Government of South Australia

SUBMISSION TO THE PRODUCTIVITY COMMISSION

ON THE

REVIEW OF THE AUSTRALIAN AUTOMOTIVE MANUFACTURING INDUSTRY

NOVEMBER 2013

Table of Contents

Executive Summary

The Government of South Australia is committed to an economy which encourages the creation of innovative, outward looking enterprises which collaborate with each other for their mutual benefit. In this way the South Australian economy can best contribute to Australia's economic prosperity.

In March 2013 the Government of South Australia published an Economic Statement. In it we set out South Australia's long term outlook, its challenges and opportunities. We also identified four areas of focus for our economy. One of these areas of focus was advanced manufacturing. Advanced manufacturing is the creation of goods and services which draws on advanced technologies, skills and processes, more innovative products, services and business models and uses excellence in design and marketing.

The South Australian Government chose advanced manufacturing as an area of focus because building a diversified economy increases our resilience in a dynamic global environment. An advanced manufacturing sector creates greater opportunities for our businesses to add value to our natural resources and more broadly shares our economic prosperity.

This necessarily involves the transformation of South Australia's traditional manufacturing sector – transformation which is well underway. While this has seen a substantial reduction in manufacturing employment in recent decades through the internationalisation of the Australian economy, manufacturing production and employment remain a substantial proportion of the South Australian economy.

A significant and strategic element of the manufacturing sector is the automotive manufacturing sector. It is significant because it amounts to a substantial proportion of all manufacturing employment and its loss could mean a number of manufacturing enterprises would no longer be viable. It is strategic because the skills and capabilities of the automotive manufacturing industry are leading edge and passed onto those enterprises which supply to it and to those who access the skills of employees and managers who have worked in it.

Securing the future of the automotive industry is therefore central to South Australia's advanced manufacturing sector, to South Australia and to the nation's economic prosperity. All reasonable steps should therefore be taken to secure the future of the automotive manufacturing industry in Australia.

Over the past decade the competitive environment facing the Australian automotive industry has proved challenging. There are several factors that have undermined the automotive industry's ability to compete within both the domestic and international markets including:

- The sustained appreciation of the Australian dollar against other key currencies;

- Australia being one of the most open automotive markets in the world;
- Foreign tariff and non-tariff barriers preventing reciprocity of market access; and
- The significantly lower level of government assistance provided to the Australian industry compared to its competitors.

These factors have resulted in a decline in market share of locally made vehicles in the domestic market and have impeded efforts to expand production for export.

Recommendation 1

As a matter of urgency the Australian Government pursue improved market access for Australian produced vehicles and automotive components both in multilateral and bilateral spheres.

As a result of the sustained improvement in the terms of trade and growth in average income, the reduced growth in labour productivity evidenced in the period 2000 to 2012 has been masked. However, in the next decade, Australia's terms of trade are expected to decline and labour utilisation rates are also expected to decline (due to an ageing population). As a consequence national income growth may decline to about half a per cent per year by 2022, if productivity remains at the same level as the last decade. A competitive business environment will be critical to lifting productivity.

Like other trade exposed industries in Australia, the Australian automotive industry's capacity to compete is affected by a vast array of 'business environment' issues. A close examination of opportunities to address impediments is warranted.

Recommendation 2

The Australian Government instigate immediate action on relevant policy settings that significantly impact on the ability of Australian industry to compete globally for investment and sales including: skills and training, bilateral and multilateral trade agreements, transport and energy costs, R&D and other microeconomic reform.

The automotive industry is a significant contributor to the Australian economy, with the majority of its activities based within Victoria and South Australia, and is focussed around the three automotive manufacturers – GM Holden, Toyota and Ford. Nationally, the industry produces 225,000 vehicles per year plus a range of automotive components.

The automotive industry has played a major role in the development and growth of the Australian and South Australian economies. According to Burgan and Spoehr[1] in 2013 the total activity contributed by GM Holden, affiliated suppliers and all wage costs are

[1] Burgan, B & Spoehr, J. 2013. *The Contribution of GMH's Elizabeth Operations to the South Australian Economy and Potential Impacts of Closure – Updated Assessment 2013.* Adelaide: Australian Workplace Innovation and Social Research Centre, the University of Adelaide.

estimated to have contributed $0.9 billion to Gross State Product, 9,500 jobs and $53 million per year to the state taxation base.

The Australian automotive industry has developed into a dynamic, innovative and globally integrated supply chain industry. Productivity and quality levels have continued to increase and R&D and innovation have been increasingly recognised as an important contributor to the industry's performance.

The long lead times and substantial capital investment required, specifically for the introduction of new car models (around 5 to 6 years), dictate the need for a degree of certainty in Government policy positions to enable firms time to commit to future investment in the domestic industry.

Recommendation 3

The Australian Government provide policy certainty for the automotive industry to enable it to plan for the long term.

Structural adjustment occurs as part of the normal flows of labour and capital markets – it will be dispersed and, in many cases, difficult to observe. But there will be times when particular individuals, businesses, communities and industries will suffer dislocation, including through job losses and premature obsolescence of capital. These situations are most likely to occur when change is concentrated in areas where there is little diversity in industry and hence few other employment opportunities; and where there is little geographic or occupational mobility of labour.

In addition, in the less favourable economic conditions currently being experienced and forecasted for Australia there is an increased risk that reduced assistance at this time will potentially lead to significant hardship, large dislocation and increased costs of adjustment. Case studies analysing the closure of the MG Rover factory in Birmingham and the Mitsubishi plant in Lonsdale, in southern Adelaide, concur that structural adjustment is easier and less disruptive in a buoyant economy. Displaced workers face fewer obstacles to finding new work when conditions are strong and the demand for labour is high.

If GM Holden were to cease Australian operations and close the Elizabeth plant in 2016, or earlier, the immediate impact is likely to be significantly compounded by concurrent events including: workforce reductions by the Australian Submarine Corporation Pty Ltd following the finalisation of the first of the three air warfare destroyers; and the completion of major State Government funded capital works such as the New Royal Adelaide Hospital and major road infrastructure.

The regional impact of a closure of GM Holden's Australian operations will be further compounded by the high incidence of unemployment and socioeconomic disadvantage in

Adelaide's northern suburbs, particularly in the City of Playford (the site of the GM Holden plant), which has an unemployment rate of 15.5 per cent.

Recommendation 4

Due to the potential scale of contraction and the significant economic and social costs and the regional incidence of these, further reductions in Australian automotive industry assistance should be avoided.

If GM Holden were to withdraw their domestic manufacturing operations, as Ford Motors are scheduled to do in 2016, it would leave Toyota as the sole manufacturer of cars in Australia. This would deprive the industry of economies of scale and further erode the competiveness of automotive component manufacturing, thereby threatening the long-term viability of Toyota's Australian operations.

All three domestic automotive manufacturers and a number of component suppliers are foreign owned, and if all local automotive manufacturing were to cease, it could be expected that head offices will direct investment to other automotive manufacturing countries. At the very best it will take significant time for alternative industries within Australia to attract the levels of investment, establish the skilled workforce and access to new markets to replace that which will be lost.

Recommendation 5

When estimating the degree of economic impact of reductions in industry assistance the Productivity Commission take into account the likelihood that foreign investment will fall.

The automotive industry generates positive spill over benefits and externalities that are vital to a diverse high value manufacturing sector. Auto manufacturing is of critical importance to manufacturing overall, because of its transmission of new technologies and enterprise based innovations, and because these capabilities provide platforms for diversification into high value new manufacturing opportunities.

Automotive production is complex manufacturing as illustrated by the South Australian Government-conducted supply chain mapping exercise to determine the size and concentration of the automotive industry in South Australia and the exposure of associated suppliers in the event of the withdrawal of GM Holden from the domestic market:

- There are 33 Tier 1 companies (where GM Holden and/or the auto industry in general are the firm's core business) in South Australia employing 3,719 people and providing components and services to Holden, Toyota and Ford. These Tier 1 companies have combined revenue of $1.131 billion and supply the three OEMs with support from 1,270 suppliers nationally;

- A further 719 companies employing 28,000 to 32,000 people are estimated to supply a wide range of services and products to the Tier 1 companies— Tier 2, 3 or 4 depending on their location in the supply chain;
- Only 25 per cent of these Tier I companies are sufficiently diversified to continue in the market were domestic car manufacturing to cease; and
- All 719 companies surveyed would be vulnerable, with risks ranging from moderate to severe. The most pessimistic forecast places 6,600 out of 7,700 FTEs at risk.

Without a strong manufacturing base, the economy would become more subject to the volatility of the commodity market and would lose skills and technology that will be costly and time consuming to replace. The automotive manufacturing industry has provided the foundations for critical flow-on capabilities to other sectors including lean manufacturing principles and senior management capabilities and contributes a proportionally greater share to total manufacturing research and development than its share of employment and industry value added.

Government assistance, through the maintenance of tariffs on automotive products (albeit at significantly lower levels) and through the Automotive Transformation Scheme, must be credited for its contribution to a better performing, more efficient sector.

Assistance has contributed in a number of key ways:

- It has allowed structural adjustment within the industry to take place at a realistic and measured pace within a secure policy environment, which has promoted investment, long-term planning, and the adaptation of technology and new management practices;
- It has provided important signals to the automotive industry that Australia continues to be committed to a domestic automotive industry; and
- It has reduced the disparity in attracting investment with its global competitors which continue to receive government support through a variety of mechanisms, both overt and hidden and often on a much broader scale.

Recommendation 6

The Australian Government continue assistance to secure a sustainable automotive industry based on its direct contribution to the economy, the broader economic benefits the industry delivers through input-output linkages as a demanding purchaser, and the significant spill-over benefits generated in such areas as skills development and technology transfer.

Recommendation 7

The Australian Government:

- *continue the Automotive Transformation Scheme;*
- *co-invest in the upfront costs for new vehicle models;*
- *reinstate the $500 million removed from the Automotive Transformation Scheme; and*
- *continue automotive tariffs at current levels.*

The readjustment and resource reallocation required if the automotive industry closes is costly and can carry significant time delays. As the automotive industry is concentrated in Adelaide's northern suburbs (see Appendix A for details), which in turn is heavily dependent on the continued presence of local manufacturing, there is a substantial risk of ongoing long-term unemployment, adverse social consequences, regionalised damage to communities and increased costs to government. This risk is heightened by the profound disadvantage of the City of Playford area – it is in the bottom second percentile of disadvantage for all suburbs in the nation as measured by the SEIFA index. These impacts will be concentrated in those areas of South Australia currently experiencing a high level of economic and social disadvantage.

When determining its options on assistance the Productivity Commission needs to examine the distributional effects and the associated transitional costs of changes and look at both overall national economic welfare as well as the regional impacts.

Walsh and O'Neil (2011) draw a distinction between regional structural adjustment assistance and regional development assistance:

- Structural adjustment assistance seeks to manage the process of change without interfering in the allocation of resources.
- Regional development assistance seeks to influence the allocation of resources integral to the prosperity, vitality and sustainability of the region.

They suggest that structural adjustment is about economic efficiency, whereas regional development assistance encompasses equity considerations and other broader social and political objectives. Those regions, such as Playford and Northern Adelaide, which are disproportionately impacted and already suffering from significant levels of disadvantage, need both.

Programs should be specific and well-targeted. Key issues that should be investigated by the Productivity Commission are the effects on employment, investment, output and income levels in regions where the automotive industry is highly concentrated.

Recommendation 8

The Productivity Commission take into account the need for significant additional targeted assistance for affected businesses, workers and regions, and other costs, in their analysis of any reductions in automotive industry assistance.

Many of the Productivity Commission's past findings and recommendations with respect to structural adjustment and estimated impacts in the comparative static economic modelling have been based on the fundamental assumption that there are few restrictions on the geographic and occupational mobility of individuals.

The variability in levels of unemployment in specific regions, even at times of economic buoyancy would suggest that displaced workers are less spatially mobile than it has previously been assumed and that factors other than wages and labour demand significantly affect an individual's incentive and ability to find work.

The South Australian Government would welcome insights provided by the Commission's current inquiry into Geographic Labour Mobility in informing the estimated impacts and structural adjustment measures being considered in this study.

Recommendation 9

The Productivity Commission take into consideration the degree of geographic and occupational mobility of people employed in the automotive manufacturing industry and industries supplying automotive manufacturing in Australia, when estimating the degree of impact of changes in the automotive industry and formulating its options for potential structural adjustment measures.

In summary, the South Australian Government has some reservations regarding the conventional assumption that, following the closure of a firm or industry activity, resources will be reallocated within the economy to their next best use. The extent to which this can occur in practice, and the time that it may take, will depend on a variety of factors which cannot be convincingly assessed through economic modelling. It cannot be ruled out that the adjustment process imposes very large costs on society and individuals.

Some of these could be permanent losses – for example, capital specific to automotive manufacturing is transferred offshore, or skill deficits force some displaced workers into early retirement, or if periods of unemployment are associated with greater risks of ongoing health problems. Even where they are impacts that resolve themselves in the very long run, their impact may still be very costly and prolonged. Societal costs are likely to be exacerbated if the adjustment occurs in regions where alternative employment opportunities are relatively low and levels of social disadvantage are relatively high, given potential barriers to mobility and threats to the resilience of families and broader communities.

In assessing the case for further support for the automotive sector the Productivity Commission cannot ignore the potentially very large adjustment costs (and potential permanent costs) which may arise from industry closure – or rely on comparative static economic modelling results which do not adequately estimate their scale, timing or distribution.

The Allen Consulting Group[2] report found that despite the long term improvement in the economy the loss of income and associated consumption continues for many years after the collapse of the motor vehicle industry. The discounted present value of the welfare benefits from retention of the industry was estimated to be in the order of $21.5 billion.

The South Australian Government considers the appropriate basis for a decision by the Australian Government regarding support for the automotive industry should be the use of an economic evaluation. Namely, assessing whether the net present value of the benefits from supporting the sector outweigh the net present value of the costs of that support, taking full account of the avoided costs associated with industry closure.

> ***Recommendation 10***
>
> *The Productivity Commission assess whether the net present value of the benefits from supporting the automotive industry outweigh the net present value of the costs of that support, taking full account of the avoided costs associated with industry closure.*

It is the view of the South Australian Government that consistent Government support for the automotive industry has ensured Australia is recognised as a low sovereign risk nation with institutional stability and policy certainty. Our low risk standing internationally benefits all Australian industries and creates a highly competitive and attractive investment climate which can increasingly contribute to the economic wellbeing of the nation.

[2] Allen Consulting, 2013, *The Strategic Role of the Australian Automotive Manufacturing Industry*, http://www.acilallen.com.au/cms_files/FCAI_26September2013.pdf

1. Introduction

The Productivity Commission has been asked to "quantify the costs and benefits, including at the economy-wide and regional level, of existing and alternative assistance mechanisms". In view of the potentially very large adjustment costs (and potential ongoing costs) which may arise from firm closure and industry contraction, economic impact analysis must be comprehensive to adequately estimate their scale and nature.

As noted by the Productivity Commission:

> *Assistance to the industry is now much lower than in the past. As a consequence, the purely 'allocative' efficiency gains that would ensue from further assistance reductions are likely to be small and 'dynamic' and other considerations assume greater significance.* [3]

The South Australian Government has some reservations regarding the conventional assumption that, following the closure of a firm or industry activity, resources will be reallocated within the economy to their next best use. The extent to which this can occur in practice, and the time that it may take, will depend on a variety of factors which cannot be convincingly assessed through a comparative static economic impact analysis.

