Submission from Autopolis Strategy Consultants

*Our purpose in making this submission to the Productivity Commission's enquiry on the future of the Australian automotive industry is not to repeat known information which is already available to the Commission from other sources. Rather, it is to explore the logic of Australia's position within the global automotive industry, the results of the public support afforded it until now, the options realistically open to it, and which of them would justify future support.*

In recent public domain discussions on this matter, many references have been made to the Sapere report, "Budgetary Assistance to the Australian Automotive Sector", Dr Alistair Davey, January 2011 ('the Report'), the stated intention of which was to "to consider the veracity of observations made by the Organisation for Economic Co-operation and Development (OECD) (2010, pp. 67-68) in its most recent economic survey of Australia released in November 2010 on the level of budgetary industry assistance provided to the Australian automotive industry".

Autopolis has been requested to provide an independent view of the conclusions reached by the Report. Autopolis' intention here is to review and extend the analysis shown in the Report, in order to develop a more critical understanding of the global industry assistance mechanisms and their effects.

**Referring to the accompanying spreadsheet:**

**Columns A-F**, coded in black, reproduce the original table, which appears on page 7 of the Report.

We note here that the Report attempts to measure support per capita. This measures the intensity of the citizenry's burden but not that of the benefit to the industry. The spreadsheet will continue that measurement along with the more valid assessment of the support provided per vehicle produced.

**Columns G and H**, coded in red, show a rebasing from per capita (what it costs each citizen) to per vehicle built (the effective rate of subsidy). Using this metric, the position of the Australian industry moves from least to 4$^{th}$ most supported.

We note that the Report then merely added all forms of assistance together for each country, assuming all schemes operated in an identical manner.

In **Columns I to L** the total support in local currency for each country is 'parsed' into its component parts, following the text on p.6 of the Report.

There are issues with several of the items in this list:

- The Report bases its analysis around the 2009 year, which was highly atypical. Many countries embarked on one-off schemes to stimulate various industries (automotive included) to head off the effects of the GFC. It is not valid to assume those 2009 schemes represent the on-going support provided by the respective countries. The Report's selection of 2009 as its representative year was unfortunate.
- **Cell I9** shows the one-off Swedish state investment in an R&D centre. This is not money handed to the industry directly, nor will the benefits (whatever they may be) accrue to the industry in the year of funding. Also, the benefit is not restricted to the Swedish Automotive industry as it works with many different sectors and industries in Sweden. We have spread the benefit received by the automotive industry over a period of 20 years.
- **Cell J8** shows the one-off, single-year German government's 'cash-for-clunkers' scheme. This is another instance of a short term scheme being put into place to head off the effects of the GFC. We comment below on the actual benefit received by MVPs by way of scrappage schemes of this nature. The benefit from this scheme should be defrayed over many more than one year. To smooth out the effects of this program the analysis should be based over a say, 20 year period. Importantly, analysis of several scrappage schemes has revealed that they are usually successful in pulling sales (and hence production and employment) forward into the immediate period. However the 'clockspring' effect comes into play in subsequent period, so that the net benefit received by MVPs over a, say, five year period is zero.
- Neither the Report nor this spreadsheet includes the data for the US, French or UK cash-for-clunkers schemes. A more complete analysis should include those schemes, bearing in mind the comments made about them above and below.
- Neither the Report nor this spreadsheet includes the various loan guarantees, tax holidays and similar mechanisms provided by individual US – or Australian – States. A more complete analysis should include those schemes.

In its analysis, the Report simply adds together all the quite disparate forms of assistance at their nominal value. There is a huge difference in the benefit actually received by the MVPs between direct support in cash grants, from which the industry benefits at 100%, and for example a loan guarantee, or a cash-for-clunkers scheme.

We have attempted to correct for this. **Columns M to P**, coded by type of scheme, show the cash equivalence 'rates' to be applied to each form of assistance in an effort to normalise them for computational purposes. We have estimated the effective rates to be:

- 100% where this is an outright cash grant
- Scrappage schemes – 'Cash-for-clunkers'. This is cash given to end consumers, not vehicle manufacturers. Given the manufacturers' low margins on new vehicles, we have assumed that 20% of the amount works through to them, through incremental sales. In fact the ultimate value may be nil, as new vehicle sales tend to crash once the incentive is removed. The 20% rate used in the spreadsheet is probably generous, bearing the 'clockspring effect' in mind.
- Loans. These ultimately have to be reimbursed and the interest on them paid. We have assumed an annual benefit of a 2% difference of rate between a bank loan and a government soft loan. This is probably generous.
- Loan guarantees (a default insurance offered to the banks). We have assumed 1% of the loan as an annual value – the loans still have to be reimbursed and the interest on them paid.
- Equity positions taken by governments in MVPs in periods of crisis. As is now happening in the US, the positions are being unwound by way of the sale of shares to the public.

The 'rate' applied to each of the assistance schemes are based on our understanding of the operation of the schemes and real benefits received by MVPs as a result of them. The precise value applied to these 'rates' is open to further analysis and debate. In their current form however they do provide a more realistic view of the real effects of the various assistance schemes.

**Column Q** is the summation of the different components of support, weighted by the cash-equivalency rates. It's still in local currency, so we use it as a correction factor (**Column R**), which is simply *value Q/Svalue B*. This is then applied to the per vehicle value of **CSolumn H** to give the corrected per capita in **Column S** and per vehicle value in **Column T**. Interestingly, this pretty much returns us to the pecking order given by the OECD, with the major difference that Sweden is now well behind Australia, which comes in as No. 1 by a wide margin.

This spreadsheet still does not present a complete and totally accurate picture; clearly the model requires more research and analysis to make it more robust. However it does succeed in providing a more accurate assessment of the effects of the various assessment schemes.

It does suggest that, far from being the least supported, the Australian automotive industry is the most supported, relative to volume of cars produced, of any in the OECD countries.