERILL (SAG): I suppose we would say we should be grappling with these things a decade at a time. I think it may be difficult to really put ourselves in the position of understanding what the car industry is going to look like in 10 years' time. One only needs to cast one's mind back 10 years previous to see how different the world was. I think this notion of certainty forever is probably something that we should just put to one side at the moment and think of the certainty for the next decade.

The discussion we were having earlier about the sustainability of the industry is not unrelated to some of the things that we could ask of General Motors as part of this agreement. I mean, we're not simply saying, "Here's some money to allow you to continue to operate." We can also ask for that company to be accountable and to structure its global plans in a way which best suits our objectives and which create, we think, a long-term sustainable opportunity here.

It's not going to be, we think, competing with our low-cost countries, where they can do things more effectively. There may be niches within the global supply chain where our skills and capabilities give us the capacity to do things and sell them into places that are prepared to pay a premium for a premium product. I think that's a conversation that we should be having with Holden, indeed with the whole of our automotive sector, and there should be room for that in any agreement that we negotiate with them. That's certainly what we have been pressing in our discussions with Holden and that's a legitimate topic for discussion by the Commonwealth if they were to sit down and negotiate these things with Holden.

MR WOODS: Are you able to reveal - this is on the public record - whether there is any progress in identifying some appropriate niches that build on our comparative advantage?

MR WEATHERILL (SAG): I'd prefer not to talk about them in detail, except to say they have been topics of discussion between the South Australian government and Holden, and, of course, some of our own work as well about these matters independently of our discussions with Holden. We're talking here about Holden and that is obviously a present and very significant issue, but there's the car industry generally that we need to think about, and its ongoing future. So we're obviously operating directly with Holden and we're also thinking more broadly about what would be a future that includes a different Holden.

MR WOODS: Yes, and we're very cognisant of the scale and importance of the component suppliers, what activity they might look to, what are the opportunities for diversification and for building into the global platforms of car companies and those issues. Do you want to pursue that a little further first? Then I want to go on to structural adjustment.

MR WEICKHARDT: I think in the interests of time, we'll go on to that.

MR WOODS: Okay. Recommendations 8 and 9, I understand the way they're phrased, but essentially they get to the heart of the issue that you were raising before of North Adelaide in particular, but the South Australian economy specifically, and we had, prior to your evidence, Professors Spoehr and Burgan discussing some of the impacts, and you quote some of those issues. I'd make the observation that their report doesn't look at the Australian economy, it looks at the impact on South Australia specifically and so adjustments would occur elsewhere, and also doesn't take into account the funds that are currently employed in supporting this industry, how they could be redeployed and what economic benefits or support they may provide.

But these two recommendations get to the heart of an issue, and I note in your submission that you actually quote a sound piece of research that we recently put out on disadvantage in Australia, so we are very focused on this issue. It is a very important issue to address in this inquiry. Do you have a view on what might be best practice? You've had the experience in South Australia with Mitsubishi. Ford currently have a plan in place in Victoria. You quote the MG Rover model that occurred in the UK. Is there developing a way to ameliorate the level of disruption that may occur should GM choose not to be here?

MR WEATHERILL (SAG): I think the first thing to say is that each time one of these very substantial restructurings occurs, there are approaches which, generally speaking, tend to learn something from what had happened earlier, so they tend to get better; not exclusively so, but we learn something from the Mitsubishi closure, we learn something from the Bridgestone closure, and we try and build on them. It's probably worth pointing out that the Mitsubishi closure occurred in a context where we had quite a buoyant economy, but it's worth I think looking at some of the studies of what's happened to those workers, because it's not as rosy as perhaps has been traditionally thought to be the case. While, of course, some were able to find alternative employment, many didn't, and for those that did find some temporary arrangement, some of them ended up failing, and to the extent that people found other jobs they generally found them in more casual and lower-paid employment or may have gone into early retirement, retirement before they might otherwise have planned to. So the rosy picture that's sometimes portrayed about the Mitsubishi closure I think probably needs further scrutiny.

We can supply some additional information about best practice, but it seems to really swing around very active case management of the individual worker, and that's very expensive. Generalised programs that don't take account of the need of the individual worker and look at their particular context are not as effective as active labour market programs focused on the individual.

MR WOODS: And you do have a particular regional issue in Adelaide more so than perhaps in some of those other cases?

MR WEATHERILL (SAG): Yes. Well, in that particular set of suburbs which - I mean, you would recall the creation of Elizabeth as a satellite city around that particular factory, and so its almost reason for existence is - - -

MR WOODS: Interdependent.

MR WEATHERILL (SAG): We know from some of the data that the mobility of people is less than perhaps is commonly assumed. For a whole range of social and cultural reasons, people don't necessarily move easily to where the growing jobs are. They tend to stay in the communities where they have the strongest social connections, especially in circumstances where they're suffering very traumatic life events like the loss of long-term employment.

MR WEICKHARDT: A quick one, bearing in mind time. We've read in the Adelaide Advertiser about a report by Prof Goran Roos, who is appearing this afternoon. I'm interested as to whether or not you have now officially received that report and, if you have, whether it could be made available to us, because it's clearly quite germane to the topic of our inquiry.

MR WEATHERILL (SAG): Yes. Prof Roos is the head of our Advanced Manufacturing Council and he has been providing regular reports - generally speaking verbal reports - as we've been dealing with this issue, really for a considerable period of time. The sentiments that are expressed in it are obviously point-in-time sentiments that were documented not for us but, I understand, for particular clients he was working for in that context, which was the union and the company, as they were grappling with a wage pause proposition, so I think it was something that was prepared at some stage. I don't know whether it was ultimately completed, but it was something that was destined for somebody else.

A number of the sentiments that are contained in it don't differ materially from the sorts of things that Mr Roos has been saying to us over an extended period, but I wouldn't want to warrant each and every single thing that's in that document as being said to us, because it's not a final document. It may not represent Prof Roos's concluded views about things. I understand it was a leaked document. I don't think it has any official status, but certainly Prof Roos might be able to assist you with that.

MR WEICKHARDT: Are you expecting a final document shortly?

MR WEATHERILL (SAG): That wasn't prepared for us, so no, we don't expect a document of that sort, although there are inputs into cabinet documents that are routine and being considered regularly on this topic, obviously, as we prepare for submissions to this body approaching the Commonwealth COAG meetings; any number of processes that require documents prepared for cabinet. So there have been a number of documents prepared, but not this particular exercise.

MR WEICKHARDT: Can I just ask one last one. Your recommendation 10 suggests that we do look at net present value of the benefits of supporting the industry and what might happen if that support were withdrawn. I guess, looking at the context of your entire submission - I'm assuming, but I'd just like to clarify - are you suggesting that the answer from that, based on the best sort of modelling that we can get, says there aren't net benefits to the Australian economy? Is that, in your view, the overriding consideration or not?

MR WEATHERILL (SAG): I think there are a number of things that need to be lined up. One is a sophisticated analysis of the benefits, and I think we've discussed this below, the benefits which are ferociously difficult to actually describe and measure. So with that caveat, I suppose what we are proposing is a much broader notion of cost-benefit than perhaps a very narrow econometric analysis of cost-benefit.

Our starting point really is, "What sort of society do you want?" and then, "What sort of economy do you want?" and then, "What sort of industries do you think support an economy of that sort?" and then I think you get down to requiring a car industry. Then I think it becomes a question of precisely what sort of assistance is reasonable.

Obviously there is a point at which the price of keeping a car industry may exceed its utility to the rest of the economy and you might then have to look at attracting something else, but if you take the view that you need a manufacturing sector to have a balanced economy and if you take the view that it's the car industry that drives the skills and capabilities of giving you an advanced manufacturing sector, if the price that's being asked to pay for keeping a car industry is too high, then you've got to find something else and you've got to evaluate what that something else is, and you might find the cost of that is even higher, and so that becomes the equation. So that's how we construct the cost-benefit question.

MR WOODS: Thank you, premier, for your time and that of your officials.

MR WEATHERILL (SAG): Thank you.

MR WOODS: We'll take a short break and resume at 11.00.

MR WOODS: Thank you. We'll resume our hearings, and our next participant from the Australian Manufacturing Workers Union, John Camillo. Mr Camillo, could you please for the record state your name, the organisation that you belong to, and the position you hold.

MR CAMILLO (AMWU): Yes, good morning. My name is John Camillo. I'm the secretary of the Australian Manufacturing Workers Union, South Australian branch.

MR WOODS: Will any of your colleagues be giving evidence today?

MR GEE (AMWU): Only if required.

MR WOODS: Do you want to, for the record anyway, state your names, organisation and position.

MR GEE (AMWU): Jon Gee, secretary of the vehicle division, AMWU South Australia.

MR SKLADZIEN (AMWU): Tom Skladzien, economics and industry adviser.

MR WOODS: Thank you.

MR RALPH (AMWU): Kevin Ralph, union official, AMWU.

MR WOODS: Thank you very much. Mr Camillo, have you got an opening statement you wish to make?

MR CAMILLO (AMWU): Yes, thank you very much. The AMWU SA branch will be making submissions in regards to the Elizabeth operation here in South Australia. Two key issues that I do want to talk about is the global financial crisis and the issues that we were facing, the workers and the company, during that period, and then I also want to talk to you about the variation to the collective agreement. The AMWU's main submission, which has been sent to you, will be presented tomorrow, and a report will be from the AMWU national and state branch of the Victorian division.

So my aim is really talking about Elizabeth, and just a few issues I want to talk about; first of all, the importance of the automotive industry in South Australia. Automotive manufacturing employs around about 10 per cent of the South Australian manufacturing workforce, 7000 direct full-time jobs at Holden and the component plants, 13,000 jobs, including flow-on effects through the state economy.

The situation I want to talk to you about is in regards to 2009 when

Mark Reuss was the CEO of Holden here in Australia, and I remember Mark ringing me up to say that they had major difficulties through the global financial crisis and that GM were getting to the situation of bankruptcy and so on. We sat down with Mark, senior executive of Holden, and the unions, and Mark made it quite clear that at that time, Holden were producing the Commodore for an export market and for a local market. My understanding at that time was probably around about 40 per cent for the export market produced at Elizabeth were being sent around the world, and 60 per cent for the local market.

Mark made it very clear that the volumes for people buying vehicles had collapsed, both at an international level and a local level, and they were in some dire straits and they wanted to sit down and work these things out. We sat down with Mark, in consultation with the workforce, and we agreed that the three-shift operation at Elizabeth would be dwindled down to two shifts. So at that time roughly around about 3300 workers were employed at the Elizabeth site. The midnight shift was roughly around about, I think, 900 to 1000 workers and we rolled that into a two-shift operation, day shift and afternoon shift, and a very small skeleton crew on the midnight shift.

We ended up managing to do a voluntary separation where no-one was forced out the door. People put their hands up and the company there would have done an analysis on whether they need those skills or not, and those people who were there would have been told, "You can leave," and it's probably the right way to go in regards to people leaving any organisation, for a voluntary separation rather than forced redundancy. I have come across people who are forced out the door at an hour's notice, and it's shocking how some employers treat workers after 10, 20, 30 years' loyal service to the organisation being marched out the door with security guards on both sides. So we managed that very well, and when I'm talking about "we", Holden, the company, the unions, the workforce and so on.

We then were in a situation that through the global financial crisis the sales just disappeared, it was getting smaller and smaller and smaller, and Holden, the situation is they had all these workers on day shift, afternoon shift, not enough volume. They come to the unions and said, "What can we do?" We sat down, we worked out the best method, and under the 2011 collective agreement, or maybe prior to that, we had provision with regards to the market response downturn. When there's downturn in the market, the company can talk to the unions in regards to having 10 days off, 15 days off, because there's no market to sell vehicles. We got a provision that the company will pay fifty-fifty. So I think it's the first couple of days they pay 60 per cent wages; the rest, the workers are going to pick up. After so many days the workers then pick up 50 per cent and the company pick up 50 per cent.