It cannot be ruled out that the adjustment process imposes very large costs on society and individuals. Some of these could be permanent losses – for example if skill deficits force some displaced workers into early retirement, or if periods of unemployment are associated with greater risks of ongoing health problems. Even where there are impacts that resolve themselves in the very long run, their impact may still be very costly and prolonged. Societal costs are likely to be exacerbated if the adjustment occurs in regions where alternative labour market opportunities are relatively low and levels of social disadvantage are relatively high, given potential barriers to mobility and threats to the resilience of families and broader communities.

The impacts of downsizing and closures during economic downturns are quantitatively and qualitatively different to those that take place during periods of growth and relatively low unemployment. For example the prevalence of long-term unemployment amongst manufacturing workers is very high as a consequence of firm closures or downsizing during economic downturns. The scale and focus of interventions to manage and minimize the negative impacts of significant change and shocks should consider the economic and labour market conditions that prevail at the time.

Regions with a high dependency on mass manufacturing have proven to be particularly vulnerable to large-scale downsizing and firm closures over the last 20 years[4]. During

[3] Productivity Commission, 2002, *Review of the Automotive Assistance Inquiry Report*

[4] Spoehr, J and Shanahan, M. 1994. "Alternatives to retrenchment : job retention and structural adjustment in a regional economy", *Centre for Labour Studies*, University of Adelaide.

periods of economic decline those experiencing retrenchment are much more likely to become long-term unemployed (unemployed for 12 months or more). During the recessions of the early 1980s and 1990s, retrenchments in South Australia increased sharply from 23,000 in 1988 to 48,000 in 1992[5]. Around one in three of these job losses were concentrated in manufacturing. Retrenchment as a proportion of unemployment in South Australia doubled during the height of the 1990s recession[6].

The Allen Consulting Group[7] report found that despite the long term improvement in the economy the loss of income and associated consumption continues for many years after the collapse of the motor vehicle industry. The discounted net present value of the welfare losses were estimated to be in the order of $21.5 billion.

Consequently the South Australian Government is of the view that when both the tangible and intangible costs are taken account of, the decision to withdraw all assistance from the automotive industry may not be in Australia's best economic and social interests.

It is the view of the South Australian Government that the Productivity Commission should fully assess the economic and social costs of alternative assistance arrangements for the industry, particularly within directly affected communities, through the use of economic evaluation. Namely, assessing whether the net present value of the benefits from supporting the sector outweigh the net present value of the costs of that support, taking full account of the avoided costs associated with industry closure. Appropriate sensitivity analysis should also be applied to all key assumptions that critically impact on the magnitude and timing of the stream of benefits and costs assessed.

Economic evaluation is a widely used tool in economics for organising information to aid decisions about the allocation of resources and assessing whether a particular program is a sound investment of public funds. An economic evaluation is concerned with incremental changes – that is, effects that would not have occurred in the absence of the project or policy and provides an estimate of the size of the net social benefits[8] (i.e. social benefits minus social costs) associated with a program.

While it may not be possible to value some of these benefits it is still important that a qualitative assessment be provided. In situations where costs exceed benefits and many (significant) benefits cannot be quantified, a threshold approach can be used.

---

[5] ibid
[6] ibid
[7] Allen Consulting, 2013, *The Strategic Role of the Australian Automotive Manufacturing Industry*, http://www.acilallen.com.au/cms_files/FCAI_26September2013.pdf
[8] Benefits and costs are 'social' rather than private or individual, as they are measured irrespective of the people to whom they accrue and they are not confined to specific market transactions (eg inclusion of environmental impacts).

The following chapters in the South Australian submission will further explore these costs by examining the structure of the industry, its contribution to the State and regional economies and the factors that have influenced its competitiveness and productivity, including past State funded assistance.

2. Importance of the Automotive Industry

The global automotive manufacturing industry is one of the largest manufacturing sectors in the world and is subject to rapid change and broader macroeconomic trends. While this industry has historically been a key activity of advanced industrial nations, and has been used as a means of industrialisation by many economies, the industry is now investing significantly in emerging economies, especially Asia and Eastern Europe.

The automotive industry is a significant contributor to the Australian economy, with the bulk of its activities based within Victoria and South Australia, and focused around the three passenger motor vehicle manufacturers – GM Holden, Toyota and Ford. Nationally the industry directly employs around 50,000 people, of which around 17,000 work for Ford, GM Holden and Toyota, and in 2011-12 contributed $5.4 billion of Industry Value Added to Australia's economy.[9]

The industry produced in excess of 220,000 passenger motor vehicles in 2012,[10] [11] down from 408,000 vehicles in 2004. In 2012, 39 per cent of vehicles produced were exported and 61 per cent produced for the domestic market.

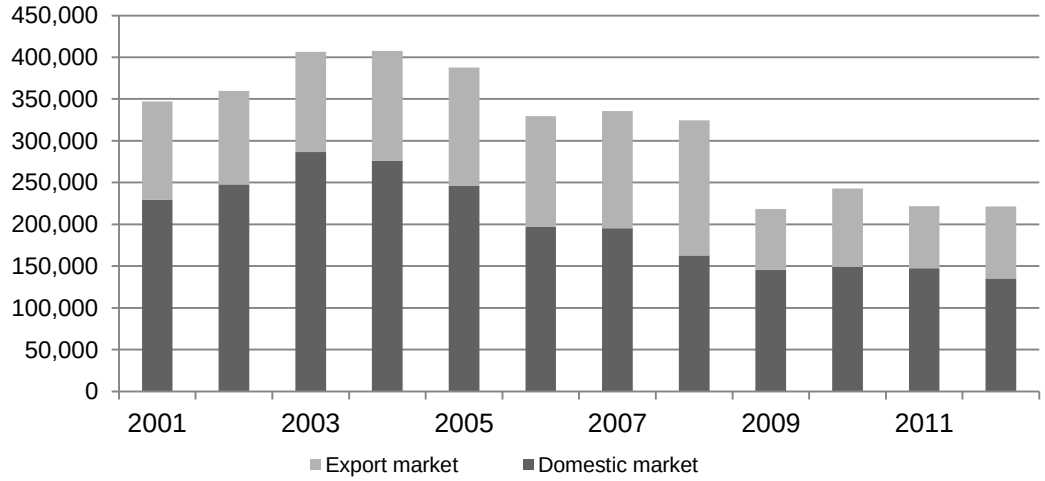
The industry has undergone significant structural change. Nissan closed in 1992 and Mitsubishi ceased its domestic operations in 2008. If GM Holden were to withdraw their domestic manufacturing operations, as Ford Motors are scheduled to do in 2016, it would leave Toyota as the sole manufacturer of cars in Australia. This would deprive the industry of the economies of scale it can already attain, further erode the industry's competiveness and substantially threaten Toyota's long term viability and that of the automotive components sector.

[9] Department of Industry, 2013, *About the Automotive Industry,* http://www.innovation.gov.au/industry/automotive/Pages/AbouttheAutomotiveIndustry.aspx

[10] Department of Industry, Production Volume of Australian-made Vehicles, 2002-2012 (units), http://www.innovation.gov.au/industry/automotive/Statistics/Pages/AutomotiveDataCardTextDescription.aspx#1

[11] Allen Consulting, 2013, *The Strategic Role of the Australian Automotive Manufacturing Industry*

Figure 1: Production of vehicles in Australia



Source: Key Automotive Statistics 2001-2011. 2012 figures based on industry estimates12

The Allen Consulting Group conducted economic modelling based on the assumption that if GM Holden were to withdraw from the domestic market, it would lead to the subsequent withdrawal of Toyota. The analysis suggests that the following would also occur:

- Australia's GDP would be $7.3 billion smaller (in today's dollars) by 2018.
- Billions in foreign direct investment would cease. Head offices overseas would direct investment to other automotive manufacturing countries, not to other industries in Australia.
- The economies of Adelaide and Melbourne would be devastated with Gross Regional Product (GRP) contracted by 0.9 per cent and 1.4 per cent respectively and it is likely GRP will be lower than current levels until the end of 2031, while employment for the two cities could fall by around 1.5 per cent. [13]

In addition to the three passenger motor vehicle manufacturers, the industry also includes hundreds of component manufacturers, ranging from small Australian producers to companies that are also subsidiaries of very large multinationals.

The Australian automotive industry has developed into a dynamic, innovative and globally integrated supply chain industry. Productivity and quality levels have continued to increase and R&D and innovation has been increasingly recognised as an important contributor to the industry's performance. This has provided the foundations for the automotive manufacturing industry to drive innovation and provide critical flow-on capabilities to other sectors including lean manufacturing principles and senior management capabilities.

[13] Allen Consulting, The Strategic Role of the Australian Automotive Manufacturing Industry

In this sense the automotive industry plays an integral part in developing and maintaining the essential skills and technology base that drives modern industrial economies. Only 13 nations, including Australia, can integrate all of the technology and resources to manufacture a car from concept to production. The spill-over benefits, or positive externalities, include the following:

- Technology transfer – As multinational automotive companies invest in Australia they bring new or improved technology. The process is two-way: technology developed in Australia also finds its way into the global industry through parent companies. This results in increased international competitiveness in the domestic industry but also can provide Australian branding to developments transferred out.

- Research and development – The automotive industry is a large source of research and development activity. New developments in components, manufacturing techniques, design and development processes sourced from the automotive industry have application elsewhere. In the case of components companies, for instance, transferability may be as close as the adjacent workshop serving another industry sector, such as defence or food processing.

- New product development – while increasing export opportunities, new product development also provides the consumer with vehicles that are, amongst other things, safer, more fuel efficient, and produce reduced levels of emissions, all of which have benefits to the broader community. The car industry is one of the few industries in Australia to deliver a reduction in CO2 emissions well above the Australian Government's overall target of 5 per cent by 2020.[14] Both product improvements and their associated developments in production techniques are transferable across industries and find application in other industries. Once transferred domestically, these deliver greater international competitiveness across the economy.

- Skills transfer – The automotive industry supports a growing pool of highly skilled people available to other manufacturing industries.

The Productivity Commission has concluded that:

> *While there can be no dispute that the automotive industry generates significant spillovers, quantifying their precise extent is well-nigh impossible.* [15]

[14] Federal Chamber of Automotive Industries, *2012 Annual Report,* http://www.fcai.com.au/library/publication//fcai_ar_2012_web_2.pdf
[15] Productivity Commission, 2002, *Review of Automotive Assistance*, http://www.pc.gov.au/__data/assets/pdf_file/0003/25284/auto.pdf, p.XXIII

2.1 Manufacturing in South Australia

In March 2013 the Government of South Australia published an Economic Statement. In it we set out South Australia's long term outlook, its challenges and opportunities. We also identified four areas of focus for our economy. One of these areas of focus was advanced manufacturing. Advanced manufacturing is the creation of goods and services which draws on advanced technologies, skills and processes, more innovative products, services and business models and uses excellence in design and marketing.

The South Australian Government chose advanced manufacturing as an area of focus because building a diversified economy increases our resilience in a dynamic global environment. Manufacturing has helped diversify the South Australian economy away from its historical agricultural base and has delivered relatively high productivity levels compared with other industries. For every job in manufacturing 2.8 jobs are supported elsewhere in the economy.[16]

An advanced manufacturing sector creates greater opportunities for our businesses to add value to our natural resources and more broadly shares our economic prosperity. This necessarily involves the transformation of South Australia's traditional manufacturing sector – transformation which is well underway. While this has seen a substantial reduction in manufacturing employment in recent decades through the internationalisation of the Australian economy, manufacturing production and employment remain a substantial proportion of the South Australian economy. The South Australian economy is more reliant on manufacturing than Australia as a whole. In South Australia manufacturing accounts for 10 per cent of GSP,[17] while nationally it accounts for approximately 7 per cent of GDP.[18]

A significant and strategic element of the manufacturing sector is the automotive manufacturing sector. It is significant because it amounts to a substantial proportion of all manufacturing employment and its loss could mean a number of manufacturing enterprises would no longer be viable. It is strategic because the skills and capabilities of the automotive manufacturing industry are leading edge and passed onto those enterprises which supply to it and to those who access the skills of employees and managers who have worked in it.

Securing the future of the automotive industry is therefore central to South Australia's advanced manufacturing sector, to South Australia and to the nation's economic prosperity. All reasonable steps should therefore be taken to secure the future of the automotive manufacturing industry in Australia. Given the degree of global supply chain integration and connectivity of firms in the industry, it would be almost impossible to rebuild if it is lost.

---

[16] Government of South Australia (2012), *Manufacturing Works: a strategy for driving high-value manufacturing in South Australia*

[17] ibid

[18] DIISRT, Key Facts Australian Industry 2011-12, http://www.innovation.gov.au/Industry/ReportsandStudies/Documents/KeyFactsAustralianIndustry.pdf

2.2 GM Holden

The GM Holden plant is located in Elizabeth Vale in the City of Playford and produces 335 vehicles per day. It currently employs around 1,700 people.

GM Holden's Elizabeth facility builds 45 variants, on two architectures running on the same assembly line, including six body styles and nine variants in left hand and right hand drive. Commodore includes short and long wheelbase sedan, wagon and utility variants, in right and left hand drive. It produces the Cruze sedan and hatch models in right hand drive.

The 124 hectare site includes a press shop and metal assembly operation, body hardware facility, paint shop, plastics operation, body assembly and vehicle assembly line, in addition to an administration building and warehousing and storage. As part of the VE Commodore program, the facility underwent a $500 million upgrade program in 2006, with upgrades to the general assembly and body shop in particular.

Recent economic modelling[19] indicates that in 2013 GM Holden's operations supports 4,300 direct jobs and supports $400 million of value added a year at GM Holden and its first round (Tier 1) suppliers. When production induced impacts are added these figures rise to 6,500 jobs and $0.62 billion a year in value added. The same analysis estimates that the total economic activity lost in the state because of GM Holden's closure (without the accompanying adjustment) would be in the order of $1.24 billion of GSP, 13,200 jobs and $72 million per year lost from South Australia's taxation base.[20]

The South Australian Government conducted a supply chain mapping exercise to determine the size and concentration of the automotive industry in South Australia and the exposure of associated suppliers in the event of the withdrawal of GM Holden from the domestic market. Its conclusion was that "if Holden and Toyota cease their operations in Australia it is predicted to have a catastrophic impact on component and parts suppliers." Appendix A provides further detail.

2.3 City of Playford

In its 2002 Review of Automotive Assistance, the Productivity Commission stated that were a vehicle manufacturer or one of the major component producers to exit, the knock-on effects for other producers as well for employees, their families and the regional economies concerned, would most likely be significant.[21] Australia now faces the prospect of all vehicle manufacturers and many component producers exiting within a short timeframe. Our best assessment of such a shock is that the effects would be extremely damaging on GM Holden

[19] Burgan, B & Spoehr, J. 2013. *The Contribution of GMH Elizabeth Operations to the South Australian Economy and the Potential Impacts of Closure – Updated Assessment 2013.* Adelaide: Australian Workplace Innovation and Social Research Centre

[20] *Ibid*

[21] Productivity Commission, 2002, *Review of Automotive Assistance*, http://www.pc.gov.au/__data/assets/pdf_file/0003/25284/auto.pdf, p.XXXIX

workers and their families, communities in which the industry is located and the State as whole.

