



Victorian Government Submission

**In response to the
Productivity Commission
2014 position paper:
*Australia's Automotive
Manufacturing Industry***

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1. Introduction

Given Toyota's recent decision to end manufacturing in Australia by 2017, the Victorian Government will limit its comments on the position paper to issues relevant to ensuring the smoothest possible adjustment and transition for the whole industry and managing the regional impacts.

The impact of the decision by all three car makers to cease production in Australia by the end of 2017, together with other recent business closures in manufacturing, presents an unprecedented shock to the Victorian economy with uneven geographic impacts. In light of the recent announcement by Toyota, the pace of industry transition will occur sooner than envisaged in the Commission's position paper.

It is imperative that the Commission be given sufficient scope to consider recent developments and deliver well-researched advice to governments that can support industry transition. In order to provide options for government on how transition and adjustment might best be managed, considerably more research and analysis needs to be done to:

- understand the regional economic and social impacts;
- assess the ramifications on the supply chain and other integrated industries;
- consider global best practice in industry adjustment and transition measures; and
- further consider the potential impact of any changes to current budgetary assistance on the timing of the departure of the three car makers so as to avoid a more rapid and painful transition.

The Productivity Commission also needs to examine:

- ways to ensure that car makers have supply chain certainty until their planned exits;
- support needed for businesses and workers through transition; and
- options for government to assist in promoting diversification and securing export opportunities.

2. Policy certainty for transition

The Victorian Government notes that the Commission has recognised the importance of limiting the severity and duration of transitional costs, and recommended against acceleration in cuts to ATS industry funding as signalled in the Commonwealth Mid-Year Economic and Financial Outlook (MYEFO).

Policy Recommendation

The Victorian Government agrees with the Productivity Commission's position that further cuts in ATS funding would not only accelerate the departure of the three local car manufacturers, but also have profound effects on the rest of the automotive supply chain heavily engaged in highly skilled R&D activity.

It is imperative that there is sufficient Commonwealth industry assistance in place to ensure that all three car makers continue manufacturing operations in Australia through to their nominated time. This will be critical in limiting the severity and duration of transitional costs.

The Victorian Government is concerned about several draft findings in the report that appear to exacerbate policy uncertainty for the automotive industry at this vulnerable time of major structural change. These include the Productivity Commission's positions of:

- opposing fleet procurement policies that require government agencies to purchase vehicles manufactured in Victoria;
- potentially supporting large-scale importation of second hand vehicles; and
- possibly allowing importers to apply for tariff concessions for automotive components.

The Victorian Government is concerned that any changes to existing policy settings could considerably increase transitional and adjustment costs and elevate the risk of earlier closures within the industry. For example, any accelerated removal of tariffs.

Given the speed of the forthcoming adjustment process, the benefits of a short term gain in reduced car manufacturing costs need to be weighed against the prospects for sustainable component manufacturing businesses and employment in the medium to longer term.

Policy Recommendation

The Victorian Government considers that further review on allowing importers to apply for tariff concessions for automotive components needs to be conducted in light of Toyota's announcement to cease manufacturing by the end of 2017.

The Victorian Government considers that the net public benefits of allowing the large-scale importation of second hand vehicles needs to be thoroughly examined. With new car sales at record levels¹, with over a million cars per year and over 360 available to Australian consumers, the used car market is as diverse and competitive as it has ever been. Second-hand vehicles need to meet regulatory requirements in terms of safety and environmental standards, therefore large-scale importation may present regulatory and practical challenges for the retail, service and repair sector as they try to support increased consumer choice in a further fragmented market.

Waste management and vehicle ownership traceability challenges would also need to be addressed when weighing up the public benefit of allowing the large-scale importation of second-hand vehicles. The Victorian Government recommends that thorough investigation into the merits of such a proposal be conducted prior to any implementation of such a policy.

Policy Recommendation

The Victorian Government considers that the timing of any policy change around

¹ ABS Cat. 9314.0 - Sales of New Motor Vehicles, Australia, Jan 2014

the large-scale importation of second hand cars should take into account current industry transition and uncertainty.

3. Supply chain and regional impacts

Victorian and Australian manufacturing has a long history of adapting to the realities of globalisation. Like all advanced economies, Victoria has seen a decline in the share of manufacturing contribution; however world-class capability in areas such as automotive design and engineering, medical devices and pharmaceuticals ensure that there is a strong future in domestic scale, niche and high value-add manufacturing and related services.

The impact of recent decisions to end production by all three local car makers, together with other recent business closures in manufacturing, represents a potent and unprecedented shock to the Victorian economy with disparate social and regional impacts.