The problem we were facing then was that our component sector had no provisions in their collective agreement like Walkers, Futuris and so on. So while we were enjoying these 10 days off at 50 per cent pay and the other 50 per cent people either had the opportunity to take up long service leave, annual leave entitlements or any other accrued leave they may have, it was good. But the component sector was screaming out, "We cannot continue being stood down without pay," and we looked at that very, very seriously.

Again it was Jon Gee and myself with all the unions working very, very closely with the company. We had to have a better mix for the component sector, and so we sat down and we developed the situation called the "one shift, two crew", which meant that the two shifts that worked on day shift and afternoon shift came into one. So we worked out in regard to skills and so on that group A would work one day shift, then the next week group B will work the next shift, and so there was always one group that was at home.

Those people who were at home were getting the 50 per cent market response, so they picked up 50 per cent of their wages. The other 50 per cent, those people had to either pick up through annual leave entitlement, long service leave, or just go without, and while you might have seven years' service or more, you would be able to do those sort of things. Those young workers who couldn't do that were struggling, and it's something we don't go to the media bragging about workers struggling in regards to reduced wages. But we did something out of the ordinary, and the reason for that - and the workers were fully supportive because you've got to bring workers along. You can't force things down on workers. You've got to explain to workers what the situation is.

The workers said, "Okay, let's do it," and they did and, you know, those workers on the night shift lost 50 per cent of their wages when they went to day shift. The afternoon shift people lost their shift loading, but also lost their weekly wages, and I had many, many people come up to me, and through the officials and shop stewards who were saying, "We can't pay our bills. We can't pay our mortgage." That was an issue because those workers weren't getting their full wages that they were used to. They were on budgets in regards to what they were getting. I personally wrote to all the managers, bank managers, because I had a lot of people that rang me that were pretty emotional, like I am now.

It was brought up that they couldn't pay their bills and they were scared about their families, they were scared about losing the house and so on. So, you know, even myself went through a tough time just like these workers and we wrote to the banks and said to the bank, "Please be easy with these people. If they can just have interest-free loans only for a period of time" - which at that time I thought it was going to be three months. We said that, and we said to the banks, "Do that," and I've got to say, bank managers - you know, to their credit I didn't hear any of those bank managers gave any of those workers a hard time. We all thought this was going to be three months. I've got to tell you it went for two years, just under two years that these workers were one week on, one week off, and it was very, very, very difficult.

We had the situation where Holden were only, believe it or not, at Elizabeth, a few days away from closing the GM Elizabeth operation. I know that in GM in the United States many, many plants closed down, and still close down right now, some very efficient plants over there where workers have lost their jobs, and those plants are still idle, and we understand the position those people have gone through.

We looked at a smaller model and I know at that time, Kim Carr, the minister for manufacturing, and the treasurer in South Australia, Kevin Foley, went to Detroit to say, "Look, if we can get a small model based on what Holden are saying, we can produce this Cruze at the Elizabeth site. We can build it. This is the cost that we can build in. This is the outcome in profits to the organisation." I've got to say again credit to the workers because you don't buy machinery from overseas because it costs too much money. You don't make money at the end of the day in regards to whether it's a four-year plan or five-year plan.

Those workers I'm talking about are engineers, designers, tradespeople and outside consultants from SAG and other places who had the expertise to remodel some of these robots. It might have been a good 10 years ago, their use-by date has nearly gone, but to get the Cruze, they worked very, very hard to redesign those robots and to manufacture those robots to be able to produce that Cruze that we see going down the body shop; again, commitment from the workforce, again commitment from all these people from within Holden, outside of Holden, to make something work, and that was the issue in regards to that.

So these are the things that we don't go to the media and brag about. We work very, very hard. You don't read that in the media, but you do read in the media in regards to if we do something wrong in regards to industrial action, walk off the job and so on. These are tough times and we understand, and workers at Holden have committed to understanding, not just having the blinkers on, looking at what they produce at Elizabeth. They know they're in competition at an international level. They know that, and I'll tell you why they know that: because they know what GM benchmarking is around the world. They know who makes the best Cruze in the world, and those workers take pride in their product and work, and I've got to say in regards to the nine GM plants around the world, my understanding is they are in the top three in quality. So how did they get that? Because those workers know at an international level what they need to do.

In regards to the work cycle at Holden, believe it or not, it's the men-at-work at cycle. We haven't got the volumes of GM in Europe and other countries where they can produce 300,000 vehicle a year. We're low volumes, and I can say that, you know, we bragged for many, many years that those workers could produce 40 different models coming down the production line. I'm a production operator. I started work at Holden in 1978, and I'll tell you who taught me how to work on the line and do the jobs that I needed to know: a blind person taught me that. There was a thing at that time in the 70s where people said the blind led the blind. "Want to spray-paint a car? Here, grab the gun. You're putting too much on it - you're not putting enough on." That's how it was taught.

We've changed from the 70s in regards to now through the Vehicle Industry Certificate, in regards to workers having skills and knowledge in regards to doing their jobs. When I was there in 1978, when I worked on the production line, when it come to working on a Saturday, you couldn't work Saturday, because each person was on their job, one job, maybe three years. I knew people in the body shop that were on one job for 20 years, and we decided to change and we changed in regards to multiskilling through the VIC, you learn your skills, you learn your knowledge, you do self-inspection, where years ago there was an inspector at the end of the line who checked to see if the job was okay and if it wasn't, it would get re-run and so on.

We've become self-inspected, we've become multiskilled. Why? It's because we went overseas, a group of people. I was included, back in 1990, and seeing what we were competing against around the world, and at that time I'm going to say the union and the company realised that if we didn't wake up to ourselves, we'll be out of business very, very quickly. So we come back and we did get together. We developed a work organisation document where we brought workers in.

It's no good the senior CEO knowing what's happening around the world and your union official, you have to bring the workers in, explain to them about the competition around the world and get them to be involved. I know that workers who want to be involved in the decision-making in the workplace, you get 100 per cent out of them. If you tell workers what to do on a daily basis, you don't get that commitment. So those issues, we've changed, and done many, many things in regards to all that, and it wasn't easy.

But going back to the overtime, we've got people now that on the Saturday if you can't work overtime, they can pick from 10, 15 different people in that department, because everyone is multiskilled in learning how to do their jobs. The work cycle in the production line, as I was saying earlier on, is one minute. Holden have brought that down, but it's one of the best efficiencies in the world in regards to getting that down, 54 seconds in a minute. 54 seconds: what that means is that you're on a workstation, a car comes down the line, it could be a utility, you need to know what you need to put in that car and be perfect in that. You can't afford to make a mistake. If you make a mistake, the car goes off the line; there's added value in regards to repairing that. It gets damaged and it gets repaired and so on. So everyone knows getting it right the first time is important.

So if you go back to the 54 seconds, the next car comes down, a long wheel base. The next car, could be an export market; next car, could be a local market. Each person has an understanding in regards to how these jobs are done. They are the best in the world, they can compete in an international market. They've proven it. The issue also for production workers, if you want to go to the toilet, you just don't walk off the job and go to the toilet, you've got to put your hand up and you've got to wait. Some days, you can wait half an hour to an hour. These are what these workers do day in, day out. But they're passionate. They want to work in the auto sector. They love working in the auto sector because if they didn't, these people would have left years and years ago. These people keep telling me they want an industry, they want to survive, they want to stay here.

Just before we move to the variation, in all the years I've worked at Holden, coming from the production line in 1978, I've been involved in all the award restructuring, continuous improvement, all the collective agreements and so on. Both sides work on that very, very hard. You would note from records over many years to the Elizabeth branch, you don't see too many walkouts, unions beating their chests. We sit down and we deal with the matter, and some days decisions have been very, very tough. But we do it with the company in consultation with the workers. So the issue in regards to collective agreement, it's both sides. Sometimes the union takes a lot of bargaining in regards to what they get in wages and conditions. You've got the business plan, the company has got to work out to go forward for the next three, four years, "This is what we want," "This is what we can afford to pay," and so on.

We push the envelope like any organisation in regards to what we can get, but we know when the writing is on the wall and how far you can push. So therefore it takes both sides to have an understanding in regards to that. We've never had a protected industrial action to walk off to get more money, because there's a fine line in regards to competing at an international level and again, workers getting wages and conditions. We talk about workers at Holden getting over $100,000 a year. Well, that's wrong, and you're probably aware of that in regards to looking at the award classification.

The other issue is, which is a bit of a myth, in regards to workers getting all these conditions. If you look at the annual leave programmed days off, the programmed days off - which was many years ago, 40 hours a week - we negotiated 38 hours a week. We negotiated 38 a week on the basis that workers can have one day a month to be home with their family, but also for workers in that one day to make an appointment to see the doctor, specialist, so they don't have to do it during working times, and that's how we managed to get Holden to agree in regards to that one day off.

We then were in the situation that everybody believed that the new Cruze and Commodore was in the bag. There was a tick of approval from Detroit and everywhere and everyone was very, very happy in regards to that. Unfortunately, I'll move now to the variation, that in June this year Mike Devereux asked me to go to Melbourne with Jon Gee, myself and Dave Smith, and indicated that they have serious problems. Things have changed, the Australian dollar is very, very high, and for them to export was becoming more and more difficult. What they indicated to me at that time was while they were prepared to ride it out at 90 cents, 95 cents on the Australian dollar, in regards to the export to the United States and the police vehicles and that, they thought the Australian dollar was going to come down and they'll ride out the losses to end up getting the gains, because they wanted to be the first of many countries trying to win that 120,000 vehicles a year, roughly thereabouts.

Mike Devereux said to us, "We've got major problems. We are losing money, we are losing so much money per vehicle, and what Detroit is asking, they want more flexibility out of the workforce," and I asked many, many questions in regards to how do you vary an agreement, "How do I know that if we sign up an agreement with you, Mike, that what happened in Canada" - when the union signed up with one of the key CEOs in Canada and agreed to flexibility, when that CEO moved on, they closed one of the plants down. So I wanted to make sure everything that we were going to do and talk about - that we were going to have a long-term rather than just a kneejerk reaction. We heard what Mike Devereux told us and explained to us on overheads. We've asked for a meeting of all unions and we've asked all the unions that represents workers from the white collar, clerical, tradespeople, production and so on; we're in a very difficult situation.

When the company indicated they were looking at taking $15 million out of the operation at Elizabeth and they wanted some form of, from what Mike Devereux said, wage haircut, workers need to take a haircut in regards to their wages because they were getting too much money and so on, we as unions sat down, we gave a commitment that we would work as one group through a single bargaining unit, that I'll be the spokesperson in regards to negotiating, through the media, to the workforce and everything, and that was the case that we done. What I'm not very good at - and in regards to understanding whether Holden was losing that much money, the unions agreed that we'll bring an independent person from outside and ask Holden whether it would be prepared to have someone who has an understanding of manufacturing in Australia, but the report would go to Mike Devereux and myself.

What I was looking at was: was Holden really losing money? That's what they were telling us, and the other issue is, if we're looking at improvements at the Elizabeth site, I wanted someone who could tell us what we needed to do to make those changes, that it wasn't just workers' wages, conditions and so on. That's why we asked Prof Goran Roos - we've invited him to come on board, we talked to him privately, and we put that recommendation to Mike Devereux. We had terms of reference in regards to what he could do. He would like to have six months, just like yourselves probably like to have six months to get all this ready, and I understand that these circumstances happen. So he only had a couple of weeks, and I understand that he did bring some GM expertise - had worked on the restructuring of GM in America - to Elizabeth to see what we can do in regards to the restructuring at GM Elizabeth.