Northern Adelaide is poorly positioned to withstand a major economic impact of the magnitude of the closure of GM Holden and major suppliers. The City of Playford is located in Adelaide's outer northern suburbs, about 30 kilometres from the Adelaide CBD. It covers an area of 346 km^2 and comprises suburbs such as Elizabeth, Craigmore, Smithfield, Davoren Park and Munno Para. In 2012 the population of Playford was slightly more than 83,000 people.

It is an area that has a strong heritage in manufacturing, which has been in structural decline for a number of years. A recent Productivity Commission staff paper identified the decline of manufacturing as a national trend, noting that demand for unskilled workers has been falling.

> *Structural change resulting from technological change and increased international competition has resulted in a shift in employment away from traditional industries such as manufacturing and agriculture to service industries.* [22]

Socio-Economic Indexes for Areas (SEIFA) is a product developed by the ABS that ranks areas in Australia according to relative socio-economic advantage and disadvantage. The City of Playford's overall SEIFA index of Disadvantage rate of 871 ranks it as the fourth most disadvantaged Local Government Area (LGA) in SA, after the APY Lands, Peterborough District Council and Coober Pedy District Council. The Elizabeth and Smithfield areas are in the bottom 2 per cent of disadvantage among Australian suburbs.

Playford is one of ten LGAs identified in the 2012-2013 Budget under the Department of Human Services' *Better Future Local Solutions* initiative to receive funding for measures to address disadvantage.

The Australian Government also recognised the special circumstances that exist in the City of Playford, when it chose the region as one of five trial sites for income management; it recognised that more is needed than the standard approaches. Furthermore Playford was designated as a site for locate of one of three Australian Government Suburban Jobs Program projects in recognition of the need to accelerate efforts in the region to increase the employment and skills base of the region. This has resulted in the establishment of the Stretton Centre which has recently released a detailed profile of the City of Playford which we refer the Commission to for evidence of the difficult conditions experienced in the area. A summary of key findings is provided in Table 1.

[22] McLachlan et al, 2013, *Deep and Persistent Disadvantage in Australia*

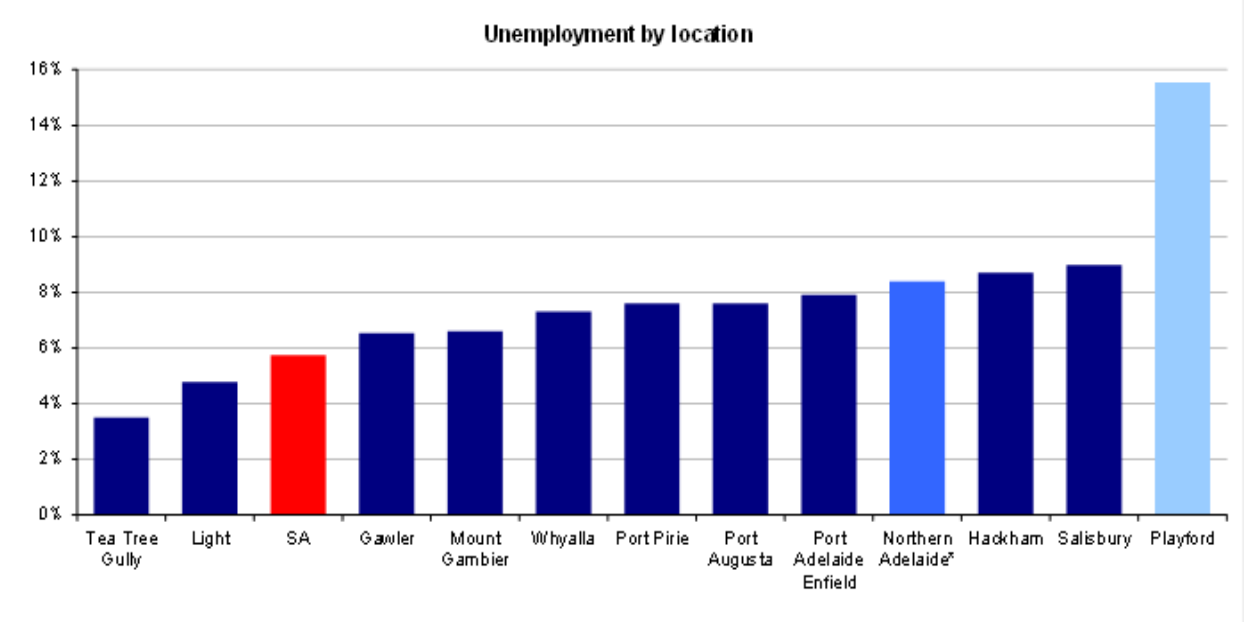
Table 1: City of Playford – Key Statistics

	City of Playford	Greater Adelaide
Education		
Persons (aged 15 years and over) completed Year 12 high school	30.7%	47.1%
Persons with post-school qualification	23.8%	36.3%
Labour force participation & occupation		
Youth (15 to 24 years) unemployment	18.3%	11.8%
Manufacturing jobs (as a proportion of jobs in the area)	20.6%	10.7%
Income & benefits		
Median household weekly income	$896	$1,106
Personal weekly income below the poverty line	32.4%	28.2%
Persons (aged 16 to 64 years) receiving unemployment benefit for more than 180 days	6.4%	3.0%
Persons (aged 15 to 24 years) receiving unemployment benefit	12.3%	5.6%
Female (aged 15 to 54 years) sole parent pensioners	12.6%	5.6%
Centrelink concession holders	35.3%	25.8%
Health		
Premature mortality (ASR per 100,000)*	347.8	251.9
Delayed purchasing prescribed medication because couldn't afford it*(ASR per 100)	14.5	10.9
Circulatory system disease (ASR per 100)	20.0	18.5
Population & community		
Growth (total) between 2006 and 2011 Census	13.0%	6.2%
Persons aged 15-24 years	15.4%	13.7%
Aboriginal population	3.0%	1.3%
Sole parent families	17.4%	11.0%
Dwellings rented	36.7%	28.3%
Dwellings without motor car	12.6%	9.7%
No internet connection	26.9%	22.5%

Source: Hordacre, Spoehr, Crossman and Barbaro (2013) City of Playford – socio-demographic, employment and education profile, Stretton Centre, Australian Workplace Innovation and Social Research Centre, The University of Adelaide.

Unemployment in the Playford area is very high compared to the rest of South Australia and the nation as Figure 2 indicates. Closure of GM Holden would further compound this problem. About 31 per cent of the GM Holden workers hold a Certificate III or IV qualification, although it is possible that this is an underestimate because of skills acquired while on the job. Given the educational profile of the GM Holden workers employed in Elizabeth, current unemployment rate and large contribution of manufacturing to the Northern Adelaide economy, there is a high probability that any exit of GM Holden from the domestic market and the likely subsequent collapse of the component manufacturing industry would lead to a significant rise in unemployment in the region.

Figure 2



Source: DEEWR Small Area labour markets, June 2013

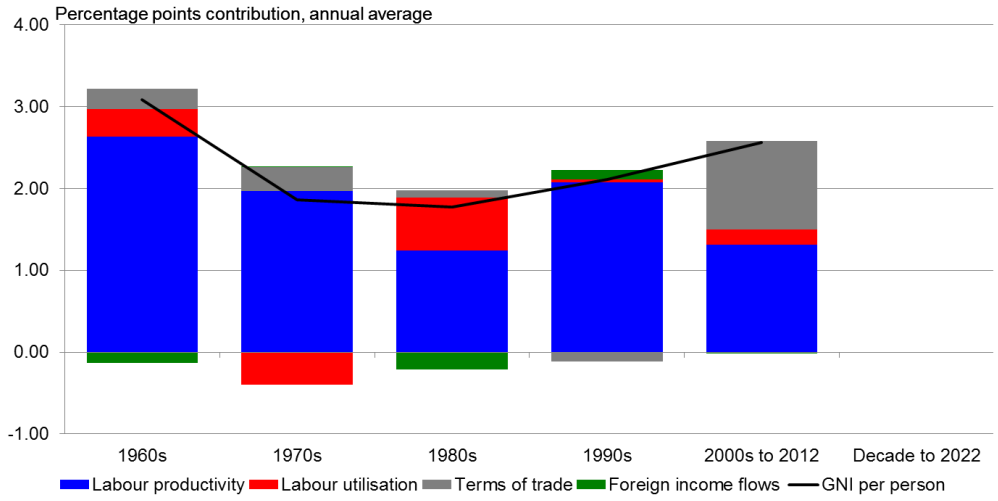
3. Competitiveness and Productivity

Over the past decade the competitive environment facing the Australian automotive industry has proved challenging. The appreciation in the value of the Australia dollar has significantly eroded the competitiveness of the industry, making export of cars more difficult and imports of componentry and fully assembled vehicles more attractive. In this environment the market share of Australian made cars continues to be eroded. This takes place in a context where trade protection in Australia has declined, but significant barriers to entry to many of Australia's trading partners remain in place. Australia's place in global automotive manufacturing has come under significant pressure over the last decade as manufacturers weigh up the relative benefits of national assistance regimes. Not only firms, but governments and nations compete for the benefits of a domestic automotive manufacturing industry.

A persistently high Australian dollar is currently a source of considerable competitive disadvantage which we believe government policy needs to consider in the formulation of an assistance package for the automotive industry. There are of course many other factors which impact on the automotive sector's ability to compete in both domestic and international markets. Broad systemic problems impact on all our industries but particularly affect our trade exposed sectors and our appeal as a destination for foreign direct investment. Whilst acknowledging that many of the challenges facing the industry are a reflection of changes in other countries, some of these challenges such as the high Australian dollar are able to be influenced by the Australian Government.

As a result of the sustained improvement in the terms of trade and growth in average income, the productivity decline evidenced in the period 2000 to 2012 has been masked. However, in the next decade, Australia's terms of trade are expected to decline and labour utilisation rates are also expected to decline (due to an ageing population), so national income growth will decline to about half a per cent per year by 2022, if productivity remains at the same level as the last decade and key trade exposed industries are not able to compete internationally, as shown in the figure below.

Figure 3: Contributions to growth in average incomes



Source: ABS cat no. 5204.0, unpublished ABS data and Treasury Calculations

Source: Trans-Tasman Business Circle Productivity Series dinner, Peter Harris Chairman Productivity Commission, 18 September 2013

3.2 Competitiveness and Productivity of the Australian Automotive Industry

In their 2013 report on Australia's Competitiveness for CPA Australia, Enright and Petty assessed the factors affecting the competitiveness of the motor vehicle manufacturing industry and rated them in terms of importance as drivers of competitiveness and performance against competitors. The three issues that were most important and where Australia was assessed as most competitive were:

- Transportation Infrastructure;
- Scientific and Technical Skills; and
- Government Freedom from Corruption.

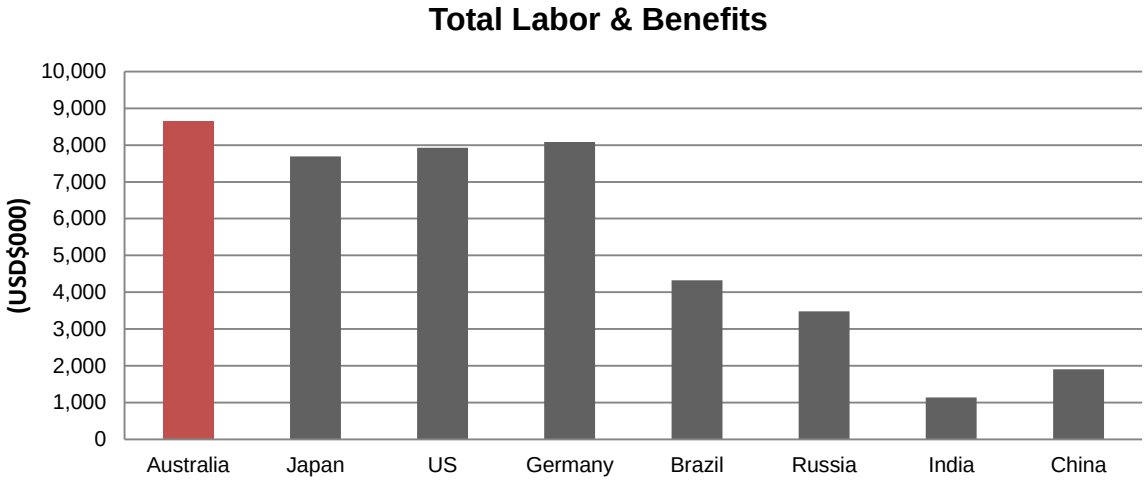
Issues that were rated most important and where Australia is least competitive included:

- Staff and Other Employment Costs;
- Size of Local Market Demand;
- Foreign Trade, Market Access and Tariff Policy;
- Exchange Rates; and
- Competition Policy.

KPMG (2012b) compares business costs and other competitiveness factors for automotive parts manufacturing (a tier 2/3 supplier) in 14 countries including Australia, United States, Japan, Russia, China, India, Germany and Brazil. Australia was ranked 8th most expensive in terms of overall costs for the countries listed above. Comparisons for the three key location-

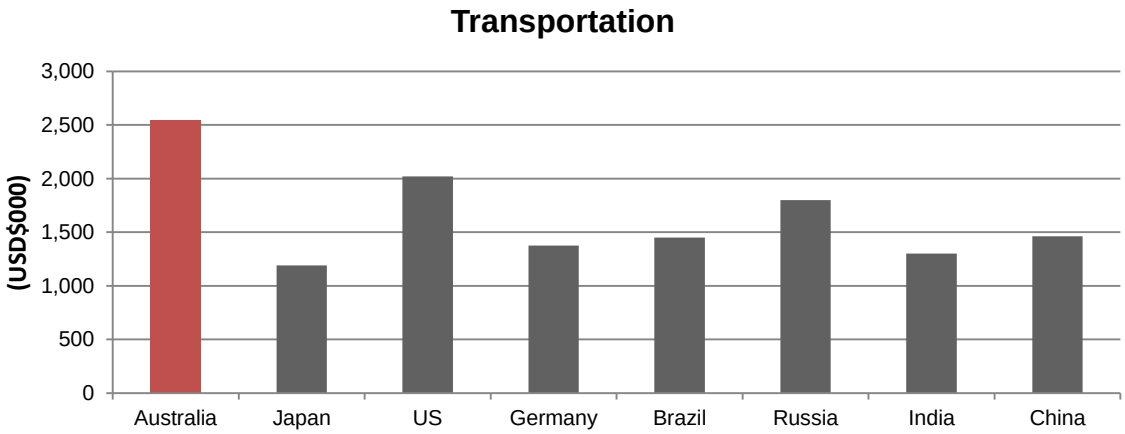
sensitive costs - labour, utilities (electricity and gas) and transportation, are provided in the figures following.