Diversification by suppliers has generated strong links and interdependencies with other industries and remains an area of future opportunity. Many component producers, designers and engineering companies provide goods and services to a range of other industries creating cross-industry spillovers of knowledge, product innovation and production and business process design.

However, even with diversification, most of these companies are still highly dependent on domestic car assembly for current sales. Multinational car component companies, including Denso, Australian Arrow and Hella, have indicated in their submissions to the Productivity Commission Inquiry that a domestic car making industry is vital for continued investment in Australia. Victorian Department of State Development Business and Innovation (DSDBI) surveys of domestic supply chain companies indicate that most are still dependent on local car assembly for a significant portion of their sales, with 45 per cent of firms relying on automotive car makers for 75 per cent or more of sales. This suggests job losses and business closures will be very significant.

The existing diversification means that some flow-on effects should be expected in industries such as defence, rail, mining, aerospace, food, heavy vehicles (transport) and general manufacturing. Many of the companies that are identified as automotive manufacturing firms are also part of the supply chain in these industries, and other, manufacturing sectors.

Policy Recommendation

The Victorian Government considers it is essential that the design of transitional assistance (including ATS) is balanced between the need to ease transition through to the end of 2017, whilst supporting diversification activities. Funding must be sufficient to support these dual objectives.

4. Research and development

The loss of automotive manufacturing is likely to reduce the amount and associated public benefit of automotive R&D and other forms of innovation. The Australian motor vehicle and parts manufacturing industry is an intensive investor in R&D, spending \$693 million in 2011-12, or 15.5 per cent of manufacturing R&D investment. Strong links have developed between the industry and Victorian based research and training centres such as the Commonwealth Scientific and Industrial Research Organisation (CSIRO), the Cooperative Research Centre for Advanced Automotive Technology (AutoCRC), and Victorian Centre for Advanced Materials Manufacturing (VCAMM).

Globally, the industry is an early adopter of technology and there is evidence of spillovers, including transfer of labour and skills, transfer of high-tech engineering and design capabilities and the uptake of lean management principles.² These and other studies have shown that the benefits of automotive industry spillovers extend beyond technology transfer to skills and training, production processes and discipline around business processes that arises from working to tight margins. These benefits will be diminished by the departure of Holden, Ford and Toyota.

Policy Recommendations

The Victorian Government considers it is vital that design of R&D assistance measures realign to the needs of a value-adding global automotive supply chain.

4.1. Suggested support measures

The response to the impending closures of car manufacturers needs to commence immediately given that impacts will be widespread and are already being felt. Commonwealth Government action is needed in the immediate and longer-term. Support should:

- assist businesses with the capability to participate in the global automotive industry, including the continued presence of Holden, Ford and Toyota global automotive engineering services;
- enable the transition of workers to new employment and businesses to new products and markets;
- ensure displaced employees remain in the labour market and minimise the time before new employment is found;
- assist displaced workers with appropriate income and services support;
- reduce the impact on economic activity, including outside the automotive industry;
- seek to ensure that the industry adjustment process happens in an expected manner to provide greater certainty and to minimise any further shocks;
- facilitate the transition of resources to highest value uses and employment; and

² Review of Australia's Automotive Industry, 2008

- ensure that Victoria has the infrastructure it needs to be productive into the future.

Policy Recommendation

The Victorian Government proposes that the \$60 million structural adjustment funding announced by the Commonwealth (as part of the \$100 million Structural Adjustment Fund) be substantially increased to allow for a comprehensive package that matches the scale of adjustment now required.

Commonwealth financial support should include a variety of support measures to help reduce the costs of structural adjustment, including a structural adjustment fund, provision of employee assistance and extended supply chain support. Commonwealth Government structural adjustment support is highly appropriate in this case given the:

- localised impacts of a policy pursued in the national economic interest;
- Commonwealth's previous support for structural adjustment in other industries, including dairy, sugar, coal, electricity, steel and timber; and
- contribution of tariff reform over the last decades to structural adjustment in the automotive industry.

5. Structural Adjustment

5.1. Structural Adjustment Fund

The \$100 million fund announced by the Commonwealth on 18 December 2013 was designed solely as a response to the closure of Holden. Subsequent announcements by Toyota and Alcoa, and broader supply chain impacts, mean that the adjustment fund now needs to be increased proportionally so that Victoria receives funding in line with the additional challenges faced.

It will be important that this fund has sufficient scale and can be applied so as to ensure that investment to support business activity and the consequent opportunities for employment are fully maximised in the transition period.