I won't go into great detail. Prof Goran Roos confidentially gave me the report, which I've kept to myself. I've haven't had the time to read all of it. What I did, I went to his house and asked for a meeting with him and sat down for two hours and said, "Can you please explain what you found, what's your outcome," and so on, and he did and he said, "John, Holden are losing money. They are losing so much money per vehicle. They're not pulling the wool over your eyes."

I've asked him to speak to all our shop stewards, to be up-front, to explain to them in regards to that, and we knew that they were losing money and we talked to all the workers, had a meeting of workers outside in their own time and all the workers attended. The message they told me was yes, they want to be flexible; yes, they want to look at saving the company, "But don't cut our wages." The reason they were saying that is that most people who were getting 975 to 1000 dollars a week have already budgeted their mortgage, their family life around that. At that time there was a rumour going around that Holden wanted to take $200 straight out of their wage packet. They had done the calculations and they were saying at that time, "You may as well close the place down. We cannot live with $800 or less a week," if they were going to take that - and the conditions.

So we went back to the company and I've got to say that I had my bean counter with me because I don't know about the figures, and they had their bean counter in regards to all the figures and so on, and we went through every issue in the 2011 collective agreement to see how we could cut the costs and save the company $15 million. We only had a few weeks of negotiating backwards and forwards amongst all unions, trades, engineers, scientists, production workers - not easy to do but we've done it and sat down, and every time we had a saving that we could both agree - sometimes the company was wrong, sometimes we were wrong - we put that aside. There was a million-dollar saving, there was $500,000 saving, there was 250. People said, "John, why get rid of the canteen tea services?" Well, by getting rid of this canteen tea service there was a $200,000 saving for the company.

We got rid of the canteen service where they provided tea and milk for all the workers and we saw that as a benefit because our target for the union was to get $15 million. That's what our target was. And again there was consultation with the workers because all these changes affected these workers. So we had the 2011 collective agreement. We did the variation and some of those variations were really hard decisions for workers to make because most people have two in the family working - husband and wife working, got to pick up kids and so on.

We have provision now that Holden have the opportunity to work overtime when needed, like during a lunch break, after hours, during the day where they say, "A customer needs another 20 cars. We've missed 20 cars. We need to build them." They can then bring workers in to be able to do that. There's that much flexibility now, giving the company the opportunity to be one step ahead. For example, if the company decide that they're producing so many Commodores and Cruzes that they don't want to have a day off next month, they cancel that and they work that day. We bank that and put that day off aside. Or if the market collapses next month and there's no sales, we can then take all the PDOs this year, one per month, and next year and bring them forward and close the plant down, which is something we've done in the past.

This flexibility, the issue about overtime, the issue also in regards to the 3 per cent wage increase - because the 2011 collective agreement quite clearly said 3 per cent the first year, 3 per cent the second year, on 15 November another 3 per cent, plus a hardship fund a month later and so on - you've got to understand that when we put all the variations to the workers, 70 per cent at the Elizabeth site accepted all those changes and are committed in regards to what's in that document, which is some major changes for both sides to accept but it will benefit Holden in regards to going forward and reducing the cost.

The issue for us was that in our variation, we made sure that we weren't going to do all these things and Holden close down next year - the reduced wages, reduced VSP and so on. We said, in regards to the first clause in the variation, the variation would come in force as soon as Holden made the announcement of the next gen. So at that time it was really in our face - the workers and so on. The decision from Detroit was going to be made late October, early November. Workers were aware of that. Workers were told, and I was told, that if they voted the variation down and didn't accept flexibility, that GM would not go to the government and ask for any co-investment; they would shut the doors.

We knew that this was fact in regards to what's happening around the world. I'm aware about the Canadian auto workers and their flexibility, also in Germany, so we knew that wasn't just a threat, that was fact. So those issues we discussed with the work personnel and the other unions, but again those workers made a commitment to agree to the variation. I know that there's media speculation that the unions and the workers want their cake and to eat it. Let's make it quite clear: there's a 2011 collective agreement that will continue until next year when Holden make the commitment to the new gen and it kicks in.

What happens right now, workers have that 3 per cent wage increase from 15 November this year but workers and the union know that as soon as Holden makes that announcement next week or next month, they drop back to the previous classification they were on and we'll all move forward. That is from all the unions and so on. Then we're moving to the new variation and the company can implement all those issues that we - when I talk about "we", Holden and the workforce - have agreed. So that's the situation and that's why I wanted to speak more about those issues today, rather than what my counterpart will talk about tomorrow.

I don't think we see on the union side what people are prepared to do. When you do give them a wake-up call in regards to what's happening, people are prepared to change. You can't do those changes through force. You can do those changes with the workforce, and I've got to say those workers are committed to work. I know that quality has gone up, absenteeism has come down, because they know the writing is on the wall. It's unfortunate that every day there are rumours on the shop floor about closure or something in the media. Those workers are struggling now, their families are struggling and it's very, very hard for those people.

We want to get a commitment that it's either yes or no, but those workers over the next few months are doing it tough. The AMWU has got a 24-hour helpline because I have gone through this situation where people get very emotional and I don't want to see anyone doing something to themselves or their family for the sake of a job or hardship. So we're on call and we have specialised people that can help people in need in regards to finances, emotions and distress and so on. That is 24 hours a day and that goes out to all our members because I know what I went through at Mitsubishi with those workers. People do silly things from time to time.

MR WOODS: Thank you, John. I appreciate the forthright nature of your presentation. We've only got a couple of minutes left and I might end up foreshadowing a couple of these that can get picked up in tomorrow's evidence, but just one: let's take this scenario of GM saying, "Yes, we'll proceed to the next model." In that case, and they move to global platforms - and I think the Cruze at the moment has only got something like 25 per cent componentry that's domestic, so the flow-on effects to the component manufacturers, and you seem to encompass their concerns as much as what's happening at the GM plant, and I appreciate that - is there an inevitability, even if GM do commit to the next model here, of a declining workforce as productivity improves and the nature of the jobs change with greater robotics? If it is a global platform, then I think Commodore has got quite a high level of domestic componentry but that may not be the case for the next model. So as you look at it from the workforce point of view, do you have in mind a way forward of a progressive structural adjustment anyway of a reducing workforce?

MR CAMILLO (AMWU): The way I answer that is that in the automotive industry it's a continuous improvement. As I said earlier on, in regards to when workers at Holden were doing 40 different models on one line cycle, which was unheard of around the world, we had people from overseas come in buses to Holden to look at it. Jon Gee just went to China and he said, "John, you won't believe what I saw in China. They picked what we had, how we've done it. They've pinched it." It's no different to what we did when we went overseas in 1990.

We're in an international competitive market. You're going to be looking over your shoulder. You've got to keep on being competitive. If you're not - and we were still making the FJ and we didn't allow robots to come in - the place would close down. I understand those things need to change as we get better. Things also get changed in regards to many things were made out of metal, and making those frames and so on required many, many parts and many, many presses to do those. Nowadays, one mould, plastics on those cars. It becomes cheaper all the time and you've got that continuous improvement. So, yes, I'm aware of that, and slowly, whether you like it or not - not just here, right around the world - the automotive industry slowly gets better and better and refines itself, but that's what we've got to compete against.

The component sector is an issue, but again for the component sector there's a number of areas that it needs to do. I represent workers in the component sector. The problem I see in the component sector: too many people have got the blinkers on, trying to make a good quality part to send to their customer - focus on that. They don't focus outside their boundary. They don't focus outside, internationally, what they can do. They don't focus in regards to whether they can build parts for the defence, as we've got. So they just focus on day in, day out working very hard, getting good quality product.

The component sector can survive in regards to doing more than just auto, whether it's defence, whether it's for other manufacturing or, if they can, as the joint that keeps changing its name down the road - Vision - SMR - they've done it. They are doing it very, very well, looking at the world and competing and changing. They're using the CSIRO in regards to how you have so many different parts in that mirror into one or two parts. That's continuous improvement. That's looking outside the square and being out there.

We can do it in this country. Unfortunately, we're all pulling at different angles. We don't work together, and each person does their own thing. The component sector can survive. It needs a lot of mergers, but we can compete in the international market and build some of those products if we all work together to be able to do it.

MR WOODS: Okay, that's very useful. The other one - but I'll just flag it for tomorrow - is: on the downside, if GM didn't proceed, what are "good" models - there's no good model for losing your job, but what are the best ways to try and overcome those disruptions et cetera? But perhaps I can leave that until tomorrow. If you have views on that, could you pass those on to Tom. We've run out of time, Phil, but is there anything in particular that you wanted to - - -

MR WEICKHARDT: No, I think we'll continue tomorrow. I understand the challenge that you guys are under and the sacrifices that have already been made. What I'd like to pursue tomorrow is: is it enough? I mean, the world is not necessarily fair and you're competing against cars made in low labour-cost countries now, and to a degree the cross we all bear is that we work in a country which has got high standards of living and high labour costs, and in some cases competing against a labour-intensive manufacturing operation in a low-cost country is very tough. So maybe we can talk a bit more about that tomorrow.

MR WOODS: And where manufacturing more generally is heading in Australia, because there are some good stories as well as some stories that have got tough decisions in them. Thank you very much for your time. One gentleman joined you towards the end, but we may as well have him on the record. Could you state your name and organisation, please.

MR EVANS (AMWU): Yes, Tony Evans from the AMWU here in South Australia.

MR WOODS: Thank you very much. I think that has everyone on the record. We'll resume with your evidence tomorrow in Melbourne. Thank you very much.

MR WOODS: Our next participant is from the Australian Automotive Aftermarket Association. Could you please for the record state your name, the organisation you represent and the position you hold.

MR CHARITY (AAAA): Thank you. My name is Stuart Charity and I'm from the Australian Automotive Aftermarket Association. My position is executive director.

MR WOODS: Thank you very much. Thank you for your submission to this inquiry, for the timely manner and the vast amount of supporting material and case studies that it contains. Do you have an opening statement you wish to make?

MR CHARITY (AAAA): Yes, I do, thank you. Thanks for the opportunity to present today on behalf of Australian automotive aftermarket manufacturers. Moreover, I want to express our thanks for the opportunity to engage in productive and open debate about the future of our industry.

I'm going to commence today with three statements of principle to summarise our position. Firstly, we believe, as many do, that Australia should be a producer of cars and automotive components. We believe that this requires government to play a role in ensuring competitiveness, encouraging innovation, assisting access to export markets and levelling the global playing field.

Secondly, we are of the view that for a long time that narrow view of who is actually in the industry has impeded overall growth and structural adjustment. Thirdly, we're of the view that up until this point, we've been missing the point. Automotive policy and program settings have been wrong and there are better ways to support the innovation, employment and the economic contribution of this industry to the Australian economy.

The issue of whether Australia should or should not have an automotive industry and the global automotive environment are areas that every submission to this inquiry is likely to cover. I wanted to focus on the areas that receive less attention. In our view, a lack of policy focus on the entire automotive industry has been to our detriment. A constructive discussion about the future of the Australian automotive manufacturing industry cannot be conducted by examining only one part of the sector. It's not only about cars and the parts that are supplied to build these. There is life outside the pyramid of car makers and their suppliers.

The automotive aftermarket is a significant part of the total automotive industry. 36 per cent of all automotive manufacturing in Australia is undertaken by the aftermarket. That's $5.2 billion per annum. The sector employs 21,000 people directly in every state of Australia and exports $800 million a year worth of Australian manufactured product.