Figure 4



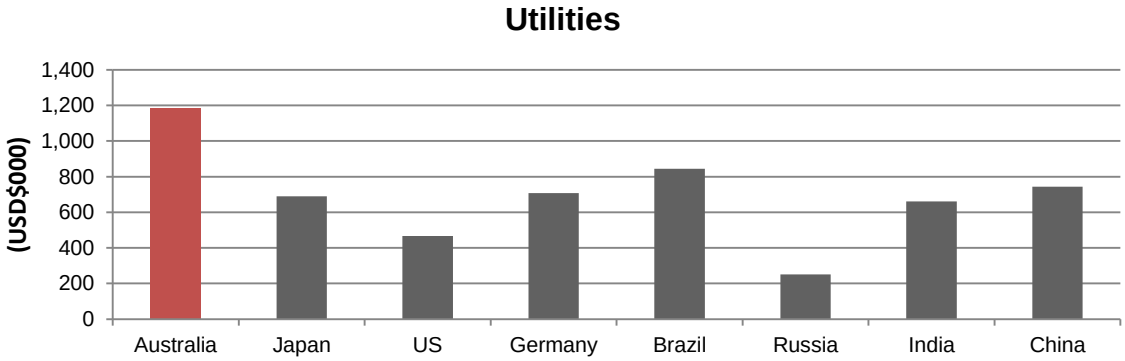
Source: KPMG Competitive Alternatives Cost Model Detailed Comparison Report

Figure 5



Source: KPMG Competitive Alternatives Cost Model Detailed Comparison Report

Figure 6:

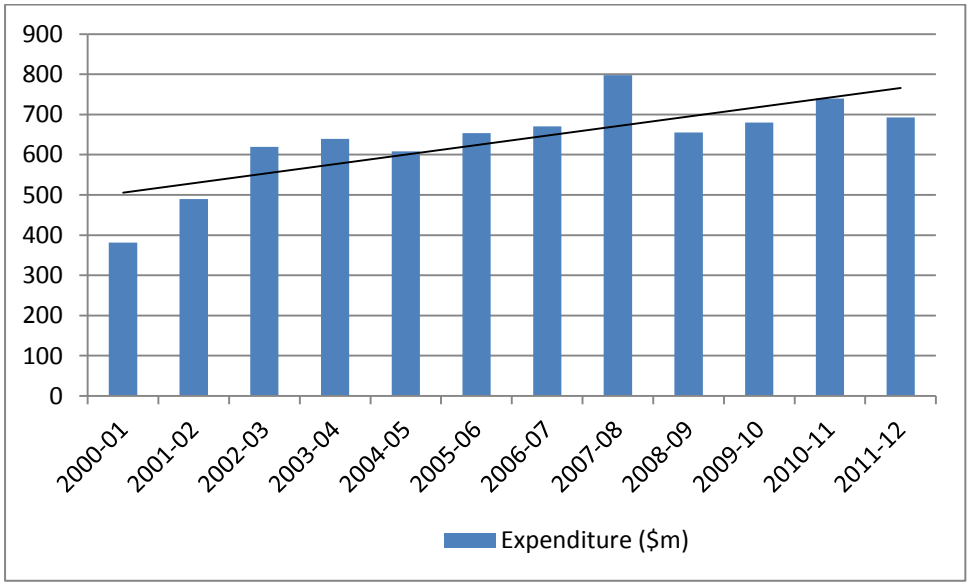


Source: KPMG Competitive Alternatives Cost Model Detailed Comparison Report

The automotive industry has continued to be a key contributor of R&D investment for the manufacturing sector. The industry accounts for around 15 per cent of R&D undertaken by the manufacturing sector compared to its employment and industry valued added share of approximately 9 per cent.[23] This indicates that it is contributing a greater than proportional share to total manufacturing R&D.

As depicted in Figure 7, industry R&D expenditure has exhibited a general upward trend over the last decade – especially in light of falling revenues and declining employment – and in 2011-12 was worth $693 million.

Figure 7: Automotive Industry Business R&D Expenditure ($m)



Source: Australian Bureau of Statistics, Research and Experimental Development: Businesses 2011-12 Cat. 8104.0

Expressed as the number of vehicles produced per employee, productivity has increased in the period since 2002 (see Table 1), continuing the trend that was established during the early to mid-1990s.

It is not surprising that automotive employment largely exhibits a downward trend as the industry has endeavoured to improve its competitiveness and productivity by adopting new labour-saving technologies. Motor vehicle production per employee over the last 20 years has increased by just over 70 per cent.

This has also, in many cases, positively contributed to Australian-made cars being price competitive (in the domestic market) on a number of purchase and whole-of-life ownership measures.[24] Australia manufactures small, medium and large vehicles with fuel efficient and environmentally friendly engine options. The local industry also made significant

[23] Australian Bureau of Statistics, 2013, *Research and Experimental Development: Businesses 2011-12 Cat. 8104.0*

[24] Federal Chamber of Automotive Industries, 2011, *Australian Automotive Industry Report*

contributions with CO_2 emissions of locally made cars reducing by 8.8 per cent, which more than doubled the industry average.[25]

Table 2: Labour Productivity

Year	Production volume	Production value ($b)	Employment	Ave vehicles / employee	Ave production value / employee
2002	359,751	8	20,914	17.2	$382,041
2003	406,668	8.5	23,119	17.6	$366,798
2004	407,537	8.9	22,485	18.1	$395,375
2005	387,821	8.4	20,908	18.5	$402,238
2006	329,428	7.8	18,390	17.9	$426,319
2007	335,625	7.7	17,751	18.9	$435,947
2008	324,684	7.5	14,728	22	$508,596
2009	218,258	5.6	12,294	17.8	$459,216
2010	242,941	6.2	13,035	18.6	$473,103
2011	221,957	5.3	12,354	18	$430,937
2012	221,254	5.4	11,053	20.0	$486,022

Source: Department of Industry, Key Automotive Statistics 2012, Reference Table 20 p14

For example, low speed collision replacement parts costs and proximity to authorised dealer networks favours Australian produced vehicles. Following a low speed collision domestically manufactured vehicles are often cheaper, quicker and more convenient to repair. Table 2 following shows a suite of 12 vehicle parts that would typically be replaced (either one or all parts, depending on severity) in a low speed frontal vehicle collision. As the table highlights, the parts for Australian made vehicles are generally lower individually or collectively in cost than an equivalent imported vehicle.

The three Australian car manufacturers have also responded to demand for cleaner and more fuel efficient vehicles by adding new models with hybrid, LPG and diesel engines, along with the addition of the four cylinder Holden Cruze and Ford Falcon. E85 (Ethanol blend) 'renewable fuel' capability and cylinder deactivation technology has also been embraced on certain Australian made models.

A testament to the quality of vehicle produced by the Australian automotive industry is provided in Text Box 1.

[25] Federal Chamber of Automotive Industries, *2012 Annual Report,* http://www.fcai.com.au/library/publication//fcai_ar_2012_web_2.pdf

TEXT BOX 1: Quality Australian Made Cars

Even in the face of intense competition from low-cost international manufacturers, Holden is disproving the myth of the supposedly inferior build quality of local car manufacturers with the high quality of its new models.

In a side-by-side review of the 2013 Holden Calais V and the Mercedes-Benz E250 (a premium sedan from one of the most distinguished car manufacturers in the world), the Holden compared favourably, particularly considering it retails for less than half the price of theE250. From *CarAdvice*:

> *"For just under $50,000, though, the Holden Calais V is arguably a more astounding car. It serves as a reminder that if manufacturing closes in this country, we lose with it the only car left to affordably blend space, dynamics, style and features to near-Merc levels."*

Technical specifications		
	Holden Calais	**Mercedes-Benz E250**
Price	$46,490	$ 96,400
Engine	3.6L V6	2.0L V4 turbo
Power	210kW	155kW
Torque	350Nm at 2800rpm	350Nm at 1200-4000rpm
Transmission	6-speed automatic	7-speed automatic

In a further demonstration of the quality of Holden's cars, the Holden SV6 Commodore, made in Australia for over 35 years, was the only locally-built winner at the Australian Best Car Awards on November 19.

On a 'winners' list dominated by imported vehicles, the iconic Australian-built Holden Commodore stood alone, winning the prize for best large vehicle under $60,000.

Table 3: Cost of low collision vehicle parts

	Current Passenger Vehicle Type							
Parts	Holden VEII Omega 2012	JHII Cruze Equip 1.4 2012	Holden Captiva CGII 2012	SZ Ford Territory TX 2012	Subaru MY13 Forester XT 2012	Toyota Camry Altise 2012	Toyota Prius 3 Hybrid 2012	Toyota Corolla Ascent 2012
Front Bumper Cover	$350.00	$450.00	$415.00	$378.16	$523.13	$253.38	$323.32	$367.83
Front Bar Reinforcement	$139.00	$280.00	$500.00	$248.31	$288.11	$154.32	$253.59	$305.23
RH Headlamp	$335.00	$335.00	$390.00	$396.08	$808.96	$176.57	$737.51	$822.69
RH Front Guard	$320.00	$300.00	$320.00	$324.14	$464.55	$210.80	S412.32	$605.36
RH Front Guard Liner	$69.50	$69.50	$64.50	$37.33	$110.28	$43.02	$108.95	$108.60
LH Headlamp	$335.00	$335.00	$390.00	$396.08	$808.96	$176.57	$737.51	$822.69
LH Front Guard	$320.00	$300.00	$310.00	$324.14	$464.55	$210.80	S412.32	$605.36
LH Front Guard Liner	$69.50	$69.50	$64.50	$37.33	$110.28	$43.73	$108.95	$108.60
Front Grille	$191.00	$287.00	$438.75	$140.46	$341.38	$118.34	$166.99	$412.46
Bonnet	$585.00	$640.00	$710.00	$700.99	$1,158.18	$480.86	$423.35	$569.88
Radiator	$390.00	$400.00	$555.00	$205.60	$672.38	$233.30	$519.24	$537.46
Air Condition Condensor	$390.00	$615.00	$720.00	$281.40	$465.41	$180.90	$413.19	$547.62
TOTAL COST	**$3,494**	**$4,081**	**$4,878**	**$3,470**	**$6,216**	**$2,282**	**$3,792**	**$5,814**
	All Pricing based on Recommended List Price ex. GST							

Source: Fleet SA

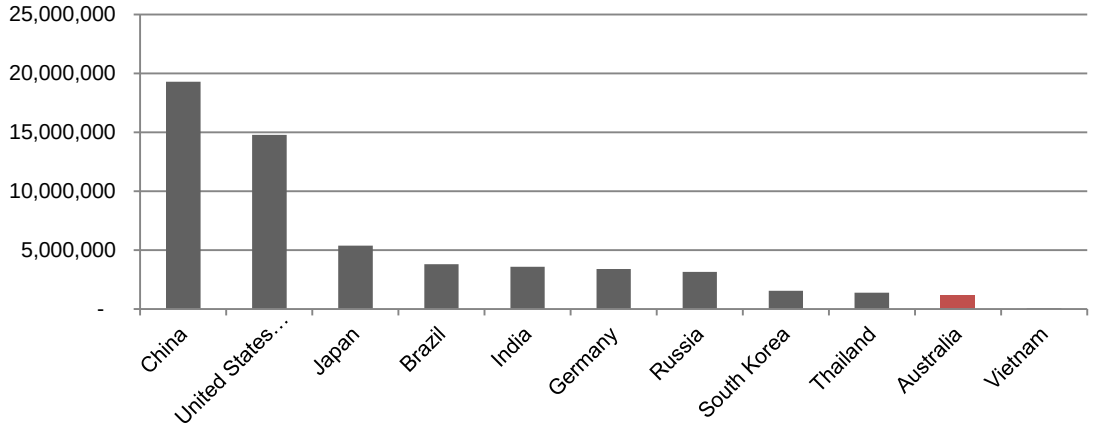
3.2.1 Domestic Market

Although the Australian passenger vehicle market is much smaller than in the United States, Europe or China (see Figure 8), it is an attractive market in terms of value with sales of more than one million vehicles per year generating revenue in excess of $30 billion.[26]

Domestic demand for imported and locally produced vehicles has steadily increased over the past decade, with 1,049,902 light motor vehicle sales in 2007 rising to 1,112,032 sales in 2012 (see Table 4 below). This represents an increase in demand of around 6 per cent during this period.

[26] Motor Vehicle Manufacturing in Australia 2012, IBISWorld Industry Report C2811, as presented in FAPM, *Discussion Paper – Stimulating the Australian Automotive Industry*, 2013.

Figure 8: International vehicle sales 2012



Source: International Organization of Motor Vehicle Manufacturers, http://oica.net/category/sales-statistics/

Demand growth, high exchange rates and tariff reductions have all contributed to making the Australian market more attractive to vehicle importers and the Australian automotive market becoming, without question, one of the most competitive in the world:

- Australia 67 brands competing for 1.1 million sales
- United Kingdom 54 brands competing for 2.3 million sales
- United States 51 brands competing for 12 million sales

As a result the sale of locally produced vehicles has been declining and now account for 13 per cent (or 140,000) of all vehicles sold, down from 20 per cent just six years ago.[27]

Table 4: Composition of Domestic Automotive market by source of vehicle

Year	Sales of Locally Made Vehicles	Per cent of Total Market	Sales of Imported Vehicles	Per cent of Total Market
2007	200,000	19.05	849,000	80.95
2008	171,000	16.9	841,000	83.1
2009	148,000	15.8	790,000	84.2
2010	146,000	14.1	889,000	85.9
2011	142,000	14.1	866,000	85.9
2012	140,000	12.6	972,000	87.4

Source: Department of Innovation, "Automotive Industry Data Card September 2013"

The Government fleet market currently accounts for around 15 per cent of the total sales each year of Australian-produced vehicles. Fleet demand for Australian made vehicles assists in maintaining volumes within the local industry, as well as fostering competition between local car companies.

[27] Australian Automotive Intelligence, *Yearbook 2012*, as presented in Federation of Automotive Products Manufacturers, *Discussion Paper – Stimulating the Australian Automotive Industry*, 2013

However Government fleet procurement has also contributed to the decrease in domestic sales. In 2012, Governments, including Australian, State, Territory and Local, procured 54,121 vehicles, down from 101,326 in 2004. Nearly all of the decrease in sales was in the purchase of locally made vehicles such that in 2012 33 per cent were domestically produced, a significant decrease from 2004 levels of 66 per cent. The level of import purchases has remained stable, with the exception of local government, which has actually increased its proportion of imported fleet vehicles. See Table 5 following.

Victoria, South Australia and the Australian Government all have existing procurement policies that require purchase of locally manufactured vehicles.

Table 5: Annual Government Fleet Sales

		2004	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Australian	Imported	3577	4039	4656	3678	3782	3594	2548	3234
	Australian	9734	10483	7349	3770	2931	2262	1774	2672
	Total	**13311**	**14522**	**12005**	**7448**	**6713**	**5856**	**4322**	**5906**
State/Territory	Imported	23269	23561	25901	25056	29593	24496	30356	25897
	Australian	41550	31851	25561	22858	16887	14973	15558	14897
	Total	**64819**	**55412**	**51462**	**47914**	**46480**	**39469**	**45914**	**40794**
Local	Imported	7861	7518	8423	10697	12246	12747	11791	10962
	Australian	15335	11605	8198	6805	5029	3429	2834	2203
	Total	**23196**	**19123**	**16621**	**17502**	**17275**	**16176**	**14625**	**13165**
Total Australian Government Fleet Sales		101326	89057	80088	72864	70468	61501	64861	59865

Source: Federal Chamber of Automotive Industries data – 9 May 2013.

Despite this, Australian built cars continue to feature strongly in the Top 10 vehicle sales in the domestic market (* denotes vehicle built in Australia) and have been consistent and dominant performers in the large and medium car market.