The Geelong Region Innovation and Investment Fund (GRIIF) and Melbourne's North Innovation and Investment Fund (MNIIF), established in mid-2013 in response to Ford Australia's announcement of the impending closure of manufacturing operations, seek to promote new business investment opportunities to support the generation of jobs. The Victorian Government is of the view that the new structural adjustment fund should be broadly modelled on these funds. Design of the fund should reflect the following principles:

- support for projects that will add to economic activity and support the long-term growth of the Victorian economy through transition to higher value add production, business expansion, diversification, export development and greenfield developments;
- provision of funding for capital investment, research and development and commercialisation, skills development and business model adjustment (with appropriate tiers of funding established);

- access for companies in the automotive sector and its supply chain, as well as other businesses that can contribute to the transition of the economy;
- access for companies and projects across all regions of Victoria, rather than being geographically limited;
- applications should be open continuously, rather than run in rounds, to allow timely and responsive support driven by business needs;
- a requirement for co-investment by firms at a minimum rate of \$3 for every \$1 of Government funds;
- complementarity with other existing Government programs;
- projects should be funded based on merit, with clear selection criteria that will enable identification of projects that meet the State's specific needs in terms of structural adjustment and allow targeting of support to those projects that deliver the greatest benefit;
- assessment of individual applications may include consultation with local governments and development agencies in the relevant region; and
- funding linked to clear performance and outcome measures and timelines.

5.2. Employee Assistance

Commonwealth action is also needed to provide assistance to employees of automotive and other affected businesses including those who are in employment but at risk. For at risk employees, career development and training would improve readiness to find new work and therefore maintain labour market participation. This assistance would include building skills in navigating the labour market as well as new formally recognised qualifications.

For workers who have lost their jobs, the pressures of transition will be most acute. Assistance should also include appropriate income and services support to ensure displaced workers have income security, can improve basic literacy and numeracy capabilities, and can access crisis management support.

5.3. Extended Supply Chain Support

The Commonwealth needs to provide support to related businesses that are partially dependent on the automotive industry but not in the formal supply chain. Assistance for automotive supply chain businesses and related businesses will also focus on program support such as support for new investment and access to export facilitation services. The Victorian Government's Trade Mission Program has been highly successful and is a useful model to consider.

While affected businesses and employees will be highly concentrated in specific regions, the size of the adjustment may affect businesses in other areas across the state. Commonwealth support should be available to businesses regardless of their location in Victoria.

Toyota's announcement to cease manufacturing operations means further consideration is required to enhance existing programs. Increased assistance during

2016 and 2017 will be needed as displaced employees enter the labour market and businesses experience reduced domestic demand for automotive components.

The response should support long-term economic growth including investment in productivity-enhancing road, rail and freight infrastructure projects and support for high growth opportunities in exports and resources development.

Commonwealth procurement and administration should also contribute through specific support for Victoria's shipbuilding and defence industry that relies on Commonwealth defence procurement and relocation of Commonwealth agencies to regional and metropolitan centres where appropriate.

It is also important to reform regulation to bring down costs to businesses and to support a competitive business environment which attracts investment. This should not only include regulation specific to the automotive industry, but economy-wide.

6. Designing assistance programs

The Victorian Government welcomes the opportunity to respond to the Commission's request for more information on options for designing assistance programs for automotive manufacturing employees and regions impacted by structural adjustment. Victoria has evidence to show that:

- support for regions is critical to manage transitions due to high concentration of manufacturing businesses in regions;
- adjustment support to firms can work, illustrated through the strong demand and high quality applications for recent programs in Geelong and Melbourne's North;
- well-designed skills and retraining programs improve the prospects of impacted workers, and reduce welfare costs; and
- well-targeted support for infrastructure can have enduring economic benefits and assist in transition.

6.1. Support for regions is critical to manage transitions

As detailed in the last Victorian Government submission and examined in the Commission's position paper, changes in the automotive industry are localised in Victoria where the industry is geographically concentrated. The municipalities of Hume, Greater Dandenong and Hobson's Bay in metropolitan Melbourne will be particularly affected, due to the concentration of parts and component suppliers in these Local Government Areas (LGAs), along with the regional centres of Geelong and Ballarat. Labour force profiles of all of these regions are provided at Appendix A.

Substantial support will be required to manage transition in these regions due to the high concentration of manufacturing businesses and current labour market conditions in those areas. For example, the Southern Metropolitan region of Melbourne contained 189 motor vehicle parts manufacturing business establishments in 2011-12,

most concentrated in Greater Dandenong. There is a risk that if the majority of these businesses fail, the unemployment generated would not be absorbed by other manufacturing businesses or other industries in the region because of limited transferability of skills or issues with worker mobility.