So let's talk more about what makes up the aftermarket sector. The aftermarket produces motor vehicle components, including parts that are replaced regularly through the life of the vehicle as a result of normal wear and tear; parts like filters, tyres, wiper blades, batteries and brake parts, and we've got an extensive list of all the products that make up the industry. But it's also products used to modify, maintain or enhance the performance of vehicles, including modifications for rough terrain, specialty products, safety, comfort, appearance, functional performance and body components.

The aftermarket industry performs very strongly. It's highly trade exposed and includes a percentage of companies that achieve cost competitiveness by importing from lower-cost countries. Among our membership of 1700 companies, 260 still manufacture aftermarket products in Australia in this highly competitive environment. The aftermarket is predominantly Australian owned and operated, with the majority of producers operating in specialist markets, including performance improvement, emissions control, stability, safety, replacement parts, collision repair and four-wheel drive parts and accessories.

I wanted to stress from the outset that the members of the Australian Automotive Aftermarket Association make car parts, the same components that have been subject to the tariff phase-down schedule and exactly the same policy regime as the original equipment suppliers. Every single economic indicator that you read about the automotive industry - employment, exports, production, value-added research and development - will include the aftermarket. So if we make automotive components and our volumes are in the data, why doesn't anyone ever talk about our industry? It's because we don't sell to the car makers, and the OEMs have always controlled the debate and the direction of automotive policy, industry policy, in this country.

Before I outline the key issues here, I want to state very clearly that we have not put forward a submission that says we're the same as OE and we want what they have. Our observations and recommendations are more complex and the issues are broader. In short, it's just not that simple. The aftermarket segment has different characteristics, different skill sets, different commercial drivers and a totally different future outlook compared to the OE segment.

I also need to state here that the aftermarket has been excluded from the structural adjustment assistance provided by the federal government to date. Every program is designed around supplying to car companies and not designed to support manufacturers outside the traditional OEM pyramid. Our sector also differs because the aftermarket segment continues to show strong year-on-year growth. So if we're growing and we don't want what they have, what's the problem? Well, let me detail what we think is broken.

First and foremost, we believe that the current government automotive industry policies and programs are not geared to the future. Regardless of whether Holden and Toyota maintain passenger motor vehicle production in Australia or not, current and projected OE volumes simply cannot support a sustainable view of the OE supply chain acting in isolation any longer. The automotive industry we had in 2008 when the $6.2 billion New Car Plan for a Greener Future was announced is not the industry we have today and it's certainly not the industry we'll have in 10 years' or 20 years' time. We need a new plan, a plan to address the global trends in automotive production and consumption.

A good illustration of my point about the difference between OE and aftermarket is illustrated in the question we asked our members in the survey that we conducted as part of the preparation for our submission. We asked them, "Could you build a sustainable future in the absence of a local vehicle manufacturing industry?" 51 per cent of respondents said this eventuality was unlikely to have any effect on their future investment plans.

Secondly, the current policy setting is a lost opportunity to maximise growth. The current policy setting has actually mitigated our industry's ability to support and leverage growth. We have areas of outstanding international success - suspension components, four-wheel drive components, high-performance and motor sport components, clusters of globally recognised companies and products and great export stories - but they're competing on their own without any government recognition and support. Just imagine what could have been achieved if the auto industry was viewed holistically. We're not talking about cash handouts, we're talking about improving productivity, opening doors, branding and marketing.

In our submission we provide economic modelling to show that if the government automotive policy settings were more effectively structured around the future role the aftermarket industry can play in the automotive sector's long-term future, then our industry could be worth some $6.56 billion today rather than the current estimated value at around $5.2 billion.

The third point I want to talk about is assisting the structural adjustment process. Not only have the policy settings had a negative impact on the aftermarket but, more importantly, the policy settings are actually hindering the entire structural adjustment process. The aftermarket segment can play a constructive role in bringing about the structural change across the entire auto components industry. In our submission we discuss the realignment of public policy support that would enable the aftermarket to achieve greater potential and be more effective at absorbing displaced OE resources.

A reorientated incentive structure for the entire automotive manufacturing industry will, on the one hand, encourage diversification by the OE segment into aftermarket and other industry sectors and, on the other hand, position the aftermarket for growth so that the resources of the OE segment can flow more easily into a more sustainable and growing aftermarket segment. In short, the aftermarket and OE sectors, if considered together in the policy-making process, can leverage up their respective capabilities and performance potential.

The last point I wanted to make here was that we believe that the aftermarket cannot reach its potential value without further structural adjustment. The automotive aftermarket is under intense import pressure. Import competition at home has forced some companies to seek offshore manufacturing opportunities to achieve sustainable volumes and global competitiveness. However, this import competition, among other factors, has forced the remaining manufacturers to move up the value chain from service parts to high-value specialty products with a technological advantage. This has created an aftermarket segment that has the right preconditions to be a globally competitive sector, including significant investment in R and D and capital, a strong export focus, but it's actually facing an environment of disincentive under the current policy settings.

The OE segment, which needs urgent access to diversification opportunities, can provide the much-needed workforce skills, R and D capability, intellectual property, quality systems and knowledge of the OEM, product development and validation processes, to help the aftermarket segment to overcome supply-side constraints to its further diversification and growth. Clearly then, policy settings which seek to maximise these synergies between the two sectors will produce a win-win outcome for the sustainability of the industry as a whole and minimise the displacement of the workforce in other resources within the industry.

In my closing comments, we strongly believe that the performance of both the OE component segment and the aftermarket segment can be simultaneously enhanced through an approach to policy that embraces both segments of the industry. Both from a product synergy and policy point of view, the easiest and most logical transitional path for the OE segment is to diversify into the aftermarket component production industry.

Our members, the aftermarket producers, have talked to us consistently about the means by which government could foster growth. Our members believe that government could encourage investment in technology and R and D by the aftermarket segment to assist in moving production up the value chain and improve our cost competitiveness. Government could encourage investment in new plant and equipment, particularly capital-deepening investments. Government could introduce a diversification program that is open to the aftermarket producers to grow and strengthen the aftermarket and diversify their customer base and provide enhanced export development and market access support.

Effective policy settings and assistance are required to address these adjustment pressures, and in our submission we discuss consolidation and right-sizing of the supply base, fostering local manufacturing volumes, diversification and accessing global markets. However, the fundamental policy principle is this: if real structural adjustment is to be achieved, policy settings must be designed and based with the entire automotive manufacturing supply chain in mind and not just the OE supply chain.

We're not asking for access to what the OE has in government co-investment programs. What we are asking for is a comprehensive reorientation of the government incentive structures for the entire automotive manufacturing sector so that on the one hand it encourages diversification by the OE segment into the aftermarket and other industries and, on the other hand, positions the aftermarket for growth.

It's time to take a step back from the traditional view of what is considered to be the automotive industry and view it in a holistic sense. It is also time to have policy settings which recognise the inherent weaknesses and strengths of all parts of the automotive industry and facilitate transition into a sustainable industry with ongoing growth prospects.

Thanks for the opportunity to present today. I'm happy to take any questions on my presentation and our submission.

MR WOODS: Thank you very much. It is a very helpful submission and it does give an insight into a related part of manufacturing that gets a different level of support. A couple of just short questions to start off, if I may. One is: are some of your members also suppliers to the OEM market so that some are more diversified and go both ways?

MR CHARITY (AAAA): They are. A lot of the larger tier 1 OE suppliers also have a strong aftermarket focus, so they have a diversified customer base and product base, but a number of our members that are not suppliers to locally built passenger vehicles also supply OEMs through their parts and accessories networks, but that's often for imported vehicles. Often we do the things that we're good at, like four-wheel drive parts and accessories, so Prado, LandCruiser, those sorts of vehicles. So they do do OE but it's not just limited to the Australian passenger vehicles.

MR WOODS: Indeed. The second one: you do make full use, presumably, of the existing generic government programs, the Export Market Development Grants and all of those things?

MR CHARITY (AAAA): Yes.

MR WOODS: And so you would have views on whether they themselves are as effective as they could be or whether they could be amended to be of greater value but at no necessarily greater cost to the taxpayer?

MR CHARITY (AAAA): Sure, but the Export Market Development Grants is probably the premier program and certainly the program that many of our members defer to. The problem with that program is that many of our exporters are quite mature, so that has a limited span of time. It was seven years; it's been pared back now to, I think, five years for developed markets. It's still out to seven years for emerging markets. So what we find is that as our members are starting to really hit their straps in export markets, they run out of claims and are no longer eligible to access that program.

We've seen new programs come in, like the Asia Engagement Business Strategy. We think that's got the potential for a very strong - because certainly the emerging markets for our industry are in Asia, but the problem is that that program was only funded, I think, to the tune of one or two million dollars a year and they were grossly oversubscribed from applications, so that's got a very limited funding envelope. Our members don't tend to access the R and D grants incentive programs to a large extent.

MR WOODS: Because they're not eligible? Because they're not doing that level of R and D?

MR CHARITY (AAAA): I think there's probably a little bit of a lack of knowledge about the benefits under that program. Certainly our members are doing significant R and D. In fact, I think a figure of about 1 and a half per cent of sales came through in our surveying. A lot of it is application engineering though, so actually taking apart and designing it for different vehicle specifications. But that, I'm assuming, would still be eligible. But we are locked out of the specific assistance through the green car plan.

MR WOODS: All right. A third brief question: it's often said that having auto assembly and associated component suppliers in your manufacturing base gives you a depth of skills and experience and capacity that then can travel across to other industries. Yours would be the very first industry that it could travel across to. Do you see it as essential that there be an auto manufacturing capacity to allow that to happen?

MR CHARITY (AAAA): No doubt. Our industry has been the beneficiary of spillover benefits and, as I said at the outset, we want to see a sustainable automotive manufacturing industry - a sustainable car industry - in Australia. There are many employees that are ex car company employees that go into various roles within the automotive aftermarket. There are a lot of skills that are in the OE supply chain in terms of design and manufacturing, and doing it very cost-effectively, that the aftermarket has adopted. In fact, a lot of our submission is based around - we believe that if the aftermarket was leveraged for growth, we could actually harness the spillover skills from the automotive industry.

We haven't focused a lot of our submission on the car industry, because we knew everyone else would be, but certainly we do want to see a sustainable car industry. I guess you have to ask at what cost though, and you also have to ask - just putting cars together, assembling vehicles, is fine. That employs a lot of people, and we've just heard some human stories about the people that are employed by Holden and Toyota and so on, but from our point of view, if you're going to maintain a sustainable OE component base, they have to be diversified, but you also have to look at what the local content value of the vehicles being made in Australia is and, if there's not a lot of local content in the supplier base, then it's a very different industry to the one that we've had in the past.

MR WOODS: But in that respect, if for some reason General Motors and perhaps even Toyota did decide not to continue operations here, how would you get your skilled labour? Again looking at the generic system - ie, the VET sector, the engineering schools of the universities, the industry development programs - are there issues there that, if they were overcome, could in some way go to offset the disadvantage of not having that sort of industry training that the OEMs provide?

MR WEICKHARDT: And perhaps if I just add to that, you said 51 per cent of your members said that their business and investment would continue even if the OEMs weren't here. So perhaps in that regard, how would those people get their skills if they felt they could just continue without the OEMs?

MR CHARITY (AAAA):   It's a good point. We certainly get skills from a lot of different areas, and it's not just the OE. I mean, the OE is very good from an engineering point of view, from a product development point of view and so on, but the aftermarket also has a lot of other skills that OE component suppliers have, and John mentioned that the OE component suppliers are very focused on getting that widget out at the lowest possible cost and in scale, whereas the aftermarket is very strong on distribution, very strong on marketing and branding and diversification and very entrepreneurial in its nature.

I think the industry would be able to overcome, through engagement with the university and training sectors and so on, skill gaps. It wouldn't be ideal. We're not saying anywhere in our submission that we're wanting - I don't think anyone wants the car industry to go and we believe that once it's gone it won't come back, and that certainly will have medium to longer-term implications for our industry.