Table 6: Top 10 vehicle sales in the Australian market

Toyota Corolla	3,861		**Toyota Camry***	**2,251**
Mazda 3	3,613		Ford Ranger	2,027
Holden Commodore*	**3,315**		Nissan Navara	1,969
Toyota Hilux	3,172		VW Golf	1,967
Hyundai i30	2,379		**Holden Cruze***	1,923

Source: FCAI*, VFACTS October 2013*

3.2.2 Trade Policy, market access and tariffs

The ability of the Australian automotive industry to win export orders has been and will continue to be hampered by trade protection measures in key markets, largely created by a lack of progress in some areas in market access gains through Asia Pacific Economic Cooperation (APEC), bilateral trade negotiations and World Trade Organisation (WTO) processes.

Australia has committed through the WTO to keep tariffs on motor vehicles below 15-40 per cent (range depends on purpose).[28] Australia's vehicle tariffs are set below the maximum allowed by the WTO with a reduction in January 2010 from 10 per cent to 5 per cent.

Australia's approach to industry and trade policy, in particular the pursuit of unilateral reductions in trade barriers, has contributed to an increasingly uneven playing field for Australia's car manufacturing sector. Of the 87 per cent of vehicles imported, approximately 21 per cent attract no tariff and the remaining imports attract a 5 per cent tariff. This degree of market access is not reciprocated by many of our trading partners, including those with which Australia maintains Free Trade Agreements (FTAs).

For example, while the Thailand-Australia FTA has seen a substantial reduction in tariffs, it has not prevented Thailand erecting non-tariff barriers:

> *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).* [29]

In the current regulatory environment a locally made vehicle such as the Territory attracts an excise which pushes its cost to almost AUD$100,000 in Thailand. Without a change to the current arrangement, Ford Australia's continued attempts to enter the Thai market are "pointless".[30]

On 18 April 2005, Australia and China agreed to negotiate a FTA. The 19th round of Australia-China FTA negotiations was held in Beijing on 4-6 June 2013. While recognising that negotiations are complex and cover an array of issues including agricultural tariffs and quotas, manufactured goods, services, temporary entry of people and foreign investment; the lack of progress to date places significant limitations on the ability of the Australian automotive industry to access some of the fastest growing markets in the world.

---

[28] DFAT (2013) SCHEDULE I – AUSTRALIA PART 1: MOST-FAVOURED-NATION TARIFF SECTION II - Other Products (tariff id 8703), http://www.dfat.gov.au/trade/negotiations/schedule/schedule.pdf, accessed 22/7/2013.

[29] Australian Industry Group (2010) *Australian Industry Group submission to PC Bilateral and Regional Trade Agreements*

[30] Park, B. 7 October 2013. "Ford's Thai Territory exports labelled 'pointless'", *GoAuto*, http://www.goauto.com.au/mellor/mellor.nsf/story2/9E6635979F3906FACA257BFD0014F7E9

Australia is also currently engaged in nine FTA negotiations: five bilateral FTA negotiations (with China, Japan, Korea, India and Indonesia) and four multilateral FTA negotiations.

Australia has seven FTAs currently in force with New Zealand, Singapore, Thailand, the USA, Chile, the Association of South East Asian Nations (ASEAN) (with New Zealand) and Malaysia. The countries covered by these FTAs account for 28 per cent of Australia's total trade.

3.2.3 Exchange Rates

Like any trade exposed sector, the exchange rate plays an important part in the profitability of the automotive industry. The high Australian dollar has hurt Australian vehicle manufacturing by making vehicle imports more competitive (offset to some extent by sourcing of cheaper component imports) and making it difficult to remain competitive in the global market.

The so-called 'Dutch Disease' refers to the adverse effects through real exchange rate appreciation that the mining boom can have on various export and import-competing industries. A Canadian study[31] estimated that the due to the Dutch disease phenomenon and exchange rate developments between 2002 and 2007, between 33 and 39 per cent of manufacturing employment was lost.

There is a potential that in the medium to long term, the exchange rate may fall back to levels experienced just prior to the Global Financial Crisis. This could render some of the current challenges as temporary and strengthens the argument for short to medium term support for the industry to provide foundations for longer term sustainability.

Between 2010 and early 2013 the Australian dollar regularly traded at historical levels above parity with the United States dollar compounding the impact of the 2010 tariff reduction.

In its May 2002 submission[32] the South Australian Government raised serious concerns about the capacity of the Australian automotive industry to absorb the effects of a rise in the value of the Australian dollar relative to other currencies. The inopportune timing of simultaneous cut in tariff rates and the high exchange rate level have further compromised the sector's ability to maintain its local market share and compete in international markets.

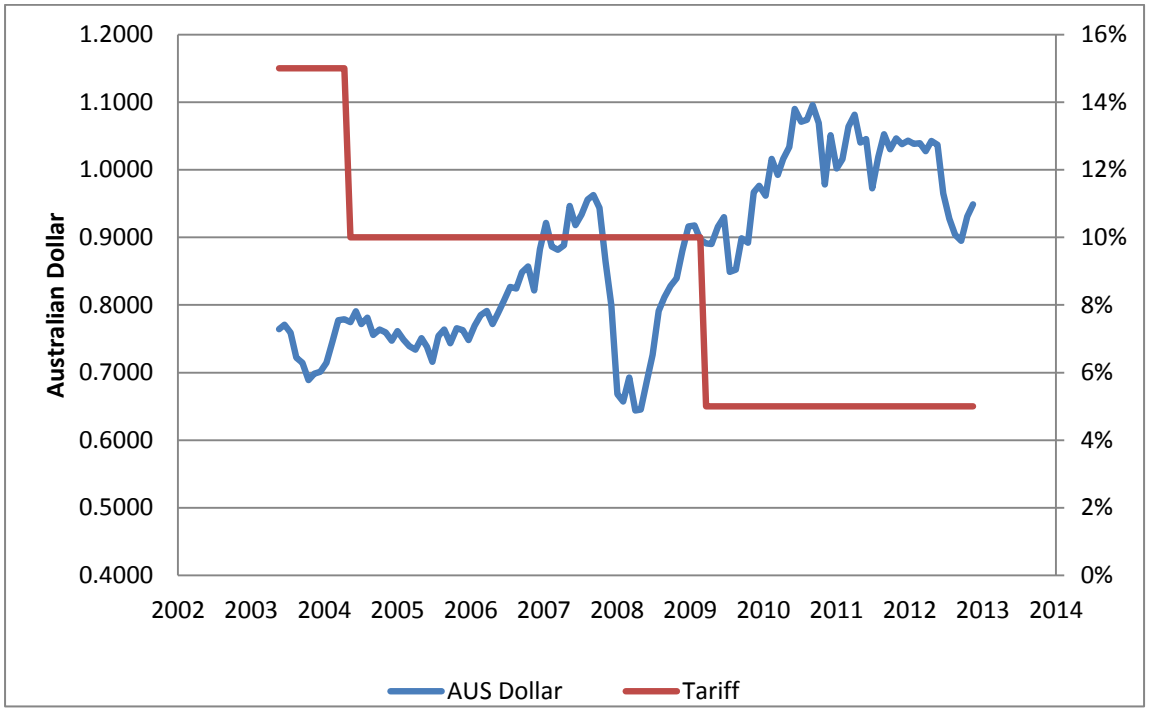
The Australian Government, in its budget, also projected terms of trade to decline by a total of 20 per cent over a 15-year period, settling around their 2005-06 level. Over the projection period, the exchange rate is assumed to move in line with the long-term historical relationship between the terms of trade and the real effective exchange rate. The

[31] Beine, M, Bos, C and Coulombe, S. 2012. "Does the Canadian economy suffer from Dutch disease?", Resource and Energy Economics, 34(4), pp-468-492

[32] SA Government, 2002, *SA Submission to the Productivity Commission on Post 2005 Assistance Arrangements for the Automotive Manufacturing Sector*

terms of trade projections imply a fall in the real exchange rate of 0.9 per cent per annum over the projection period.

Figure 9: Australian Dollar and Tariffs



Source: Reserve Bank of Australia

The projected return of the Australian dollar to a historical mean – below parity with the USD – would positively contribute to the sector's competitive position and a more sustainable industry in the longer term. If the dollar remains high then it would be prudent for the Australian Government to ensure that levels of assistance to the industry take account of this competitive disadvantage.

3.2.4 Industry assistance

The global automotive industry is characterised by subsidisation, protection and assistance. The extent of assistance is unknown - countries are not renowned for publicising assistance measures and much information is deemed commercial-in-confidence. However assistance can be broadly categorised into three groupings:

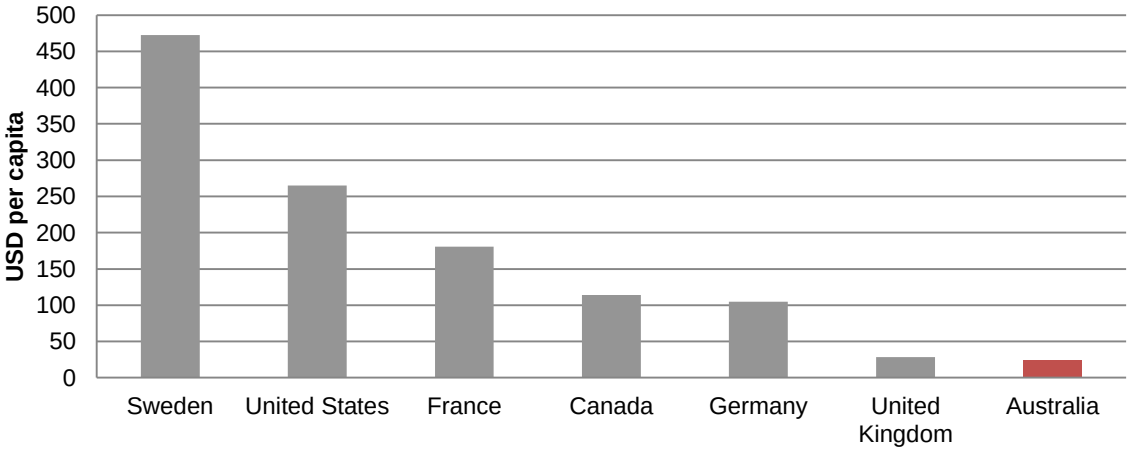
- protection from imports in the form of tariffs and non-tariff barriers to trade;
- investment attraction incentives; and
- measures to build industry capability, including innovation capability.

In their February 2002 report, the Allen Consulting Group and Deloitte examined assistance measures in eleven[33] comparator overseas countries. The report divided the countries into two categories, developed and developing countries. A conclusion of the report was that:

- developed nations have started to move away from offering their domestic industries protection from foreign imports and towards providing investment attraction incentives ("co-investment") and assistance to build innovation capability (such as R&D incentives and subsidised training), although Japan is the exception to this rule; and
- developing countries tend to have higher barriers to trade than developed countries and also provide significant incentives to attract foreign investment. [34]

The Sapere group (Davey 2011) compared the level of budgetary assistance provided to the automotive industry in 2008-09 and found that the level of direct budgetary assistance provided to the Australian sector was quite low, at around USD18 per person. However it should be noted that it is very likely that assistance levels to some nations during the period assessed was temporarily boosted by their response to the global financial crisis.

Figure 10: Budgetary assistance for the automotive industry 2008-9, USD per capita



Source: Davey (2011), adjusted for recent exchange rates.

3.2.5 Policy Environment

Australia has historically been recognised as a low sovereign risk nation with a record of stable and generally sound policy-making, creating an environment where businesses have a high degree of certainty that their investments will not be subject to inconsistent and poor government decision making. However, domestic manufacturers have cited some recent policy decisions that potentially threaten this reputation.

[33] Germany, Japan, USA, Canada, Sweden, UK, Republic of Korea, Malaysia, Thailand, Poland, South Africa.
[34] The Allen Consulting Group & Deloitte Touche Tohmatsu 2002, *Benchmarking the Automotive Industry Policy Environment – Report to the Federal Chamber of Automotive Industries and the Federation of Automotive Products Manufacturers*, February.

The frequency of the changes, the lack of industry consultation and the level of impost on industry all threaten the industry's competitiveness and lead to confusion and uncertainty for the industry. It also damages global perceptions of Australia as a destination for foreign direct investment and future investment decisions.

Examples of policy settings that remain uncertain or have unexpectedly changed and have reduced the investment appeal of the automotive industry are briefly outlined below.

CO_2 Emissions Standards

The previous Australian Government determined that mandatory carbon dioxide (CO_2) emissions standards will apply to new light vehicles less than 3.5 tonnes from 2015. The policy proposed average mandatory emission targets of 190 grams per kilometre (g/km) by 2015 and 155 g/km by 2024, representing cuts of 14 per cent and 30 per cent on 2008 levels respectively.

In a submission to the Australian Government, GM Holden supported the adoption of the standards in the original policy proposal. The lack of firm timelines for finalising mandatory carbon dioxide emissions targets for new light vehicles and potential shift to a higher emissions reduction target would impose major technical challenges for the industry as well as significant compliance costs.

Green Car Innovation Fund

In 2009 the Green Car Innovation Fund (GCIF) was initiated to help enhance the research and development and commercialisation of Australian technologies that significantly reduce fuel consumption and/or greenhouse gas emissions of passenger motor vehicles.

Across the Australian automotive industry, a total of 17 GCIF grants have been announced totalling $415 million.

This $1.1 billion grants program was closed in January 2011, as part of the Federal Government's saving measures to support rebuilding of infrastructure damaged by the floods in Queensland.

Automotive Transformation Scheme

The Automotive Transformation Scheme (ATS) aims to encourage competitive innovation within the automotive industry, placing greater emphasis on investment in research and development to increase competitiveness and productivity. Applications for registration in the ATS are open to motor vehicle producers, automotive component producers, automotive machine tool, automotive tooling producers and automotive service providers.

The ATS commenced on 1 January 2011 and is expected to run to 31 December 2020. It currently comprises:

- Stage 1: capped assistance of $1.5 billion from 2011 to 2015;
- Stage 2: capped assistance of $1 billion from 2016 to 2020; and

- uncapped assistance of approximately $847 million.

$300m is allocated to be spent per annum under stage 1, any underspend is carried over to the following financial year.

During its election campaign the former Opposition announced plans to cut $500m of funding from stage 1 of the ATS, a decision opposed by the SA government.

Climate Change Policy

In July 2011 the then Australian Government released Clean Energy Futures package which contained a broad range of policy measures to reduce greenhouse gas emissions. In July 2012 the carbon pricing mechanism was introduced which required businesses to acquire and surrender emissions units for their greenhouse gas emissions.

Following the change of Government legislation was prepared to repeal the Clean Energy Act 2011 and related legislation that establishes the carbon pricing mechanism. This will be replaced with the Coalition's Direct Action Plan which includes the Emissions Reduction Fund. This will allow industry to sell carbon abatement back to the Government. This new policy will be further developed through a White Paper process.

3.3 Implications for Export Markets

The Australian automotive industry has long recognised the importance of the export market to attain sufficient scale and drive down unit costs. While an increase in exports is a desirable outcome, the South Australian Government shares the industry's concern that the major impediments to export at the present time are the high value of the Australian dollar and barriers to entry into major competitor markets.

