

Submission to the Productivity Commission inquiry into public support for Australia's automotive manufacturing industry

Australia's automotive manufacturing industry has long been the recipient of relatively high levels of Government assistance through tariffs, quantitative import restrictions and direct government payments. It has also been assisted through unique Australian Design Rules and associated restrictions on the private importation of vehicles even if those vehicles meet stringent European, Japanese or North American standards. While these assistance mechanisms in overall magnitude have been reduced over past decades it is unarguable that the Australian automotive industry is placed in an exceptionable position relative to other Australian industries in competing for national resources. The playing field continues to be tilted very much in favour of the local automotive industry at the expense of other Australian industries.

An apparent premise underlying this reference, that high assistance to competing industries in other countries is a justification for high levels of assistance is afforded the Australian industry, is false. Any consideration of the benefits and costs of government assistance must include the impact of both Australian consumers and taxpayers. Foreign subsidies to the production of vehicles exported to Australia (subject to adequate competition among importers) are a **benefit** to Australian consumers. Any attempt to offset access to cheaper imported vehicles is either a direct cost to local consumers (including local industry) or a cost borne by taxpayers if the mechanism used involves direct transfers. Any consideration of the costs and benefits of further Government assistance should involve a consideration of the impact on consumers and taxpayers and the opportunity cost of the resources diverted by virtue of such assistance from other uses.

The domestic economic environment

The recent boom in mining investment has been a key factor in driving the restructuring of Australian industry. These pressures have been transmitted via a strong Australian dollar (AUD) but have been fundamentally caused by the strength of domestic investment relative to domestic savings. To understand this we need to look at some basic national accounting identities. The current account deficit (CAD) is, of course, simultaneously equal to both:

1. Investment minus Savings; and
2. Exports minus Imports (plus net foreign income flows).

The exchange rate is a key price which keeps these two equalities in balance.

In practical terms a huge mining investment boom not able to be fully serviced by an increase in domestic savings will lead to a higher CAD and a higher AUD. The AUD is not overvalued if its value is at a level necessary to facilitate the foreign capital inflow necessary to fund profitable domestic investment over and above domestic savings. A consequence of the investment boom is that imports must rise relative to exports. Consequently, a range of import competing industries and export industries will decline in absolute or relative size as the mining sector expands.

From a national perspective it is only possible to shield certain industries from these adjustment pressures by exacerbating the adjustment pressures being felt by other

industries. This is the context in which further assistance to the motor vehicle industry needs to be assessed. There is no free lunch in industry assistance. To the extent to which the adjustment pressures being faced by the motor vehicle industry are offset by further assistance it will only increase those pressures faced by other industries. Any "saving" of jobs in the motor vehicle industry are likely to be offset in job losses in other industries including for example other manufacturing industries, education and tourism.

The international economic environment

The international motor vehicle industry is characterized by large scale production, overcapacity, a structural shift to countries with wage levels below those expected by Australian workers and extensive subsidies provided by governments. None of these characteristics provide a logical argument for assistance to the local industry. Rather, the rational economic approach would be to take advantage of these factors to ensure that Australian consumers (including local industries) obtained vehicles at the lowest possible prices. It is strongly argued the national interest would be best served by Australians having access to the latest vehicles and most efficient vehicles at the lowest cost. It is more than likely that the overall employment benefits of such a policy would be greater than the loss of jobs in the motor vehicle sector.

Economic efficiency of the local industry

The fact that the Australian motor vehicle industry receives and apparently requires more assistance than almost all other industries is strong evidence that the industry is among the least efficient users of Australian labour and capital. Faced by the inevitable structural adjustment taking place in the Australian economy, what sense does it make to limit structural adjustment for the industry arguable least able to compete?

The Productivity Commission should critically assess claims that the positive externalities associated with the industry are sufficient to offset the large economic costs of the assistance currently afforded the industry. Assistance to the motor vehicle industry has its own negative externalities for other industries, consumers and taxpayers. The negative externalities are no less important to consider than the positive externalities often claimed for the industry.

Another government objective is the improvement of productivity, a subject presumably dear to the heart of the Productivity Commission. The systematic provision of greatest assistance to industries least able to compete makes a complete economic nonsense. The Tariff Board (the very antecedent of the Productivity Commission) pursued its references on the basis of the "compensating tariff" whereby industries got the minimum assistance they needed to survive in the Australian economy. The Tariff Board was replaced in order to get away from needs based assistance and the gross misallocation of national resources which ensued. Government responses to the demands of the motor vehicle industry run the risk of a dangerous return to failed policies.

The terms of reference refer simultaneously to the need for the "the long-term sustainability of the sector" and the "Australian Government's desire to improve the overall performance of the Australian economy". The question is – are both objectives simultaneously achievable?

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