What we are saying though is that this tunnel vision focus on keeping the car industry and just doing the same thing over and over again is clearly not working and it's actually, we think, hurting our industry and hurting our growth prospects. So we think that a more holistic view at what makes up and who makes up automotive manufacturing in this country could actually assist in our industry growing and taking the next step, diversifying internationally, diversifying in our other product areas and diversifying into other segments.

MR WOODS: Just one last one from me at the moment, and that's to overcome a little confusion. You've said a couple of times that you're not here asking for the same sorts of things that the OE sector is asking for and yet, as I read your submission, you talk about, "The ATS program should be extended to include aftermarket component producers," and you talk about, "The auto industry structural adjustment style programs should be considered," and you're included in it. So I'm a little confused. You do seem to be actually asking to be in the tent getting the goodies but in your submission you're trying to differentiate yourself. Could you just clarify that for me.

MR CHARITY (AAAA): We've done, I guess, a bit of an analysis of what's currently offered from a structural adjustment point of view and we've made comments on whether we think it has some applicability. We also have talked about some other things: an automotive innovation centre or an aftermarket innovation centre which is modelled on a US-style centre which helps companies do all the testing and product development to get their products to the market faster.

I think that the ATS program has been very successful in helping companies to make decisions on investment in new R and D and capital expenditure, and we think that the aftermarket could benefit from that. There are other programs that we haven't recommended that proceed. So there are certainly elements of the current assistance arrangements that we think would benefit the aftermarket, but I'm not sure we're saying, "Just bring us into the tent and let us go and everything will be rosy."

MR WEICKHARDT: Yes. Thank you again for your submission. There are lots of good news stories here, as I read it. Here you've got a growing export-oriented business that's competing in a fiercely competitive environment, as you point out, against lots of low labour-cost countries, and yet your members are making what look like quite respectable profits. So many people would say "hallelujah". You talk about moving up the value chain and differentiating your products and finding niches where you've got competitive advantage.

MR CHARITY (AAAA): Yes.

MR WEICKHARDT: All that is fantastic. I guess where I'm sort of struggling a bit - and it's probably the same as Mike - you then go on to say there's a policy failure here that the aftermarket is excluded from the government support. I know everyone would like some money from the government, but the government doesn't have any money. The money is ours, it's taxpayers' money, and there's a sort of general principle that governments shouldn't hand out money unless, first of all, there's some sort of market failure and, secondly, the benefits exceed the costs. Government programs aren't without cost to both the government and also to the industry, because you've got to comply with them.

MR CHARITY (AAAA): Yes.

MR WEICKHARDT: So the question I've got is: what is the market failure? What is it that's going wrong? This sounds like a terrific success story, where people are getting on and focused on their customers, focused on innovation and differentiation, and they're making money. So why should the government get involved in that?

MR CHARITY (AAAA): Okay. One of the policy failures is that by intervening in a market and only picking one segment of the market, by default you hurt other players in the market. What we're saying - and we've modelled - there's actually a policy gap between where government policy is and our contribution to the industry. So government impact on our industry as part of our modelling had a net negative impact on our industry, so that's first and foremost.

MR WEICKHARDT: I understand you might say it's not a level playing field, but how does that actually hurt your industry?

MR CHARITY (AAAA): Well, you could have a pure aftermarket manufacturer that chooses as a business decision not to deal with the car industry, to go to supply chains externally. They're a local manufacturer, they might be making the same product as an OE supplier, and you've got to understand that there's not this sort of exclusivity in different channels. Most companies or many companies operate across both channels, so companies that produce OE components also compete in the aftermarket, so you have one segment of the industry being supported by government whereas another isn't. So that's a net negative for our industry, but from the broader global environment, our members and manufacturers are highly trade exposed.

We go into quite a lot of detail about the inequities in market access arrangements with many of our trading partners around the world and I guess at the end of the day our manufacturers will make a commercial decision on whether it's justified to maintain their manufacturing operations in Australia. Whilst there are fantastic success stories, and we've certainly highlighted those to try and give you a feel for what the potential of the industry is moving forward, we believe that if the policy environment stays as it is that we will see, slowly but surely, those manufacturers start to move their manufacturing offshore. We've already seen that happen with a number of our major manufacturers. Some of them will close them down altogether and become importers; we've also seen that business model happen.

We think we can sustain a future business model which has Australian manufacturing as a part of it. If the Australian manufacturing goes, I can tell you the aftermarket will still be alive and well in Australia but will be an import and distribution sector, not a manufacturing sector. So our hope is that we can, through some structural support from government, transition our manufacturing industry into something that's sustainable and growing into the future.

MR WEICKHARDT: All right. Thank you.

MR WOODS: We've run out of time. Thank you for the submission. The other issue is the impediments to consolidation and you talk about the Fair Entitlements Guarantee and some of the issues there. We'll follow those up, but if we need any further information, our staff will - - -

MR CHARITY (AAAA): Sure. We're happy to work with your team.

MR WOODS: Particular examples of that - because that in itself has applicability more generally, not just to your sector.

MR CHARITY (AAAA): Sure.

MR WOODS: Thank you. That concludes the morning session. We will be commencing the afternoon session at 12.30 rather than at 1 o'clock. For those who want to grab a quick bite rather than a slower bite, that's the schedule. Thank you very much.

(Luncheon adjournment)

MR WOODS: Thank you, ladies and gentlemen. We will recommence the hearings for this afternoon. Participant Prof Goran Roos, if you could please for the record state your name and the organisation, if any, that you may be representing today.

PROF ROOS: Goran Roos. I am here as a private citizen giving a set of statements which I think need to be heard relative to the automotive industry.

MR WOODS: Thank you very much. Do you have an opening statement you wish to make?

PROF ROOS: Thank you. Firstly, in terms of the theoretical reasoning - so in other words, the supply-side economic rounded reasoning around the automotive industry - I would refer the commission to the excellent submission by Phil Toner that carries all those arguments in some detail, so I will not go into those theoretical arguments.

The first thing I'd like to say, just to set the scene, is that the state Australia is in today, it's substantially better for us to keep the existing automotive industry than it is to lose it. Let me try to ground that argument. The automotive industry is a global industry and it produces around 60 million cars a year, with a total global employment of around eight million. In Australia we produce very few, about 200,000 or so. I rounded the numbers to simple numbers. There are about 15,000 employees in the three OEMs and 45,000 or so in the suppliers. The actual number, of course, is much larger than that and that depends on how you count, but it's somewhere in the vicinity of 200 to 250 thousand and something in the vicinity of 20,000 enterprises.

The automotive industry share of the economy is, as a whole, around about 1 and a half per cent and it's about 14 per cent for manufacturing. This industry is incredibly scale intensive, so to achieve sufficient scale to be profitable is a key challenge in the global industry and that is because of the incredibly high cost of developing new cars. An engine is a billion and a half and the car is very, very large. So the automotive industry globally spends around $A107 billion on R and D, of which 20 per cent globally would be for research and 80 per cent for development.

In Australia it's somewhere around $600 million and it's about 10 per cent for research and 90 per cent for development. This makes up about 40 per cent of all business R and D spendings in Australia. That gives the industry an R and D intensity of about 11 per cent, which is very high. The average for manufacturing is somewhere just under 5, so it's an incredibly high R and D intensive industry. On the global scale you require a plant size today of about 250,000 vehicles per year to have sufficient economies of scale, and this is increasing constantly.

MR WOODS: But that's per plant.

PROF ROOS: That's right.

MR WOODS: Whereas in Australia you were saying we have 200,000 - - -

PROF ROOS: That is correct. We do not have these scales in Australia. That's right. So Australia is not a location that would provide an optimal location, given general costs and the structure of what is a small domestic market. Given the continuous increase in competitiveness in this automotive industry globally, with producers from new car approvals in countries like India and China, the market share of a given model is likely to decrease as the number of available brands increase. At the same time the life span of a given model is likely to decrease, increasing not only the scale pressure but also issues around time to market and zero defect in produced models. A six-month delay in launching a model or a major recall can easily wipe out the profit of a given model in this increasingly competitive landscape. In other words, delays are incredibly expensive in this industry.

Australia is an example of this increased competition, with around 60 models being sold in this very small market, so one can see that the relative unit numbers will be small and this is again likely to increase as a negative direction. All automotive producers need export to achieve sufficient economies of scale and this makes automotive producers highly sensitive to currency movements. If you look, for example, at the Japanese yen, the depreciation of that has in fact saved the production in Japan of the Japanese car producers. Without that it's highly likely - and also there were trends - that a lot of the manufacturing, both of consumer electronic companies in Japan and Japanese car makers would continue to leave the country. Now that has somewhat been reversed due to the Japanese yen issue.

This drive to scale is behind a movement to standardise and mass customise, which is what we call the global platforms in this industry, and this move will further limit the location of production since the same vehicle can be produced in many places and will be produced and exported solely from those places where it makes economic sense. In other words, if you have two plants and one produces a vehicle at a higher cost than the other one, the higher-cost plant will not be allowed to export; the lower-cost plant will be allowed to export. This, of course, is linked also to certain path dependencies, because you invest yourself in and you do certain things. Path dependency, which I'll come back to, is critical in an industry with this level of complexity.

This, of course, is especially true for a small market like Australia. With such a high dependency on export and very small operating margins, it's obvious that currency movements can have a devastating effect on profitability in the short term and, given that the Australian dollar has appreciated around 40 per cent since 2008, it has had an effect, even though over time you adapt to it and so on, so any movements will be negative from a given position. But it's not easy to export from this country when you need to do that. In other words, the ability to export at a profit to contribute to the scale issue is very, very limited, if bordering on non-existent in Australia. In other words, you can summarise so far that Australia is not a location where it makes sense to produce global platforms for export as such, given the present cost situation.

Automotive manufacturing is very capital intensive and this will continue to increase due to increasing complexity, increasing model varieties, mass customisation and shorter product life cycles. If you think back about the complexity of the vehicle you bought 10 years ago compared to the complexity of today, you can see that the present vehicle is substantially more complex at a lower cost as a share of your revenue source. This of course points at the productivity level and I will come back to those.

In Australia there's about 25 cents or so of capital investments for every dollar of labour cost and that is quite a substantial investment and it will continue to increase. That of course means that the operating cost to environment becomes an issue under these circumstances and hence it's important to look at impost costs in terms of taxation, regulation and input costs like labour and material. The corporate tax rates among car-producing countries fall into basically four brackets: around 40 per cent in the US and Japan, around 30 per cent in Australia, France, Germany and India, around 25 per cent in China and the UK, and around 20 per cent in Sweden. So Australia does not have an offsetting advantage on the corporate tax rate.

On the regulatory environment side we can basically divide the regulatory cost between old car-producing countries where the regulatory cost is high, and new car-producing countries where the regulatory cost is low, and again Australia does not have an offsetting advantage on the regulatory cost. On the input side, low labour unit costs and high labour productivity - the latter more important than the former - are key issues for the automotive industry, so productivity improvement is critical.

On the input side, the combination of very high labour unit costs - and they have increased in Australia by around 2 and a half per cent annually over the decade 2000 to 2010 compared to an increase in the UK of around 1 and a half per cent, in France of around 0.5 per cent, in Germany of around zero, in Sweden of around minus 1 per cent, in the US around minus 1.5 per cent, in Japan around minus 3 per cent - it is very clear that the cost level is not going the right way in Australia compared to these competing nations.