Table 7 presents data on Australia's automotive exports over the period 2000 to 2012. Total exports, both of vehicles and components, trended upwards from $4.21 billion in 2000 to $5.76 billion in 2008. This was during a period when the Australian dollar appreciated from 0.60 USD to about 0.95 USD.[35]

[35] http://www.rba.gov.au/statistics/hist-exchange-rates/index.html?accessed=2013-11-19-16-25-56

Table 7: Value and Growth of Automotive Exports (nominal figures)

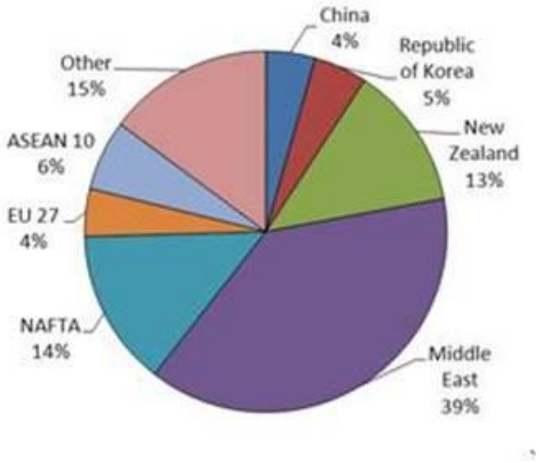
Year	Vehicle Exports	Components Exports	Total Exports	Annual Growth
	($b)	($b)	($b)	(per cent)
2000	2.42	1.78	4.21	29.5
2001	3.26	1.64	4.90	16.4
2002	3.08	1.71	4.80	-2.0
2003	2.98	1.71	4.69	-2.3
2004	3.03	1.64	4.67	-0.4
2005	3.47	1.68	5.15	10.3
2006	3.06	1.80	4.86	-5.6
2007	3.25	1.83	5.09	4.7
2008	4.03	1.72	5.76	13.2
2009	1.84	1.23	3.08	-46.5
2010	2.09	1.46	3.56	15.6
2011	1.67	1.58	3.25	-8.7
2012	2.14	1.57	3.71	14.1

Source: DFAT, STARS Database.

Exports of vehicles contracted dramatically in 2009 during the global financial crisis, from $4.03 billion to $1.84 billion. At the time the Holden Commodore was being sold in the United States as the G8 under the Pontiac brand. As a consequence of the General Motors Chapter 11 bankruptcy, the company decided to drop its Pontiac brand, and as a result exports of Commodores to the United States ceased.

This following figure shows Australian automotive exports to regions and countries in 2012-13. It illustrates that 39 per cent of automotive exports by value was to the Middle East, making it Australia's largest automotive export market. Next largest was New Zealand (13 per cent), and the North American Free Trade Association (14 per cent), followed by the Association of South East Asian Nations (six per cent), Republic of Korea (five per cent), China (four per cent), the European Union 27 (four per cent) and others (15 per cent).

Figure 11: Automotive Exports by region



Source: DFAT STARS Database, based on ABS Cat No. 5368.0, August 2013 data

Australia is ideally located to export cars and components to the fastest growing motor vehicle markets in the world in Asia, but faces high tariff and non-tariff barriers. As discussed previously, this highlights the important role of Government in gaining market access through both bilateral and multilateral trade negotiations.

3.4 Foreign Direct Investment Flows

With low levels of domestic savings, FDI has played an important part in the historical growth of Australia's manufacturing sector. FDI has brought with it new technologies and approaches, improving productivity, which tends to have a larger impact on economic growth, per dollar invested, than domestic investment.

All three domestic vehicle manufacturers and a number of component suppliers are foreign owned, and if their local manufacturing were to cease, it could be reasonably expected that head offices will redirect investment to other automotive manufacturing countries. For example Mitsubishi Motors sold its plant and equipment (including the production line) to the Chinese automotive industry and Nissan did not re-invest elsewhere in Australia.

It will take significant time for alternative industries within Australia to attract the levels of investment required to build new production capacity and secure new markets.

4. Government Assistance

As demonstrated in the previous chapters, over the last decade the Australian automotive industry has been an important contributor to the national economy through direct employment and investment, R&D and technological advances, and spill-over effects into other industries.

Government assistance and intervention are ubiquitous in those countries manufacturing automotives. Not only firms, but also governments and nations, compete for the dynamic technological and other benefits that having a domestic automotive manufacturing capability brings.

South Australia agrees with the Productivity Commission that any further gains in allocative efficiency from further reductions in automotive assistance would be relatively small compared to the economic and social costs of adjustment.[36]

In South Australia, where it comprises a greater proportion of the economy than for any other state or territory, the automotive manufacturing sector is an even more significant contributor to overall economic performance. In view of the scale of economic contraction which would result from the closure of Holden and potentially the industry, and the significant and prolonged negative impacts on employment and incomes, the South Australian Government strongly supports the continuation of Australian Government assistance to the automotive industry.

The Productivity Commission estimated that the automotive manufacturing industry received total assistance of $1,179.9 million in 2010-11.[37] This included $519.7 million in budgetary assistance and $660.7 million of net tariff assistance. Adjusting for a sector's contribution to the economy shows the automotive manufacturing industry's net effective rate of assistance was 8.5 per cent in 2010-11, reduced from 11.3 per cent in 2009-10.

Table 8 following compares the net effective rates of assistance for other Australian industries. It shows assistance to the automotive industry is not as high as is commonly believed, with the effective rate of combined assistance to manufacturing as a whole (4.2 per cent) not much higher than for primary production (3.4 per cent).

It should also be noted that this analysis excludes the Fuel Tax Credit Scheme, which allows a number of industries (including mining and agriculture) to claim a rebate on excise paid on certain types of fuel (including diesel).

[36] Productivity Commission, 2002, *Review of the Automotive Assistance Inquiry Report.*
[37] Productivity Commission, 2012, *Trade and Assistance Review 2010-11*, Annual Report Series http://www.pc.gov.au/__data/assets/pdf_file/0004/117292/trade-assistance-review-2010-11.pdf

Table 8: Effective rate of combined assistance by industry grouping, 2005-06 to 2010-11

	2005-06	*2006-07*	*2007-08*	*2008-09*	*2009-10*	*2010-11*
Primary production[b]	**5.0**	**7.1**	**7.6**	**5.5**	**4.9**	**3.4**
Dairy cattle farming	11.2	15.7	14.8	5.1	4.9	2.9
Grain, sheep & beef cattle	4.2	7.5	8.2	7.2	5.9	3.5
Horticulture & fruit	5.1	5.0	5.3	6.2	5.6	5.0
Other crop growing	7.0	5.8	4.7	1.6	1.6	0.6
Other livestock farming	2.4	2.8	3.7	3.0	2.2	1.7
Fisheries	4.8	18.0	10.0	4.0	3.7	3.0
Forestry & logging	7.5	5.5	5.6	-1.7	4.1	4.6
Other primary production[c]	0.5	0.5	0.8	0.5	0.5	0.5
Mining	**0.1**	**0.1**	**0.1**	**0.0**	**0.2**	**0.1**
Manufacturing[b]	**4.6**	**4.6**	**4.5**	**4.6**	**4.5**	**4.2**
Food, beverage & tobacco	3.3	3.3	3.3	3.3	3.3	3.4
Textile, clothing & footwear	15.2	14.6	14.4	14.6	12.9	10.6
Wood & paper products	4.8	4.9	5.1	5.2	4.7	4.7
Printing, publishing & media	1.4	1.4	1.5	1.4	1.5	1.5
Petroleum, coal & chemicals	3.5	3.6	3.6	3.7	3.8	3.7
Non-metallic mineral prod.	2.5	2.5	2.6	2.5	2.5	2.5
Metal products	4.6	4.7	4.4	4.4	4.4	4.3
Motor vehicles & parts	12.1	12.3	11.8	11.7	11.3	8.5
Other transport equipment	2.0	1.8	1.8	1.9	2.0	2.0
Other machinery & equipment	3.7	3.6	3.6	3.6	3.6	3.5
Other manufacturing	5.3	5.2	5.3	4.9	5.0	5.0

a 'Combined assistance' comprises budgetary, tariff and agricultural pricing and regulatory assistance. **b** Sectoral estimates include assistance to the sector that has not been allocated to specific industry groupings. **c** Other primary production includes *Services to agriculture* (including *Hunting & trapping*) and *Poultry farming*.

Source: Productivity Commission, Trade & Assistance Review 2010-11

The Productivity Commission records assistance to mining as low ($151 million in 2010-11). However, the Commission does not count the Fuel Tax Credits or Statutory Depreciation Lives for the Oil and Gas sector as concessions.

Recent research by the Australia Institute[38] indicates that Australian Government support to the mining industry could be as high as $4 billion per year. This is significantly higher than assistance to the automotive industry.

There is a critical relationship between the investment that Government has made to secure the future of the automotive industry and our capacity to retain a viable manufacturing industry. The long lead times and substantial capital investment required, specifically for the introduction of new car models (around 5 to 6 years), dictate the need for a degree of

[38] Grudnoff M 2012 *Pouring Fuel on the Fire: The nature and extent of Federal Government subsidies to the mining industry* Policy Brief No. 38. The Australia Institute.

certainty in Government policy positions to allow firms time to plan future investment in the domestic industry.

The South Australian Government regards a strong manufacturing sector as critical to a diversified and prosperous economy. In October 2012 the South Australian Government released *Manufacturing Works: A Strategy for Driving High-Value Manufacturing in South Australia.* The primary objective of the strategy is to transition the manufacturing industry from predominantly low value-added activities competing on cost, through medium value-added, to high value-added activities competing on value for money in global markets.

On 22 March 2012, the Australian, South Australian and Victorian Governments jointly announced a $275 million co-investment program for GM Holden to build two new vehicles at Elizabeth over the period 2016 to 2022. The South Australian Government has agreed to provide a $50 million contribution spread evenly over the years 2016-17 and 2017-18 (subject to conditions) and continues to work with Holden to secure the longevity of the Elizabeth operations and the next generation vehicle program.

Through its support for the state's automotive sector since 2002, the South Australian Government has previously committed the following financial support to Holden and Mitsubishi:

- Holden
    - $50 million for two next generation cars;
    - $30 million for Holden Cruze;
    - $5 million for Labour Adjustment following the downsizing of vehicle manufacturing operations in recent years (closure of third shift);
    - $1 million for GM Holden Secondary Employment Activity to assist workers to find employment while on reduced shifts; and
    - $2.2 million for a Holden Safety Enhancement Project.
- Mitsubishi
    - $35 million (10 year loan) for manufacture of a new vehicle line (repaid in full following the closure of the Tonsley Park manufacturing facility in 2008);
    - $2.648 million for retraining of redundant Mitsubishi employees following 2008 closure of the Tonsley Park manufacturing facility;
    - $189,250 for worker redundancy training packages in 2002;

The South Australian Government is currently providing $300,000 over three years from 2012-13 to the Auto Co-operative Research Centre (AutoCRC) for two projects which will deliver outcomes that will enhance the viability and sustainability of the automotive industry in South Australia through increased product and process innovation that takes into account economic, social and environmental impacts. The two projects are:

- Next Generation Automotive Coatings: through a combination of applied and strategic fundamental research (involving the application of thin film coatings to polymers), deliver high value add, advanced manufacturing technologies/products to the University of South Australia and SMR (a local automotive firm).
- Stars for Cars: The University of South Australia to develop a new rating scheme for vehicles that will apply Life Cycle Analysis (LCA) techniques to determine the relative costs during the manufacturing, use and disposal phases of a vehicle's life.

The South Australian Government, previously provided the AutoCRC with $700,000 over seven years (2005-06 to 2011-12) for projects which included:

- $200,000 for the establishment of Australia's first Ergonomics Laboratory at the University of South Australia (UniSA);
- $200,000 in support of two electric vehicle research projects at UniSA; and
- $50,000 in support of the development of magnesium automotive components by the South Australian automotive firm T-Mag, in collaboration with GM Holden, CSIRO and AutoCRC.

The State Government has actively supported the automotive and component manufacturing industry through funded employment, training and skills development programs since 2009.

Through State and Australian Government programs such as *Skills for All*; *Skills in the Workplace*; *Productivity Places Program* and the *Automotive Industry Structural Adjustment Program*, over $13 million has been invested into this sector to support more than 4,500 people in training and skills development activities including more than 600 apprentices and trainees for 14 automotive and component manufacturing companies.

Training has predominantly been undertaken in qualifications from Certificate III to Advanced Diploma for Competitive Manufacturing, Engineering, Electro-technology, Training & Assessment and specific skill set needs.

More generally the South Australian Government recognises the value of and need to nurture the manufacturing sector. Growing advanced manufacturing is one of the state's seven strategic priorities and the South Australian Government has implemented, amongst other things an $11.1m Manufacturing Works Strategy, which is built around four areas:

- enhancing manufacturers capacity to be innovative;
- upgrading the leadership, knowledge and skills of our workforce;
- capturing overseas markets; and
- addressing infrastructure policy and gaps.

4.1 Impact and Effectiveness

In its 2002 inquiry into the industry, the Productivity Commission recommended that the automotive tariff be reduced to the average for the manufacturing sector of 5 per cent in 2010, cushioned by an extension of the Automotive Competitiveness Investment Scheme (ACIS) program to 2010. It was considered that further, yet still gradual, exposure to competitive pressures would encourage the industry to continue to enhance its competitiveness. The anticipated benefits of increased competition in driving workplace and other efficiencies played a greater role than modelled resource effects in the Commission's recommendations. The recommended program also provided the industry with the decade of policy certainty that it sought, to facilitate investment. Reinforcing this objective, the Commission made no recommendations to modify other assistance schemes pending the phase down of tariffs and ACIS.[39]

Government assistance, through the maintenance of tariffs on automotive products (albeit at significantly lower levels) and through the Automotive Transformation Scheme, have contributed towards its transformation to a better performing sector in a number of key ways:

- It has allowed structural adjustment within the industry to take place at a realistic and measured pace within a secure policy environment, which has promoted investment, long-term planning, and the development of technology and new management practices;
- It has provided important signals to the automotive industry that Australia continues to be committed to a domestic automotive industry;
- It has reduced the disparity in attracting investment with its global competitors which continue to receive government support through a variety of mechanisms, both overt and hidden and often on a much broader scale.

To minimise the potential transition costs ongoing Government assistance is required to allow time for further industry and labour market adjustment.

[39] Productivity Commission, 2008, *Modelling Economy-wide Effects of Future Automotive Assistance*, p.XIV

5. Structural Adjustment and Transition

The South Australian government recognises that structural adjustment, technological and workplace innovation and management modernisation are essential ingredients for improvements in sectoral performance, greater productivity and improved competitiveness.

The automotive industry has been subject to significant rationalisation and adjustment over many years and will continue to face pressures over decades to come. Government has played a significant role in assisting the industry to adjust and has been called upon again to consider what level of assistance it will provide to secure the future of GM Holden in Australia. Government can assist to significantly reduce the costs of adjustment and has a leading role to play during periods of economic change when sectors like the automotive industry face extraordinary competitive pressures. Investments in industry transformation designed to secure investment and foster improved competitiveness have direct and indirect benefits to the nation.

The South Australian Government believes that assistance to the automotive industry is justified to facilitate adjustment, improve productivity and competitiveness, and make an important contribution to national economic welfare. It is important that Australia pursue policies that are reflective of our competitors. In this respect we believe that close examination of our trading partners' assistance regimes is of the utmost importance in helping to determine what level of assistance government provides to the Australian automobile industry and other industries subject to global competition.