Manufacturing employment in Melbourne's Southern Metropolitan region has declined by 10,790 workers since 2008, while overall employment has risen by 32,820 workers. The majority of employment growth that occurred in the Southern Metropolitan region between 2008 and 2013 was concentrated in three industries (health, construction and education); all requiring substantially different skill sets to manufacturing. Despite employment growth in these industries, there was an overall deterioration in unemployment and participation rates, implying not all workers wanting to work were able to gain employment.

The labour force profile data suggests that most automotive workers in the Southern Metropolitan region that become unemployed would need to find manufacturing work elsewhere or, to remain employed locally, would need to re-skill.

6.2. Skills and retraining support improve the prospects of impacted workers and reduces welfare costs

While there may be some opportunities for affected employees to find jobs in other areas of manufacturing or analogous industries, actions to address these barriers need to commence immediately. It is difficult for workers to transition to new jobs without some degree of retraining, especially for low skilled workers. Some automotive workers come from multicultural backgrounds and may also require language support.

The skills profile of Victoria's automotive industry reveals 42 per cent are low-skilled employees; broadly comparable with other industries. A relatively high proportion holds Certificate III-IV (23 per cent compared to 19 per cent in other industries) with relatively less holding higher qualifications (31 per cent compared to 36 per cent).

Looking at the occupation profile of Victoria's automotive workforce reveals there are opportunities to move into stable sectors outside the declining manufacturing sectors, but few opportunities in the high-growth sectors. For the largest occupation – product assemblers who comprise 17 per cent of all employees – re-skilling will be essential given three quarters are in the declining manufacturing subsectors. That said, product assemblers are employed in other stable sub-sectors in Victoria such as repair and maintenance services, food and metal manufacturing, construction and warehousing. For the next two largest occupations – industrial engineers and structural steel and welding tradespersons – opportunities exist in stable sub-sectors such as professional services, metal manufacturing, construction and repair and maintenance.

Secondly, the continued overall decline of manufacturing means that many of the workers will need to seek employment outside of that industry, thus requiring additional re-skilling. Thirdly, unlike past programs, which were targeted at one large company, the re-skilling program that is needed should encompass the whole industry.

This changes the scale and complexity of the required response.

Finally, complicating this re-skilling effort is the current lack of concentration of training providers to match the concentration of manufacturing enterprises. Modelling undertaken by PricewaterhouseCoopers for the Victorian Department of Education and Early Childhood Development in 2011 forecast unmet need for vocational training in the region. These shortfalls will likely increase as affected employees begin to seek retraining options. With assistance, well-placed providers can take advantage of this opportunity to meet the growing demand for skilled employees in the region.

The Commonwealth has an established responsibility for supporting workforce adjustment transition programs and it did so in the 1980s and 1990s through the Labour Adjustment Training Arrangements (LATA) scheme. Under these arrangements, retrenched workers in designated industries, including automotive manufacturing, were provided support after retrenchment but before they served a prescribed period on unemployment benefits. Support included training costs, employment services and a special benefit above unemployment benefits while they undertook full-time vocational training.

To improve employment prospects for workers that are part of industry-wide retrenchment and restructuring, a similar approach would see all forms of adjustment assistance being made available to impacted workers immediately. Impacted workers are not only those facing retrenchment but also those remaining in firms undergoing transition to longer term sustainability.

Policy Recommendation

The Victorian Government considers that the arrangements formerly in place under the LATA scheme should be reinstated and modernised.

6.2.1. Labour Adjustment Training Arrangements

Affected workers will be best placed to reskill and secure continuing or alternative employment if they can access income support (or equivalent payment), reskilling and job search assistance. Specifically, the Commonwealth should provide access to job placement services to affected workers as soon as retrenchment is known or likely.

The Commonwealth should also:

- provide financial support associated with training (for example, tuition fees and materials) for workers who are retrenched, facing a real risk of retrenchment or require reskilling to remain employed in eligible transitioning firms; and
- make Newstart and Youthstart available to retrenched eligible workers irrespective of the timing and size of the retrenchment payments to better support workers transition to their next role.

6.2.2. Supporting affected workers to retrain for the jobs of the future

Past programs for retrenched employees have shown that early intervention is critical

to achieving optimal outcomes for employees in transition. See Appendix B for a summary of lessons from past programs. Skills assessment and career advice should be provided as early as practicable, together with access to training where necessary to support displaced or at risk employees to make an effective transition to new employment. Training providers are ideally placed to provide these transition support services.