Again, look at the very low hourly labour productivity improvements, when

Australia has been around 2 per cent annually over the decade compared to an improvement in the UK of around 3 per cent, in France around 2 and a half, in Germany around 2, in Sweden around 4 and a half per cent, in the US of around 5 and Japan around 3 and a half. So whereas Australia has gone down by minus 2, the other ones have gone up in that sense. That has resulted in an increasingly unfavourable position compared to the competing locations, and this is bad, not only for the industry but also for the country since the wealth we generate is a function of our differential productivity improvements so we have to go faster than the rest.

This means that the automotive industry is the industry with the highest pressure to improve productivity, and this pressure has been around for a long time, and it's only increasing. As a consequence this industry has originated almost all tools and techniques relating to the productivity improvements, and it's the industry that has achieved the highest sustained productivity improvements of any industry, and depending on the study, the company, the definition and so on, the annual productivity improvements in the automotive industry globally sits between 2 and a half per cent and 9 per cent annually, and that's a fantastic number, 9 per cent and - - -

MR WEICKHARDT: Sorry, can I just clarify?

PROF ROOS: Yes.

MR WEICKHARDT: These numbers you're quoting are labour productivity, are they?

PROF ROOS: These are labour productivity.

MR WEICKHARDT: Thank you.

PROF ROOS: That's right - no, let me - sorry. Thank you for the question. Total factor productivity in automotive, total factor productivity.

MR WEICKHARDT: Okay. All the numbers you've quoted are - - -

PROF ROOS: No. The first number sets were labour productivity. This last 2 and a half to 9 per cent annually is total factor productivity.

MR WEICKHARDT: Okay. Because the industry is investing ferocious amounts of capital to automate, so - - -

PROF ROOS: Yes, absolutely, but it needs to sit down. You know, if you think about that, 9 per cent per year is quite an amazing number if you go for the higher area and Australia is benefiting from the access to the automotive industry productivity improvement competence. Actually in my opinion that's one of its core benefits to the country, that we have access to this productivity improvement competence that this industry sits on.

As a consequence, companies linked to the global automotive industry have adopted productivity improvement tools and techniques to a higher extent than generally manufacturing, and I have numbers which I'm not going to go through in that, and from this it follows that the automotive industry is both a source of and a repository of productivity improvement tools, techniques and competence, and this is a core value of it.

The automotive industry has a very high multiplier factor, again depending on the country varying - that's employment multiplier, between 2 and a half in Sweden and about 6 in the highest level, which is in some areas of the US and also in Australia if you look at the numbers. It depends on the economic structure, and a few studies are to be looked at in this scenario, and there are some numbers which I'm happy to supply which gives an example of the establishment of an Alabama plant in the US which gives you exactly the investments, the flow-over effect. There have been detailed studies and I'm happy to provide those numbers to the commission in detail.

MR WOODS: Thank you.

PROF ROOS: So the benefits from the automotive industry can be divided into, economically, corporate tax return, personal income return or salaries, GST returns on discretionary spendings and GST on value added, and I'm not going to go through the numbers, but if you look at those things, it's a not insignificant amount of money. It's in the billions.

Now, the other thing I'd like to say I think as a concluding scenario is something around the economic complexity of a nation. The ability of a country to benefit from a random economic activity, sometimes we occasionally call it "entrepreneurship", is around how many different types of activities are spread throughout that economy. So if you have a very complex country with very many things going on at the same time, if I am an entrepreneur, it's highly likely that I will find a customer and a set of suppliers locally. In other words the local economy can benefit from my activity.

If I sit in a country which only does one thing and it's not what I do, then it's highly unlikely that that country can benefit and I will likely go somewhere else as an entrepreneur. There are a set of measures around economic complexity, and they have been developed by a couple of people at Harvard-MIT, and they have a range to go from, about plus 2.6, give or take, to about minus 2 or so, and the top countries are Japan, Germany, Switzerland and Sweden at about 2 to 1.9, US at 1.4. Australia sits at minus 0.3. That means it has a very low economic complexity.

The contribution factors to high economic complexity is complex and sophisticated manufacturing. They are very, very high numbers, whereas things like growing agricultural products has very low numbers. So if you look at Third World countries, generally speaking they have very low economic complexity because they do things like agriculture, raw materials. They do things like minerals without value adding, and they do a little bit of services related to primary public sector related activities, whereas if you look at sophisticated economies with high economic complexity, you look at Germany where they have every supply chain you can imagine within the economy, and if Australia loses the automotive industry, our economic complexity will be reduced by give or take 10 to 20 per cent, and that means that even if you assume that all the people in that industry will get another job, it is highly unlikely they're going to get a job in a higher productivity industry because we basically don't have any, and that means that they, even if they get another job, will have a lower productivity contribution to the country in its own right, which will continue to drag down its economic complexity. So for the wellbeing of our future it's fundamental that we have these type of complex industries.

So in conclusion, I would say that where we stand as a country at the moment, it is fundamentally important that we retain the automotive industry we have, primarily because we are not ready to lose it from a national standpoint. That was my introductory statement. I am happy to take questions based on that.

MR WOODS: Thank you, Prof Roos, for that statement, and you've made a comment both at the beginning and at the end about the importance of retaining the industry, but then you've added an interesting rider at the back end "because we're not yet ready to lose it". Does that mean that if we were to sit here in 10 years' time and ask you that same question that you might in fact have a different answer?

PROF ROOS: Possibly. I mean, it depends what we have done in the meantime, and how the global economy has developed. But, yes, the answer is I could well have a different answer.

MR WOODS: Okay. So let's then pursue that a little further. What would be required to transform the nature of activity so that to an extent - and I'd be interested in your views on what extent that might be - but to an extent be able to compensate for the eventuality if GM and perhaps also Toyota left, and I ask that question partly because you also presented a conundrum at the front end that minimum efficient size of plant is at 200,000, our total sales are 200,000 of which 70,000 are exported et cetera. So is there some inevitability about the industry going, and therefore what do we need to do so that we are in a better position in 10 years' time?

PROF ROOS: Okay. So let me try to divide it into two questions, if I may.

MR WOODS: Please.

PROF ROOS: The first one relates to the automotive issue. As long as we try to operate in the domain of global standardised platforms, our scale will be too low, and as long as we cannot compensate that by profitable export, our future looks very bleak in that area. If we are able to compensate with export, then we can have production here and achieve a scale level in that area. So there is something about our ability to export profitably which has to deal with relative productivities and price levels and all the normal things. So there is a theoretical issue even in the global platforms, but that is a bleak future generally, with some exceptions to get our export going. But you don't have to operate in that part of the manufacturing industry. There are exceedingly profitable car manufacturers that operate on lower scales. Now, they don't do globally standardised platforms for the mass market. They operate in kind of extreme niches of different types. So in theory one can have one of those.

I have an extremely profitable car manufacturer who produces eight extremely fast and extremely expensive sport cars a year about 30 kilometres from my summer house in Sweden. so you can go and look that up who that might be. They cost the odd million dollars, couple of million dollars apiece. So that's a bit of an extreme one. He only employs about 10 people, so it's not good for employment but, you know, it's one of those things. So you have a whole scale issue, and the world's most profitable car company, which is Porsche, is not known for its enormous scale activities, but they have a different issue. So in other words, the problem we have is that we don't have the boundary conditions to be where we are, you know. The problem is we are where we are. So that's an issue.

The second question relates then to how can we ensure that the economy is not being negatively impacted by a potential exit of a car manufacturer, and that has to do with two things; (1) it has to do with the dependency of the supply chain of these few players. So the lower the dependency of the supply chain, the lower the multiplier impact of course of an OEM leaving. So diversification of the supply chain is critical. Now, that is very easy to say and incredibly difficult to do. A diversification journey takes three to seven years so you can't just do it overnight. You need to find something to diversify into and it has to be likely another global supply chain of some type or nature where your skills are needed.

I mean, we are where we are, but we have not focused on ensuring suitable diversification of the supply chain, nor have those companies done that in their own interests, nor have they focused on linking into global opportunities in other areas. So one of the things we need to do, no matter what, given an automatic consequence of an increasingly globalised platform, which would mean that smaller suppliers would likely be locked out anyway, is to ensure that the diversification activities are started up incredibly urgently and with some force. So that's the issue.

Then of course there is something around: diversifying into what? It's the same thing as: what industry should replace automotive? It's relatively easy if you sit in Sweden and look at Saab and say, "They won't keel over," because we have 250 other global supply chains headquartered in the country, so it doesn't matter. In Australia we only have one basic global supply chain that is fully within the country, and that's automotive. That means that we need to put pressure on other supply chains to emerge, be that faster growth for the mining equipment and technology services area, be that more value adding to food or other types of areas where we have a comparative advantage and can add value. Easy to say, difficult to do. It is still a necessity to do that.

If we have done that seven years from now, then of course our dependency on the large automotive firms will be lower for the economy. All that said, let me ask a different question. Should we be part of the global automotive system? My answer to that is an absolute yes. The reason is that it is the core driver of productivity towards improvements and competence. The question then becomes: are there alternative ways we can be part of that rather than necessarily producing complete cars, and the answer is yes. There are different ways we can do that. We can do a complex subsystem for cars, for which we would have a potential advantage given a closer linkage within the research we do in certain users in universities and the type of industry structure we have, but it does require a different approach to linking into those global supply chains.

MR WOODS: That's helpful.

MR WEICKHARDT: The sort of introductory picture you presented of the global industry is an important backdrop to this. You mentioned the very high fixed costs of this industry, and they're a fact of life, and it's an industry that's got global overcapacity. A high fixed-cost business with overcapacity is not a recipe for making money. Indeed, I think it's true that over the last two or three decades car companies have basically destroyed shareholder value. They haven't made their cost of capital.

In those circumstances, as you say, we are where we are. It was interesting that just before lunch we had the aftermarket component people in talking and they talked about the fact that their businesses tended to try to move up the value chain, tried to find differentiated niche products, and surprise, surprise, they're making money and they're growing and they're exporting.

We are shortly going to be left with two automotive companies and they're both operating on global platforms, and that's an area where you suggested it's going to be extraordinarily hard to make money. So the question is: how much longer should the Australian government try to push a very heavy object up a steep hill with a very sharp stick, a very difficult act to get ready for this point of transition, because it sounds as if we're going to have to continue to defy gravity against all sorts of forces of the global competitive market that we're operating in.

PROF ROOS: There was an old Greek chap who was condemned for life to pushing heavy things up hills. The first thing I'd like to say is that the industry referred to as the accessory providers to the automotive industry is an excellent example of an industry that has adapted, diversified and made itself independent of a given OEM. They can serve whatever comes into the country. So that's exactly what you would want to see as a whole. My hat is off to them. They've done the right thing and, as a consequence of doing that, they are doing well, but I'm sure they also told you that they have to continuously invest to stay in that position and stay relevant, and that's also what you want to see. I think that's number 1. If every - well, "every" is an unrealistic issue, but if the overwhelming majority of the suppliers to the existing OEM were in that position, we wouldn't have an issue. They are not, so we do have an issue in this scenario.

I think it's also important to say that, although the industry - as I totally agree with your statement - has destroyed shareholder value over a period of time - you know, you can do anything with statistics - there are companies that have done exceedingly well. I mean, Porsche, a relatively small company, has acquired the VW group, which is a relatively large company, due to its high level of profitability. So there are variations in the industry.

I'm not going to get into whether your count is per car or in absolute dollars, but on the whole I haven't found yet a country which does not provide some form of government assistance, whatever the euphemistic name, to the automotive industry, and of course they are not stupid. There is a reason for them doing it and the reason is that it makes sense, and it makes sense because of all the other things that the industry provides.

That does not necessarily mean that that's the right thing to do in all countries. There will be different contextual issues and so forth and this, that and the other, but it is very, very clear that the payback returns that are estimated in these scenarios, on a plant-to-plant level frequently - there's a nice table in the submission from the AMWU that outlines those submissions - are based on a return calculation which, exposed, turns out to be rather good.