5.1 Economic Outlook

A wealth of literature has provided important data that has confirmed the difficulties experienced by the global economy in recent times. A combination of reforms and government stimulus programs has brought many economies back to stability or anaemic growth. Although many economic reforms are beginning to take hold, the prospects for the global economy, and with it, demand for Australia's merchandise and manufacturing exports, remain subdued.

The Organisation for Economic Cooperation and Development (OECD) has had to significantly revise down its global growth forecasts for 2013 and 2014, citing particular weakness in emerging market economies (EMEs).[40] It is the lowest annual growth forecast from the OECD since the depths of the global financial crisis.

Australia's economy has so far proved remarkably robust but our prosperity cannot be taken for granted, particularly as vulnerable EMEs look to respond to slowing growth by reinforcing their domestic industries. The OECD report cautioned the Australian

[43] Spoehr, J. 2013, *Holden workers weigh uncertain future as funding talks continue*, 7:30 ABC-1

Government against dramatic budget cuts, suggesting that public sector demand has a valuable surrogate role to play to promote continued growth.[41]

The Reserve Bank, in its November 2013 board minutes stated that:

> *Recent indicators suggested that the Australian economy had been expanding at a below-trend pace. The revised staff forecasts suggested that growth in the near term would be constrained by the decline in mining investment, the high level of the exchange rate and weak public demand.*[42]

Reserve Bank and IMF economists have recently expressed views that the Australian dollar is significantly overvalued. The high Australian dollar has had a disproportionate negative impact on the economy of South Australia, given this state's relatively high levels of exports and manufacturing as a share of the state economy.

At the same time, the state has largely yet to benefit from the mining boom that has occurred in other states, particularly Western Australia and Queensland, where resource investment and export demand have proven relatively immune to the high Australian dollar. South Australia's resources industries are at an earlier stage of development, and attracting global capital necessary to develop them is more challenging than it was 12 months ago.

Latest data from Australian Bureau of Statistics indicate that South Australia's trend unemployment rate had risen to 6.6 per cent in October 2013, which is higher than the national rate of 5.8 per cent. Small area labour market data published by Department of Education, Employment and Workplace Relations indicate that unemployment is higher again across northern Adelaide, particularly in the City of Playford, at 15.5 per cent in the June quarter 2013. This implies that parts of South Australia are well below full employment levels.

Unless non-mining investment and other activity picks up there is a risk that Australia and South Australia will face a number of years with below trend economic growth. The Australian Government, in its budget, projected terms of trade to decline by a total of 20 per cent over a 15 year period, settling around their 2005-06 level. Over the projection period, the exchange rate is assumed to move in line with the long term historical relationship between the terms of trade and the real effective exchange rate. The terms of trade projections imply a fall in the real exchange rate of 0.9 per cent per annum over the projection period.

Against this economic backdrop, the cessation of automotive manufacturing in the near term is likely to lead to a significant loss of confidence and increase the risk of protracted high unemployment and the legacy of a less diverse economy when the relative economic conditions for Australian manufacturing improve.

[43] Spoehr, J. 2013, *Holden workers weigh uncertain future as funding talks continue*, 7:30 ABC-1
[43] Spoehr, J. 2013, *Holden workers weigh uncertain future as funding talks continue*, 7:30 ABC-1

5.2 Timing of Structural Adjustment

The argument is not about structural adjustment versus no structural adjustment but rather the nature and objectives of structural adjustment, and the context in which it occurs. In a well-managed economy with consistent economic growth and flexible labour and capital markets, a large volume of change can be comfortably absorbed without significant adverse effects. Structural adjustment can occur as part of the normal flows of labour and capital markets – it will be dispersed and, in many cases, be difficult to observe.

The 2004 closure of the Mitsubishi Motors engine plant in Lonsdale, in Adelaide's southern suburbs, put 1,183 people out of work immediately. This was an adverse social and economic outcome yet domestic automotive manufacturing and the relatively buoyant economy was able to absorb these losses and continue.

> *Mitsubishi closed during a time when the economy was relatively buoyant. It's much less likely that people lost their jobs through the closure of Holden would be able to find alternative manufacturing jobs.*[43]

Measures were put in place to deal with the 2008 closure of Mitsubishi in Adelaide's southern suburbs. Although in a growing economy, it was found that many of the assisted ex-Mitsubishi workers did not maintain working hours or prior earnings, with implications for the region overall.

Many Mitsubishi workers experienced a significant deterioration in their income and security post redundancy:[44]

- 225 of 316 respondents (72 per cent) reported earning less than they did after redundancy;
- just 11 per cent reported earning around the same post-redundancy while 15 per cent reported earning more;
- around one third of those in employment had held three or more jobs in the last 12 months.

Around 36 per cent of respondents found work in manufacturing while around 11 per cent worked in retail, 7 per cent in construction, 6 per cent in health services and just 2 per cent in mining and 2 per cent in defence.

Other effects of the Mitsubishi closure on surveyed employees indicate, as earlier studies have also demonstrated, the need for attention to be paid to a holistic response to downsizing and closures involving a coordinated response from a range of agencies beyond

[43] Spoehr, J. 2013, *Holden workers weigh uncertain future as funding talks continue*, 7:30 ABC-1

[44] Beer, A., Baum, F., Thomas, H., Lowry, D., Cutler, C., Zhang, G.J., Ziersch, A., Verity, F., MacDougall, C. and Newmann, L. 2006. *An Evaluation of the Impact of Retrenchment at Mitsubishi Focusing on Affected Workers*, Their Families and Communities: Implications for Human Services Policies and Practices, Flinders University.

industry, employment and training, including health, community services and housing. The evidence for assistance includes:

- Half of respondents believed that the loss of employment at Mitsubishi affected their social life;
- Higher levels of mental health issues were reported relative to the population as a whole; and
- Housing costs were a source of worry for around 60 of the respondents who sought assistance with their housing. [45]

However in the less favourable economic conditions currently being forecasted for Australia there is an increased risk that reduced assistance at this time will potentially lead to significant hardship and large dislocation. If GM Holden were to cease Australian operations and close the Elizabeth plant in 2016, or earlier, the immediate impact is likely to be significantly greater.

If GM Holden were to withdraw their domestic manufacturing operations, as Ford Motors are scheduled to do in 2016, it would leave Toyota as the sole manufacturer of cars in Australia. This would deprive the industry of the economies of scale it can attain and further erode the industry's competiveness and substantially threaten Toyota's long term viability and that of the component sector.

5.3 Distributional Impacts

There will be times when particular individuals, businesses, communities and industries will suffer dislocation, including through job losses and capital being rendered prematurely obsolete. These situations are most likely to occur when change is concentrated in areas where there is little diversity in industry and hence few other employment opportunities.

Walsh and O'Neil (2011) draw a distinction between regional structural adjustment assistance and regional development assistance:

- Structural adjustment assistance seeks to manage the process of change without interfering in the allocation of resources.
- Regional development assistance seeks to influence the allocation of resources to support the prosperity, vitality and sustainability of the region.

They suggest that structural adjustment is about economic efficiency, whereas regional development assistance encompasses equity considerations and other broader social and political objectives.

As depicted in Section 1.2, the City of Playford needs both. Not only would this region bear the brunt of the job losses, but the scale of the industry collapse would be without

[45] ibid

precedent. The regional impact of a closure of GM Holden's Australian operations is compounded by the high incidence of unemployment in Adelaide's northern suburbs, particularly in the city of Playford which has an unemployment rate of 15.5 per cent.

The Universities of Birmingham and Coventry have conducted research concerning the April 2005 closure of the MG Rover plant in Longbridge in the West Midlands. The closure was one of the most significant in the UK for 25 years, with the immediate loss of 6,300 jobs.

This research found that any assessment of successful labour market adjustment should also address the issue of job quality. This is particularly pressing for displaced workers who are only able to obtain forms of work which are insecure, or precarious in nature.

However, because of the research focus on those workers who remain unemployed or who transition into training, the plight of these employed workers is often overlooked. In this sense the overriding labour market policy emphasis has been a focus on transitioning into 'any job'.

Other international research has looked at the sort of job insecurity faced by displaced workers following the closure of a significant regional employer.[46] [47] [48] This insecurity can include:

- Lower income levels;
- Poor protection against dismissal;
- Lack of statutory entitlements;
- Unsociable hours;
- An ambiguous legal status;
- Lack of training opportunities;
- Lengthier commutes to the workplace; and
- Lack of voice mechanisms in the workplace.

The research has identified that these insecurities impose costs on the wider economy and society through lower rates of skill formation, reduced consumer confidence and family instability.

At one level, adjustment for the ex-MG Rover workforce before the recession impacted had been successful, with approximately 90 per cent of ex-MG Rover workers having obtained some form of employment in April 2008: with nearly three-quarters employed full-time, 11

[46] Westergaard J, Noble I and Walker A. 1989, *After Redundancy. The Experience of Economic Insecurity*. Cambridge: Polity Press.
[47] Turnbull P and Wass V. 2000, *Redundancy and the Paradox of Job Insecurity in Heery E and Salmon J (eds) The Insecure Workforce.* Routledge: Cardiff.
[48] Shuttleworth I Tyler P and McKinstry D. 2005, *Redundancy, readjustment, and employability: what can we learn from the 2000 Harland & Wolff redundancy?* Environment and Planning A., 37:1651---1668.

per cent self-employed and 5 per cent employed part-time. In contrast, only 5 per cent were still unemployed and looking for work.

However, also evident were sharp declines in income security, with a majority of respondents reporting a significant decline in earnings compared to when they worked at MGR, and further that a quarter of respondents reported that they were experiencing financial difficulties. The findings also indicated a much greater dispersion of earnings. The decline in representation security reported also highlights the need to make sure that workers have adequate redress to advice and advocacy (traditionally provided by the union movement); and that measures are put in place to avoid a repeat of very sudden plant closures.[49]

Research from Birmingham also found that, three years on from the closure, approximately 60 per cent of the redundant workers had migrated to the service sector. Based on average industry earnings, it was estimated that these jobs paid a mean of £5,600 less ($9,600 AUD) per annum.[50] A glance at published industry earnings in Australia, circa 2011, revealed a similar fate in store for Australian automotive workers if they were to migrate to the service sector at similar rates.

According to Jefferson and Preston, the average weekly ordinary time earnings (AWOTE) for Other Services, a useful catch-all for the sectors of the economy displaced manufacturing workers often move to, are 88.4 per cent of manufacturing.[51] Compared to the AWOTE for manufacturing, this translates into an average wage differential of $7,400 AUD—a figure in the same order of magnitude as that found in Birmingham. This finding, among others, should lead the Productivity Commission to review its assumptions on the mobility and reservation wage of displaced labour, especially in outer suburbs which face entrenched disadvantage and geographic isolation.

Low pay is the norm for many who are able to gain employment following redundancy and structural adjustment. More needs to be done to "make work pay" and link this to training and skills development - and supporting manufacturing as a provider of skilled, quality jobs.

A downturn in economic conditions will result in greater concerns over tenure and income security. For example, successful adjustment in 2008 was no guarantee that a worker would not be made redundant again with the onset of the 2009 economic downturn. The lack of employment security therefore undermines otherwise successful policy responses.

[49] Ruyter A, Bailey D and Bentley, G. 2012, *Plant closure and labour market precariousness: an analysis of the status of MG Rover workers 3 years after closure*. SURGE Working Paper Series – Working Paper no. 5. University of Coventry.
[50] Bailey, D, Chapain, C and de Ruyter, A. 2011. *Employment Outcomes and Plant Closure in a post-Industrial City: An Analysis of the Labour Market Status of MG Rover Workers Three Years On*, Urban Studies, 48, pp.1595-1612
[51] Jefferson, T and Preston, A. 2012, *Labor Markets and Wages in Australia in 2011*, Journal of Industrial Relations, 54, pp.293-311

When determining its options on assistance, the Productivity Commission is asked to consider both overall national economic welfare and regional impacts. There needs to be an examination of the distributional effects of changes.

5.4 Reallocation of Resources and Adjustment Assistance

An important determinant of the impact of the labour market adjustment required with the automotive industry is the level of occupational and geographical mobility of the labour force. As noted by the Productivity Commission in its current inquiry:

> *By enabling labour to move to its best use across different regions of Australia (including outer metropolitan and non-metropolitan locations), it can alleviate labour shortages and regional disparities in labour market conditions, such as high levels of unemployment, and increase skills utilisation, earnings and community wellbeing.*[52]

Some of the Productivity Commission's past findings and recommendations with respect to structural adjustment, and the automotive industry as a specific case study, have been based on the fundamental assumption that there are limited restrictions on the geographic and occupational mobility of individuals.

While it is often argued that there is a stronger rationale for additional assistance where the adjustment pressure is a result of policy change, the case is not clear cut. Drawing a distinction between market-based changes and those resulting from government policy raises a number of equity issues. As noted by Rotternberg:

> *Many kinds of phenomena produce losses. These include natural disasters, as well as wars, the discovery or exhaustion of natural resources, technological discoveries and changes in preference sets – and changes in public policy.*
>
> *On grounds of equity, it does not seem warranted to select isolated public policy changes from this set as a trigger for making transfer payments. The existence or intensity of suffering is independent of the cause.* [53]

In the past the Productivity Commission[54] has advised that the generally available measures such as unemployment benefits and assistance to find alternative employment should be sufficient. However, generally available assistance measures are not designed to meet all contingencies.

In view of the prospect that the Australian and South Australian economies will be experiencing below trend growth at the time of industry contraction expected to flow without Australian Government co-investment, as well as the relatively high rate of unemployment and socio-economic disadvantage already being experienced in the City of

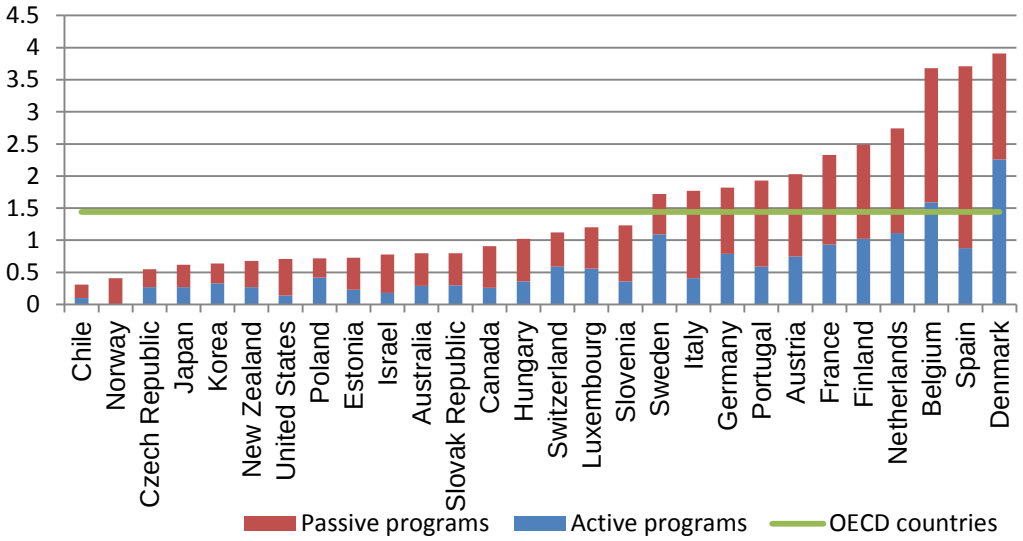
[52] Productivity Commission, 2013, *Geographic Labour Mobility – Issues Paper*
[53] Rotternberg, S., 1986, *On compensation for losses and policy* in Choksi, A. *"*Economic Liberaliszation in Developing Countries*",* Oxford.
[54] Productivity Commission, 2002, *Review of the Automotive Assistance Inquiry Report*

Playford region, sole reliance on economy wide welfare, skills, and labour adjustment programs is unlikely to be sufficient to address disadvantage in Playford and facilitate the movement of labour, capital and land to higher productivity uses.