Using the existing Victorian Training Guarantee (VTG) is the most efficient way of delivering the required training and is highly successful. The VTG, a training entitlement, has proven effective at improving the skills of low-skilled employees (Certificate II or below). This cohort represents around 40 per cent (or 1.4 million) of Victoria's working aged population. Latest figures show that around 18 per cent (or 250,000 low-skilled employees) were undertaking Victorian Government subsidised vocational training, with this group marginally more likely to take up VTG training than higher skilled employees.

The VTG is also designed to increase employees' emphasis on language, literacy and numeracy skills. The 2011 Victorian Competition and Efficiency Commission (VCEC) Inquiry into a *More Competitive Victorian Manufacturing Industry* identified this as a key need for manufacturing employees responding to structural change. The VTG funds foundation skills programs including literacy and numeracy for adults (including English as a second language), core employability skills and general education certificates. All adult students training below Diploma level are eligible for this subsidised training, and controls are in place to ensure providers effectively assess individual learner capabilities and customise foundation training to career-specific needs.

In light of the recent closure announcements, it is likely unprecedented demand will be placed on the Victorian training system and the VTG. Commonwealth financial support is required to meet this increased demand so that subsidised accredited training including language, literacy and numeracy and specific vocational skills training, careers advice and recognition of prior learning through the VTG can be made available to all workers in transition.

The Victorian Government proposes retraining arrangements to be funded by the Commonwealth have the following features:

- employees would be given a Careers Advice Entitlement (CAE). Career advisory services enhance the choices made by employees seeking to manage their career in the face of economic restructure; and
- employees would be eligible for a new category of VTG entitlement - an Employee in Transition Entitlement (ETE) - to undertake study in their chosen course and to receive formal Recognition of Prior Learning (RPL) at an approved Registered Training Organisation (RTO). The ETE would provide access to government subsidised training and skills support prior to a firm announcing closure. This means that all eligible employees would have access to subsidised training, allowing them to have existing transferable skills formally recognised and to retrain for their next role or in areas targeted by restructuring businesses.

This approach would build on Victoria's Workers in Transition program (WiTP), which since 2011 has offered participating companies in metropolitan and regional Victoria who are retrenching staff access to government subsidised training for nationally recognised qualifications. This training advice will be aligned to current industry and regional economic needs to maximise the possibility of those employees transitioning to new employment as quickly as possible.

6.3. Creating job opportunities through new investment in productivity-enhancing infrastructure

Well targeted support for infrastructure can have enduring economic benefits. It can also support the creation of new jobs, which is critical for supporting the economy. Victoria's full infrastructure pipeline has the potential to generate over 35,000 direct jobs over the life of these projects. Commonwealth funding support is critical to bringing these projects to market in the short term.

High quality economic infrastructure reduces business costs, attracts new private investment, and improves workforce participation and productivity. The benefits of infrastructure investment extend beyond the direct user, and can have spillover effects that spread into the wider economy, supporting land use and economic growth.

Strategic investments in productivity enhancing infrastructure boost economic activity resulting in ongoing increases in taxation revenues. Good investment decisions by Victoria should become a platform for funding the next round of investments that grow the Victorian and national economies.

In 2013-14, Victorian general government sector investment in roads, public transport, health, schools and other infrastructure is estimated to total \$5.8 billion. This builds upon on the \$5.4 billion infrastructure spend in 2012-13.

Policy Recommendation

The Victorian Government considers the next steps in the city and state-shaping infrastructure investment pipeline, and top priorities for additional Commonwealth funding are: the East West Link's western connections to the Port of Melbourne and beyond to Western Ring Road, and the Metro Rail Capacity Project to overhaul Victoria's rail network.

The efficiency of outer suburban and regional arterial roads impacts Victorian freight and commuter movements as directly as any of the state-shaping major projects listed above. Improvements to these arterials, including duplications and other upgrades - like grade separated interchanges, removal of bottlenecks, and bridge strengthening - are critical to the functioning of the network. There are billions of dollars in high priority, high productivity works that could be delivered much sooner with a Commonwealth contribution.

7. Conclusion

In summary, the Victorian Government's view is that adapting to the emerging environment in automotive manufacturing and associated industries will be a significant challenge. It is therefore paramount that the timing of any policy changes and assistance measures ease rather than exacerbate transition and that the design of assistance is balanced between the need to ease transition through to the end of 2017, whilst supporting diversification activities.

The Victorian Government will continue to work hard to manage these challenges. It will not be enough to rely on the historical strength of the Victorian economy to absorb the impact of the cessation of car manufacturing. Given the scale and complexity of the task, substantial Commonwealth assistance is required to support businesses, workers and local economies and ensure that the Victorian economy is sufficiently robust to adjust. It is imperative that this inquiry delivers well-researched advice to the Commonwealth on how best to achieve this end.