There are also examples where the government has not provided assistance, and Saab is an example of that, where the government said, "Okay, off you go." You know, they get a short loan, which was secured in the spare parts business. There was zero risk for the taxpayers in that. So you have to have a view, and I think that the view is very much on comparing the cost of supporting versus the cost you incur of not supporting in that scenario. I would claim that at the present moment the cost of support, no matter where it may be in the range that has been discussed, is substantially lower than the cost we have to incur if they would exit now. That of course is something which is an unfortunate situation. If that was not the case, we might be able to have a different discussion. So the question I would say for the country is to position itself in a situation where, the next time this discussion takes place, that is not the case.

MR WOODS: I guess when one looks at history and one starts with the Button car plan, et cetera, there have been many attempts at having the final plan and the transition pathway, and we are where we are. I guess I'm looking for some more concrete guidance on what such a transition plan should actually look like, so that it has some chance of success, because otherwise those high costs of departure may visit us anyway, from what you are saying. I take your view to be that it is inevitable that they will go and therefore it's in our interest to place ourselves in the best position for that situation.

PROF ROOS: The first thing I would say is that it is any government's responsibility to have scenario planning and plan for the worst possible case, or several cases. The American army has a plan somewhere for the invasion by Canada into the US. It doesn't mean it's likely but they still will have it, or as Eisenhower said, "A plan is nothing, planning is everything." So I think I subscribe to all those things.

Let's have a little look at some of the numbers, just to look at the global suppliers to the automotive industry and where they stand and then we can do some comparisons to Australia, which I will allow the individual firms and the Productivity Commission to do. If I look at the revenue growth in the global automotive suppliers from 2005 until now - so estimated 2013 - on an index level it's 45 per cent growth in that period. In other words, each of these average global suppliers has grown by 45 per cent over that period.

MR WOODS: That's in nominal dollars?

PROF ROOS: That is in nominal dollars.

MR WOODS: Yes, thank you.

PROF ROOS: But it's still, you know, not insignificant.

MR WOODS: Absolutely.

PROF ROOS: That period has not been one of high inflation.

MR WOODS: Yes, true.

PROF ROOS: The other one is that the average EBIT margin for these type of companies is around 6 and a half per cent, and it's been stable for the last four years. So it is a reasonably sensible business to be in, not fantastic but not bad in that sense. Return on capital employed hovers at around 12 to 13 per cent, in that region, reasonably stable. So in other words, being a global supplier to the automotive industry in a period that includes the global financial crisis has not been a bad thing.

If we look at the Australian situation, that is not as positive as that. So that, in its own right, indicates for us that we are not on par with the supply industry in this area, and this has to be my estimates. My estimate is you have about a third of the key players below those numbers, you have about a third on them and you may have a third above them. But the difference is, the ones above are not very much above and the ones below are relatively much below on this area. So we have a situation where we need to do, I think, two things for the suppliers, and it's triggered by the exit of one of the OEMs and the remaining two and the change in volume that that entails. Number 1, we need to have a concentration in the industry. In other words, we need to ensure that we don't sit on three if we can sustain two, that that's a given thing. Now, that of course is something that will entail an engagement between the suppliers and the two OEMs, because you want to make sure that it's the best capability that resides, not something else.

Now, that is not made easier by the existing ACCC regulations. So my first recommendation is to have a temporary exemption from the ACCC. They can well have a member at each meeting, that's okay. But a temporary exemption to make sure that these types of dialogues to strengthen the supply chains are happening. That's number 1, so a concentration.

MR WEICKHARDT: Can I just clarify that. We have heard other people make that comment. I mean, I've been part of an industry that went through dramatic rationalisation and the ACCC's general guideline was if the barriers to entry by imports was not high, then they were content to see an industry rationalised to only one player, because the imports would keep the remaining player honest. So is it really the ACCC regulations, or is it that the complexity of engaging lawyers to try to make sure they satisfy the criteria the ACCC would look at, and gain the evidence the ACCC would need to look at about the market, is beyond the sophistication of these component suppliers?

PROF ROOS: Well, I think the ACCC issue is primarily perceived by the two OEMs. They feel, as far as I have understood it, and I may be wrong, that they do not dare sit down in the same room and talk about which of those three people have the highest capability and ought to be the one that they should focus around, rather than allowing a temporary financial situation or something to drive up somebody else who actually doesn't have necessarily the technological capability and so that would happen in a randomised market situation; so I do believe, if nothing else, a clarification to the two OEMs around what they are allowed to do and ensure that they have that ability to partake in an industry concentration that would benefit the system.

MR WEICKHARDT: But aren't you talking about the suppliers rather than the OEMs themselves?

PROF ROOS: No, I think the suppliers need to concentrate, but the OEMs are able to say which of them have the skill need to do so. Because if you look at these things, if you're the three OEMs and you're fighting over something, then you will have different capital equipment, you'll have different capability developments, and you may not be able to make that judgment between yourself and your competitor, which is the most one, whereas the OEMs, who look into the future and see what capabilities are needed for future models and future changes, will be able to have a relatively strong view on which of those players is the one that sits on the capability benefit and that input needs to be had in such a structual change.

MR WEICKHARDT: So you're saying the issue is because it should be OEM-driven - - -

PROF ROOS: Yes.

MR WEICKHARDT: - - - rationalisation of the supplier base that the ACCC - - -

PROF ROOS: Correct, and that's what we've seen in some other countries, where you can compare. If you have a randomised effect, the outcome is actually worse than if you have one where the OEMs have had the discussion about which capabilities are necessary for the future and forced that type of an issue. It is not for the OEM to get an economic benefit per se, it's for them to get the capability benefit in the supply chain; in other words, sustainability.

So I think that is my first recommendation, to enable that to happen and that requires some small changes in the ACCC issues; if nothing else, a clarification. The second one I think is that there is a need for, as I said, the diversification. I would say that if you are a supplier and you have more than 30 per cent of your business to these OEMs, you need to diversify to reach a 30 per cent level, because with a 30 per cent level, you can handle something negative happening, but with more than that, you will find it exceedingly difficult.

For many of these companies, they are fighting to survive on a day-to-day basis. They have no knowledge about what is possible, they don't know what they know, they don't know where they can go. In other words, there's a hand-holding exercise necessary because there is information asymmetry. So in other words, helping them to map out what their key capabilities are, trying to map that towards a new industry - I don't care what it is right away, so whatever it is - and then finding the journey which enables them to get the certification, the capability development, the elite customer involvement, the reference installations, that is a journey of, as I said, three to seven years, and that needs to happen. The very successful automotive companies have already done this. You know, they are already out there doing it.

By the way, when I talk about "automotive supplier", I think it's important to identify that they actually fall in four groups. The first one is the global offshoots, offshoots of global suppliers. We don't need to worry about them. They are doing whatever they do and if something happens, they will be gone as well. The second group are the three or fours under the Australian issue, the top, the middle and the bottom. The bottom may well be lost causes. The top have already done it, so that's fine. So the focus area is the middle bit. That is where we can make a difference, by ensuring that we move them from the middle towards the top area in performance and dependency reduction of the existing OEMs.

MR WOODS: As an observer of the vehicle industry, do you notice a difference in approach between the OEMs here in Australia in terms of their supply relationships and development of diversification strategies, or do they all have a very similar approach?

PROF ROOS: They do not have a similar approach. I think there is a difference that is possible for the commission to read out of the existing submissions in that area.

MR WOODS: Okay. But you would support that conclusion?

PROF ROOS: Yes, I would indeed.

MR WOODS: Thank you.

MR WEICKHARDT: Just going back to the global forces pushing this industry, I mean, it would appear that almost all the global players have moved from higher labour-cost regions to lower labour-cost regions or lower labour-cost countries. In Europe there's a drift to the east. In the US there's a drift to Mexico or to the southern states, and I guess in Asia we've seen a move to China and Thailand and other places. We don't have a low labour-cost environment, nor does Germany of course, but even the Germans have moved plants to the US, the south, and to South Africa and places like that.

Given that situation and your comment that the OEMs have moved into and have made this decision based on their own, I guess, global strategy, have moved into a sort of global commoditised platform, if it was your money, how long would you give for us to get ready for what you're sort of painting as an almost inevitable situation, if that business model continues? If we could attract a Porsche to come and invest here, I think we'd all say hallelujah, we could understand how that could work. But in a commoditised product with global overcapacity and manufacturing elsewhere in low-cost countries, it just doesn't seem to be something that's going to work for Australia very long at all.

PROF ROOS: I think that's a correct conclusion. I mean, if you look at the German situation, I think today - and I may be wrong about the odd percentage - but about 64 per cent of German cars are made outside Germany, and the only German manufacturer that does not operate outside Germany is Porsche. Everybody else operates outside Germany. In the most recent internal tender, because like all global corporations the different factories fight against each other, for the production of I think the recent BMW model, the winner was the South African factory in that zone. So, yes, there is a need to do that.

Now, it's not only an economic argument. There's also other types of arguments like the Chinese occasionally use, where there are reasons about forcing certain activities to happen to benefit the country and then releasing other benefits for the big players. So I think we have to accept that some of it is economics, some of it is other trade-related domain activities.

Again the issue is that as long as we cannot maintain - I mean, look at it this way: Volvo is a relatively small player. It's now a Chinese-owned player, Geely. They sit in Sweden. They produce in Sweden, and at the moment a Volvo factory is being built in China. It will have a volume which is substantially larger than the plant in Sweden. So why is the Swedish plant maintained by the Chinese? The answer is because they are co-located with the world's highest capable cluster on safety-related activity for automotive. So in today's world the most important automotive company in Sweden is not Volvo, it is Autoliv who is the centre company in that enormous cluster. So not only does that cluster require the presence of a factory in order to make the appropriate development issues, it is also one that attracts research. So numerous Chinese researchers have relocated from China to Sweden in order to be where the capability level is, and I think that that leads me into a discussion about how to implement the answer to the question, "Do we want to be part of the automotive industry?" the answer being yes.

So, as I said, Sweden will move to having what will basically over time become a pilot plant for new vehicles but primarily the systems in them, and that pilot plant will benefit the Chinese manufacturer but also forms the basis for the capability of the cluster as a whole to serve the global industry with those safety solutions, and in other words there is a mutual benefit to both of being there, in spite of the fact that it's a small factory and, you know, on other merits might not necessarily survive. So one of those is to ensure that we have here in Australia something that forms a basis for a world-leading cluster in some form of either a sub-activity of an automotive vehicle and platform development and/or around one of those subsystems for a vehicle in this area, and I think there are some opportunities for us to do that. Now, that will require a presence of a factory, but if the value of the cluster presence is high enough, that factory will be allowed to be maintained here to provide the ability and the insourcing of those type of areas because you design primarily for the one that's with you, and secondarily for the ones that are outside because your learnings comes from the first one in this area.

So the economies of learning is one of the concentrating forces. You have the forces that throw things out, which is basically efficiency-driving issues which is the disintermediation, the value chain, the offshoring to lower cost issues. But you also have concentrating forces which bring things back to other locations which are high cost, and they are access to key lead customers, access to key suppliers of core knowledge, access to cluster activities, which provides on average a 14 per cent higher growth rate, 7 per cent higher profitability rate, and a 2 per cent higher productivity improvement rate, and there is a trade-off between those two things. So, yes, the volume of standardised factories will be outsourced to low-cost and close to market issue where you trade off the trade barriers versus the transportation costs versus the production cost obviously, but they will be retained. I mean, there is no way that the German auto manufacturers will close their factories in Germany because if they did that they would lose the closeness to the know-how of this world and all the other clusters that provide such knowledge. What they will do is that once they have that, they will also take advantage for some of their models over a lower cost production area in this scenario. So it's not a simple cost issue; there are many other issues at work in this area.