The Productivity Commission is therefore asked to consider the need for specific adjustment assistance measures targeted at easing adjustment costs for employees, businesses and regions affected most directly by significant change within the industry.

The need for specific structural adjustment support from the Australian Government also needs to be considered against the backdrop of Australia providing very low funding for economy wide labour market programs, compared with the OECD average.

Figure 12: Public expenditure on labour market programs as a percentage of GDP, 2011



Source: OECD 2013, http://www.oecd.org/employment/database

There is a strong precedent for Australian Government funded structural adjustment support in similar circumstances. In 2012 the Productivity Commission identified 15 regional adjustment funds that had been put in place since 1997 to diversify local economies, following closure or downsizing of iconic local employers and major employing industries (see Appendix B).

The South Australian Government believes that among those options for the automotive industry canvassed by the Productivity Commission, consideration should be given to a comprehensive package of structural adjustment assistance measures to be introduced in the event of significant sector contraction. This would include programs designed to:

- assist workers made redundant by structural change within the industry, including labour, job-search and counselling, training and re-training programs; and

- assist regions negatively impacted by industry adjustment to find new economically sustainable industries to maintain overall levels of employment and economic wellbeing
- improve connectivity from regions impacted negatively by industry adjustment to other regions in order to speed adjustment.

6. Conclusion

The intention of this report is to demonstrate the structure, importance and evolution of the automotive industry to South Australia and urge the Productivity Commission to consider how strategic support could maintain a robust, technologically advanced industry for years to come. This submission has outlined the specific challenges facing automotive manufacturing in South Australia and made a case for targeted, continued federal government support.

Government support to car manufacturing is lower now in real and proportional terms than in the past. Domestic firms and their employees have had to confront increasing competitive pressures, exacerbated by the weakening of tariffs and a strengthening Australian dollar. Because of this, automotive manufacturing has become an industry which provides high value manufacturing jobs while contributing more than its employment share to value added and research and development.

The South Australian government is urging the Productivity Commission to proceed with an understanding of the benefits resulting from a domestic automotive industry which are hard to capture with static economic modelling. Static comparative Computable General Equilibrium modelling aggregates economic impacts at specific points in time and do not indicate the magnitude of the benefits and costs, or their social dimension.

Research conducted on the closure of MG Rover in Birmingham and the liquidation of Ansett Airlines in 2001 teaches difficult lessons: industry closure imposes difficult economic costs and stress on communities. Modelling is capable of estimating the static effects of the closure of domestic car manufacturing but is less well suited to calculating the economic and social costs of long-term industry adjustment.

Automotive manufacturing has played an important, decades-long role in strengthening the Australian economy. The importance of that role is magnified in South Australia, where manufacturing constitutes an above-average share of GSP and is vital to the economy and social cohesion of Adelaide's northern suburbs.

The Government of South Australia urges the Productivity Commission to take into account the findings of this submission and in particular considers the appropriate basis for a decision by the Australian Government regarding support for the automotive industry should be the use of an economic evaluation. The key question relates to the soundness of the Government investment decision and assessing whether the net present value of the benefits from supporting the sector outweigh the net present value of the costs of that support, taking full account of the avoided costs associated with industry closure.

Appendix A: State Government Industry Mapping

The South Australian Government conducted a supply chain mapping exercise to determine the size and concentration of the automotive industry in South Australia and the exposure of associated suppliers in the event of the withdrawal of GM Holden from the domestic market.

The exercise found that there are 33 Tier 1 companies (where GM Holden and/or the auto industry in general are the firm's core business) in SA employing 3,719 people and providing components and services to all three OEMs (Original Equipment Manufacturers: Holden, Toyota and Ford). These Tier 1 companies have combined revenue of $1.131 billion and supply the three OEMs with support from 1,270 suppliers nationally. A further 719 companies employing 28,000 to 32,000 people are estimated to supply a wide range of services and products to the Tier 1 companies—these can be labelled Tier 2, 3 or 4 depending on their location in the supply chain.

Information provided by GM Holden indicates that the 'core supplier base of parts and components in the manufacturing process' amounts to $528 million per annum created by 29 suppliers based around the state.

Only 25 per cent of these Tier I companies are sufficiently diversified in their operations to continue in the market were domestic car manufacturing to cease—it is predicted that all 719 companies surveyed would be vulnerable, with risks ranging from moderate to severe. The most pessimistic forecast places 6600 out of 7700 FTEs at risk.

Elsewhere the exercise found a low level of diversification and high dependency on the automotive industry among the Tier 1 companies, which would expose them to greater risk in the event of a GM Holden plant closure. Only 44 per cent of SA suppliers have achieved significant levels of diversification; suppliers which have invested in niche markets and high tech capability are now benefiting.

Industry-wide adoption of manufacturing techniques which respond to orders received ('just in time') have made automotive and parts manufacturers more vulnerable to industrial disruption. The small size of the Australian market makes it difficult for parts manufacturers to realise effective economies of scale meaning fixed costs remain a stubbornly high proportion of total production costs. This problem would be dramatically exacerbated if GM Holden were to withdraw from the Australian market.

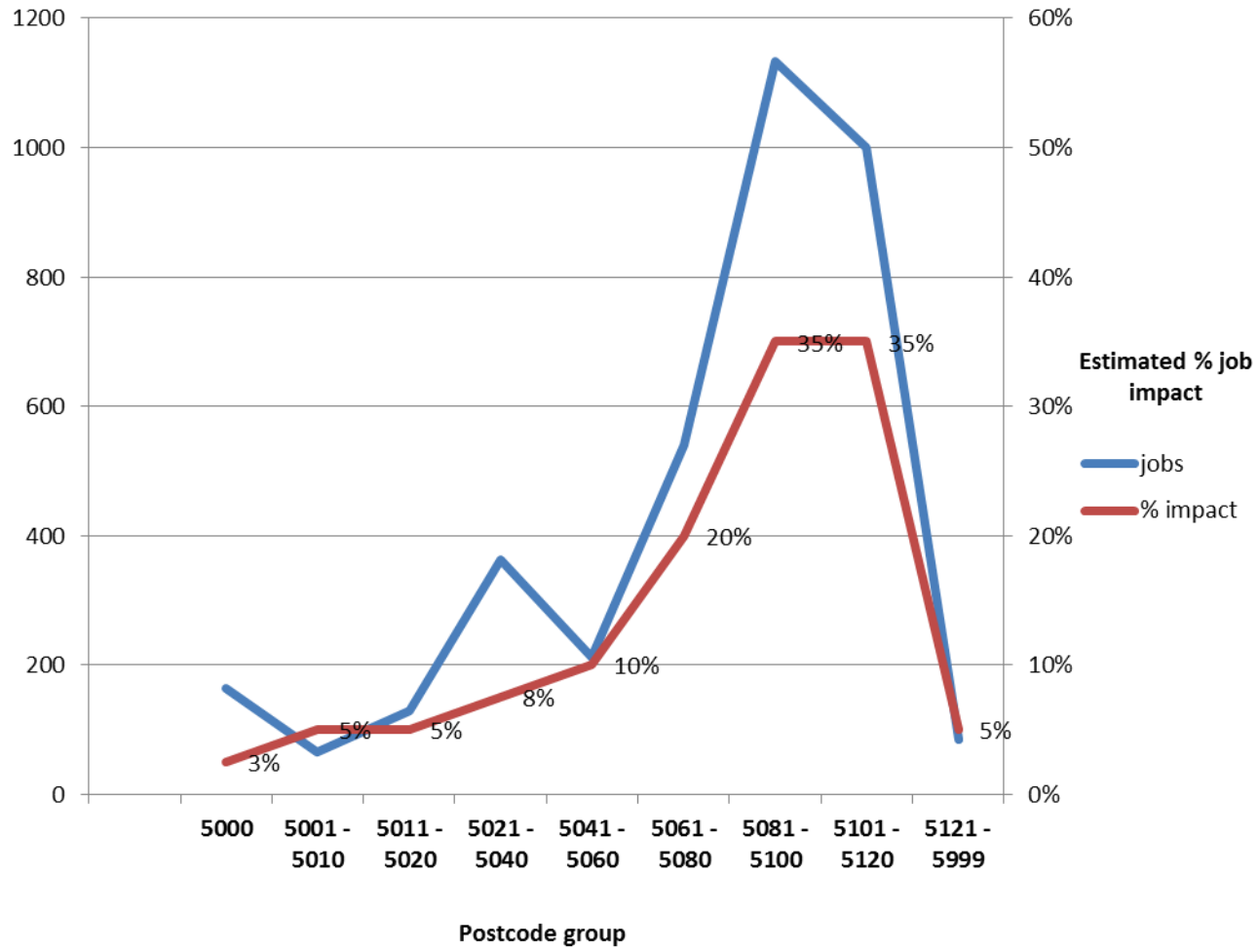
Of the 719 companies participating in the automotive supply chain in SA, 203 operate from the Northern suburbs. The high percentage of retail and distribution oriented companies in the northern suburbs are indicative of the complex requirements of the sector. The exercise indicates that the northern suburbs are likely to sustain more severe employment impacts than any other region. The employment impacts of a failure of the automotive supply chain

are estimated to be between 20 to 90 per cent of the current northern suburbs-based workforce.

The graph below illustrates the likely distribution of employment vulnerability of automotive suppliers by postcode. It shows that the suburbs at greatest risk of employment loss are those in Adelaide's outer north, such as Elizabeth (5112), Davoren Park (5113), Smithfield (5114), Munno Para (5115) and Salisbury (5106).

This graph shows that employment in the automotive sector is concentrated in the northern suburbs of Adelaide, which have historically been regarded as socioeconomically disadvantaged, and that is those disadvantaged suburbs which will bear the brunt of industry collapse.

Figure 13: Number of jobs and risk in the event of GM Holden closure



As the two graphs below show, GM Holden dominates the automotive sector in South Australia. In addition to the 1700 workers currently employed at the Elizabeth site, GM

Holden is directly responsible for 1400 Tier 1 automotive supplier jobs. By this estimate, over 3,000 jobs would be lost in short order were the plant to close.

Figure 14: SA automotive supplier jobs by firm

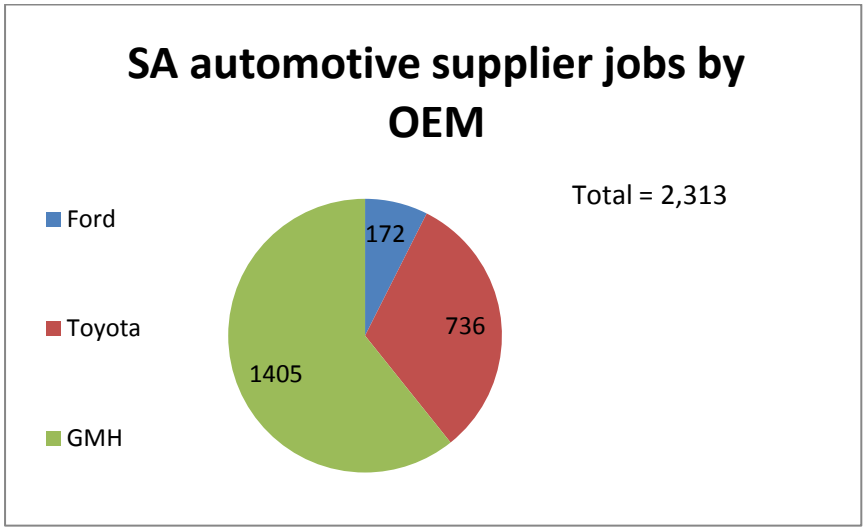
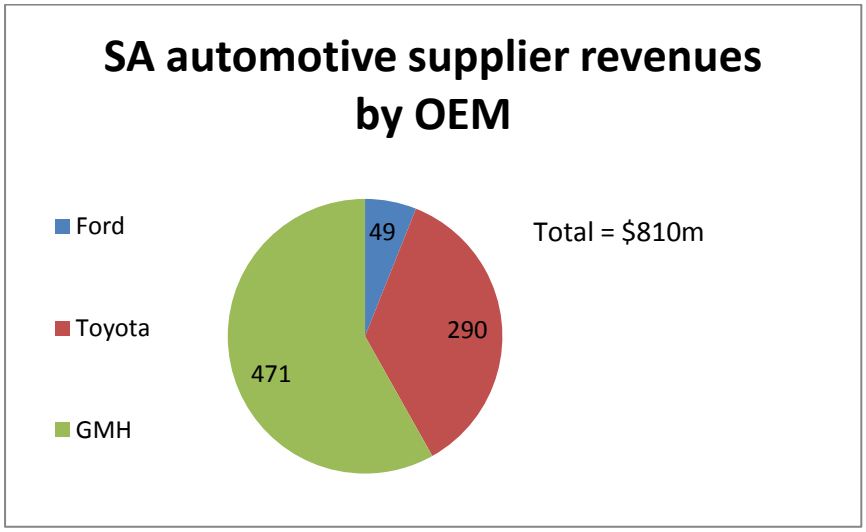


Figure 15 paints a similar story: GM Holden contributes $471 million to local suppliers; 58.15 per cent of the total. If GM Holden leaves Australia, it would have devastating consequences for the automotive supplier industry in South Australia and the northern suburbs of Adelaide.

Figure 15: SA supplier revenues by firm



Appendix B: Australian Government Structural Adjustment Funds since 1997

Program	*Date*	*Expected closure or downsize*	*Expected job displacement*	*Funding***a**
Newcastle Structural Adjustment Fund	1997	BHP	2800**h**	$10 million**b**
Eden Regional Adjustment Package	November 1999	Forestry access; fish canning plant	143	$3.6 million
South-West Forests Structural Adjustment Package	1999	Reduced forestry access	unknown	$5 million
Structural Adjustment Fund for South Australia (SAFSA)	May 2004	Mitsubishi (Lonsdale)	1100 ($40m Aust. + $5m SA)	$45 million
Beaconsfield Community Fund	May 2006	Gold mine collapse	235	$8.3 million
Port Kembla Industry Facilitation Fund (PKIFF)	June 2006	BlueScope Steel	250	$5 million
Innovation Investment Fund for South Australia (IIFSA)	September 2006	Electrolux ($25m Aust. + $5m SA)	500	$30 million
Scottsdale Industry and Community Development Fund (SICDF)**d**	March 2007	Auspine	280	$6 million**c**
Geelong Investment and Innovation Fund (GIIF)	August 2007	Ford ($15m Aust. + $6m Vic. + $3m Ford)	600	$24 million
South Australian Innovation and Investment Fund (SAIIF)	February 2008	Mitsubishi (Tonsley Park)	930 ($25m Aust. + $5m SA)	$30 million
North East Tasmania Innovation and Investment Fund (NETIIF)**f**	August 2008	Gunns	135**i**	$3.7 million

Source: Productivity Commission, 2012