MR WOODS: Can I suggest to you that one major company has in fact taken the opposite approach of closing its proximate manufacturing plant but retained one of its three research and design facilities, being Ford here in Australia.

PROF ROOS: Yes.

MR WOODS: So how does that strategy mesh with what you've just portrayed elsewhere?

PROF ROOS: Yes, that's an interesting one. I am not privy of course to what the company has decided to do and what the reasoning is, so I cannot comment on that. But what I can say is if I look at some other companies, the fundamental learnings are that if you separate manufacturing from product development or design, you incur a cost because you will have issues around manufacturability and stuff like that. If this happens at the same time as the time dependency of not getting it wrong in time to market and so on increases, I would say that structurally it is very likely that questions will be raised about the sustainability of that activity once that starts to be realised through the system. Actually its capability is not the issue, it is the separation issue between the manufacturing situation and the design and development issue. In complex systems, and automotive is a very complex system, they have to be co-located to ensure that there is almost a walk-across scenario, and if you look at an even more complex scenario, which is trucks, a classic example of that is to look at the Scania trucks. They do not outsource and they do not separate, and they have ensured that all product development design is next to the factory, otherwise they have calculated a 15 per cent cost differential to the negative the moment they separate them.

MR WOODS: All right. Well, we'll have to watch that space and see how it unfolds. Now, you were talking earlier at several points in this conversation about an option being not necessary to do full vehicle assembly, but to sort of focus on one or two modules or systems integration, or parts of vehicles where you could develop an expertise, whether it's a hybrid engine or whatever it might be. Is there a third model which is sort of somewhere between the two, and that a contract car manufacturer could identify some capital opportunities, a skilled workforce et cetera, and find a sustainable business here in Australia?

PROF ROOS: There is. On paper, the principle of manufacturing is a service. In other words, that the remaining OEMs would choose a player and say to them, "You make the cars for both of us, and you make them in this plant," very much what's happened in the sport footwear issue with Nike and Adidas and those type of scenarios where you have a trust, because there has to be trusted party with Chinese walls between the areas, but still have the economies of scale around the plant. In theory that is possible.

It would have to stack up financially and strategically for the player in place, and that space of those type of players basically boils down to two. So it's a relatively straightforward issue who you talk to, and they would have to believe that they could achieve this. Now, given that these players already do those type of services - they produce the BMW X3, the Gelandewagen, the Aston Martins, they produce a number of pick-up versions for GM and Ford in the US and Canada, these type of players - they already do this, and of course they wouldn't be able to do that unless they could achieve a relative cost advantage compared to what the OEM does. So they do know how to produce smaller versions.

Now, the question then becomes would they see Australia as a tactically beneficial and strategically beneficial location, because it would have to be both, and both of these players are European, although from different countries, and they would not come here if they would require a handout. So one would expect them to look very, very carefully on these ones because they have a business model which is not about handouts, but about guaranteed market access of certain things. They operate towards an OEM. They never sell under their own name. So they have a guaranteed volume take-off, and that is what had to be agreed then between the OEMs, such a player, and potentially with the government involved. But, yes, that is a theoretically possible scenario.

MR WOODS: Can we peel back "theoretical" and speculate on whether it might also be achievable, possible, likely, maybe not? Where do you live on that spectrum?

PROF ROOS: If you divide a scale of "unlikely, possible, highly likely", I would say I am somewhat on the lower end of "possible".

MR WEICKHARDT: Okay. Going to your point about the fact that if Australia were to do what Volvo in Sweden have done - that is, to build upon a cluster of some sort of expertise - whilst the Productivity Commission have not been asked to devise a strategy for the auto industry, it would appear tempting to say we have a globally competitive mining industry and mining services industry, we also have a globally competitive agricultural industry, and one instinctively thinks why on earth haven't the Australian car companies focused on making vehicles, whether they be small trucks or SUVs or things of that sort, that would be of great appeal to both the mining industry and the agricultural industry?

The one company that's got closest to that, Ford, with the Territory, have abandoned ship. Why do you think the car companies have not pursued that sort of opportunity here in Australia successfully? The SUV market, even for domestic mums and dads, has grown much more rapidly than the cars that they have focused on themselves.

MR WOODS: Even in that respect, I think HiLux is the second highest-selling vehicle model in Australia.

MR WEICKHARDT: But the Japanese originally, before they got into marketing the LandCruiser globally, trialled the original versions of that in Australia in a tough market which was so far from the rest of the world that, if it went wrong, it wasn't too much of a disaster, but we never seem to have built upon that.

PROF ROOS: I think there are two comments I will make on that. The first one is, the Australian car companies are not Australian and so their decisions are not made here. I think one has to be realistic about how relatively little power the managing directors of the local companies have within the global operations. The local sales here are a very low, single-digit percentage of the global operations, and hence the attention that it deserves on the corporate global board meetings is relatively low and decisions are normally not, I would assume, taken at the board level but delegated one level below and then just reported back and taken for note. That means that we have relatively little impact on what happens in these companies, given that they are not Australian, and it would be up to a local CEO or MD to bring forth, through finding his own resources, a really compelling business case that would make a difference on the global level, and that would have to be a relatively large number to make that work. So even though we could well do with the things that you allude to technically and all that kind of stuff, the structure, the ownership structures of these firms would make that highly unlikely to happen, and this is one of the minor effects of what is known as the headquarter problem.

MR WOODS: Actually, it's interesting in that respect that the aftermarket manufacturers did say that one of their areas of very significant specialisation in fact was four-wheel drive products.

PROF ROOS: Absolutely.

MR WOODS: Whether it's bull bars, shock absorbers, the whole area. So they have picked up exactly that theme - - -

PROF ROOS: Absolutely.

MR WOODS: - - - and said, "This is working here. This is an important base."

PROF ROOS: Correct, and they are Australian companies.

MR WOODS: Yes.

PROF ROOS: Yes, and they do these things. Just to take a case example here, there is one of the global automotive suppliers in Australia who has done a diversification exercise. They have entered into the mining industry with a product that draws on their core capability. The only reason they were allowed to do that was that the local CEO - by the way, who wasn't Australian but who came in and turned the company around - looked and said, "This is a huge opportunity," and he spent a not insignificant amount of time and his personal political capital within the organisation to be allowed to make that.

It took some time, and if it hadn't been for his previous track record, he wouldn't have been allowed to do that. He has now built an incredibly successful business in that area as a second leg, so he is one that will stay, for obvious reasons, but I think that illustrates the problem that if you do not have a historical track record, with personal connections to the senior management, and the political astuteness and the business case and the clarity of vision and the market issue, it's just not going to happen.

MR WEICKHARDT: Just going back to your issue about the complexity of the economy and the fact that the car industry in Australia is an important driver of that, if you look at a country like Switzerland, which you nominated was right up at the top of the scale, to the best of my knowledge they don't have a car industry, so it's possible to have a complex economy without having a car industry.

PROF ROOS: It is indeed. Switzerland, a country of about eight million people, has a manufactured product export that is larger than India's. It has a trade surplus with China that's larger than Australia's, and it's not about chocolate primarily. They have two primary industries. One is pharmaceutical and the other one is machine tools. The core customer for machine tools is the automotive industry, so they are one of the core suppliers of the automotive industry worldwide through their sophisticated machine tools, and machine tools are generally recognised as the most complex of economic systems. It's actually about 50 per cent more complex than pharmaceuticals in its economic complexity impact, so that is one of the reasons it's high up. They do not have an automotive industry of their own, but they are highly interlinked with both the direct automotive industry out of Germany and the sub-supplier systems in Austria to the German automotive industry, plus the fact that they have customers around the world. So the answer is yes and no.

MR WEICKHARDT: I have one final one, if I may.

MR WOODS: Go for it, yes.

MR WEICKHARDT: There are some people who put it to us that the reason that the car industry and the OEMs at the moment are far from viable or sustainable without a lot of government support is that we've had a temporary appreciation of the Australian dollar. If you could be absolutely certain that the Australian dollar was going to go down significantly, I guess you might argue, "Well, there is a justification in trying to ride through this unusual situation." None of us, unfortunately, know what the Australian dollar will do in the future, but do you have a sense of what value to the US dollar or the yen the Australian dollar would have to be for the local industry to be viable at its existing scale with the existing business model?

PROF ROOS: Firstly, I think it's an excellent question and I'd like to divide it into two bits. For manufacturing in Australia for Australian use, the actual exchange rate really doesn't matter as long as it sticks for a time at wherever it is, because you adapt your supply systems to do that. The exchange rate is not important for manufacturing for the domestic market because you globally balance that off. Actually, if you have done that, then if the exchange rate goes down you're actually going to be worse off, so there are some interesting issues around that. The real issue is to look at what the export market price needs to be.

MR WEICKHARDT: Just to clarify that, if you're competing against imported vehicles and your price is determined by that, surely the exchange rate does matter if you're manufacturing to the local market?

PROF ROOS: Yes, but it doesn't matter very much because you can source most of your goods from international suppliers at very low cost, and then your problem is more going to be a transportation issue, so you set yourself up to optimise that system as such. So, yes, it will have an impact but not as large as people may think on that one, on the pure manufacturing for local issue, given that you have a global supply chain that you can play with. It's more an export issue. So you can say what the comparable pricing needs to be in your primary export market and you can work backwards to say, "What does the dollar have to achieve to make that price a competitive price?", whether that is 85 cents or 70 cents or whatever it is. I think the theoretical long-run rate of the exchange ought to be about 70 cents to the dollar, but unfortunately the theory doesn't really apply to reality in many of these things. So the answer is, lower is better for export markets. The exact level depends on the market you're in and who you compete with. On the domestic market, lower is better but on a more marginal basis that on the export market.

If I may add something again - and I'll let it be my final statement - I think that having a low-complexity economy is really, really problematic, because what it means is that we're lacking industrial commons. If you're going to build a high-tech industry, you still need access to firms who can do simple things in that scenario. You need somebody who can bend a bit of metal and do a bit of plastics. If you don't have those, then you can't build a high-tech industry. So the question you have to ask then is: what is it that maintains this industrial commons? There are a few things. You have the mining equipment, technology services industries, you have a bit of the aerospace, a bit of defence, and automotive.

So automotive is the biggest player in maintaining an industrial commons, and that is what we need. If we lose that industrial commons, then even if we want to develop some high-tech industries, we may find it difficult, except in random niches, and that means that we don't get the benefit of agglomeration economics around these high-tech issues, and I think that is worth reflecting as well.

As I said in the beginning, a Third World economic structure of a country does not justify a First World living standard. It means that you have two choices as a country. You either increase your economic structure to become that of a First World economic structure, and in complexity terms that's up to about 1 and a half from the minus 0.3 it is now, or you reduce your wellbeing to the level of a Third World country. If you don't do either of those, you will see the effects in accumulating budget deficits, because you can't raise enough money to pay for what you want and the inability to supply long term the infrastructure, the economics, the education and the pensions that people would want, and that is something that I do not wish for my children if I will have them live here. Thank you.

MR WOODS: My final question: you've been doing some work with some unions and one of the OEMs. Has that been produced as a report and is that report available to the commission?

PROF ROOS: The answer is it has been produced as a report. I am not the owner of that report. The owner is the unions and the OEMs, so you would have to approach them for any permission to access that. I do not have the right to share either the content or the report with you.

MR WOODS: Thank you very much. That concludes today's scheduled hearings. Is there anyone present who wishes to come forward and make an unscheduled presentation to the commission? That being the case, I adjourn today's hearings and we will resume tomorrow in Melbourne.

AT 1.33 PM THE INQUIRY WAS ADJOURNED UNTIL
TUESDAY, 3 DECEMBER 2013