



Driving on Innovation and Competitiveness

June 2008

Submission to the Review of the Australian Automotive Industry





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PREFACE

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Declaration of Interest:

Ai Group is the largest individual industrial organisation of employers in Australia. Ai Group represents industries with around 440,000 business employing around 2.4 million people. Ai Group represents employers in manufacturing, construction, automotive, food, transport, information technology, telecommunications, call centres, labour hire, printing, defence, mining equipment and supplies, airlines and other industries.

Ai Group and its affiliates have approximately 60,000 members and employ in excess of 1.25 million employees. Ai Group itself provides services to approximately 10,000 companies employing around 750,000 employees.

In addition to representing industry, Ai Group provides a wide range of services to its members in the areas of: workplace relations; legal; human resource management; occupational health and safety; workers compensation; the environment; energy; international trade and export; economics; research; statistics; training courses; traineeships and apprenticeships; group training; career advice; seminars and conferences; publications; networking; equal employment opportunity and discrimination; taxation; superannuation; and immigration.

A large number (48 in total) of other Australian associations are affiliated in various ways with Ai Group. Also, Ai Group has close links and affiliations with 78 overseas organisations. These include, for example, the US National Association of Manufacturers (NAM), the US Chamber of Commerce, the Confederation of British Industry (CBI), the Engineering Employers Federation (EEF) in the UK, Business New Zealand, and the Confederation of Indian Industry.

Ai Group has offices in New South Wales, Victoria and Queensland and we maintain strong partnerships with the Engineering Employers Association of South Australia (EEASA) and the Chamber of Commerce and Industry in Western Australia (CCIWA).

The Engineering Employers Association, South Australia (EEASA) aims to represent and promote the interests of companies in the metal and engineering manufacturing sector in South Australia. It provide a range of advisory services to member companies in the areas of industrial relations, human resource management, environment, industry development, education, training and industry performance

Ai Group provides administrative and executive support to the state councils and members of the Federation of Automotive Products Manufacturers in NSW and Victoria. EEASA provides similar support in South Australia.

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EXECUTIVE SUMMARY

The Australian Industry Group and the Engineering Employers Association South Australia (EEASA) welcome the Federal Government's decision to review future policy settings for the automotive sector. We agree that this should be an integral part of the broader National Review of the Innovation System as the future of the industry is dependent on its capacity to drive innovation and competitiveness.

As a general principle, Ai Group and EEASA believe that where there is a case for government intervention, industry programs aimed at lifting the productivity and competitiveness of business (whether that be through innovation, global supply chains, improved production techniques or skills enhancement) should be available to industry generally. This minimises the likelihood of market distortions that can arise from sectoral strategies. Our Innovation submission highlights a wide range of initiatives which are aimed at benefiting all industries including the automotive industry, such as the R & D Step-Up Program and Collaboration Grants.

This however is not to deny that there are particular instances where for structural adjustment purposes, or because of a sector critical importance to Australia's national and economic interests, that specific program support to a sector is warranted.

The case for such sector support must be won on its economic merits and benefits to the national economy.

The Australian automotive sector is at the forefront of confronting the forces of global economic change, including the challenges created by the emergence of China and India. These include an accelerating Australia dollar and oil prices, the need to respond to carbon emissions, the globalisation of the automotive industry, and the competition for investment from multinational companies. In investing in the industry, the Federal Government needs to be certain that its investment will contribute to a sustainable and competitive automotive sector. This is particularly so when other sectors of the economy and consumers would bear the cost of maintaining the current tariff regime and significant financial support.

The automotive industry has called for automotive tariffs to be frozen at the current levels beyond 2010 and for funding for the Automotive Competitiveness and Investment Scheme (ACIS) to be maintained at current levels (rather than halved after 2010).

The tariff argument rests on three factors: the erosion of competitiveness caused by a sustained stronger dollar; economic modeling pointing to negative net economic benefits; and the need to negotiate from strength on improved access to overseas markets. The ACIS argument rests on the need to compete with other countries for highly contested investment funds in the global automotive industry. However, despite its benefits, ACIS has a significant design element that encourages the importation of foreign cars and components.

Whatever policy solution is adopted, Ai Group and EEASA believe that as soon as practical automotive tariffs should move to the general tariff rate applying across all other industries.

Ai Group's and EEASA's submission also addresses a number of other issues important to the automotive industry. This includes better access to the R & D tax concession, particularly where it involves process innovation; improving capabilities and skills within the automotive

sector; and support for enhanced environmental sustainability practices, including the recently announced Green Car Fund.

Finally, the submission deals with issues relating to workplace relations, the process of restructuring and employee entitlements. Ai Group and EEASA support enterprise bargaining which enables each company to negotiate employment arrangements best suited to their individual needs and circumstances. Ai Group and EEASA oppose pattern bargaining and the union push for an industry framework agreement. The current provision of a GEERS scheme makes redundant the need for a separate arrangement to protect employees' entitlements.

The Review's interim report to the Federal Government will need to consider the arguments outlined in our submission in making recommendations to support the automotive industry and Australian economy as a whole. Ai Group and EEASA look forward to receiving the interim report to the Federal Government.

AN INNOVATIVE AND COMPETITIVE FUTURE

The Australian Industry Group and its affiliate, the Engineering Employers Association, South Australia (EEASA) welcome the Federal Government's initiative to undertake a review of the Australian automotive industry. Ai Group and EEASA have a strong involvement with the industry, firmly believing in its ongoing importance to Australia's economic future.

The automotive industry (covering producers, suppliers, and repairers) is important to a globally competitive Australian economy in a number of respects: it makes a significant contribution to the Australia economy, with an annual turnover of over \$25 billion; provides direct employment for over 52,000 people; is a significant investor in manufacturing facilities and plant (totaling over \$4.5 billion in the last five years), a key provider of research and development expenditure (in excess of \$900 million); a top ten exporter for the Australian economy (totaling \$4.8 billion a year); and significant contributor to skills training and upskilling. Nationally, an additional 100,000 jobs in other industries (steel, glass, plastics, textiles and services) are dependent on the automotive industry¹.

The changing nature of this industry is widely recognised, with many differences apparent since the Productivity Commission's Automotive Inquiry undertaken in 2002. A scan of changes to the industry since the Automotive Inquiry reveals changed characteristics needing a correspondingly new set of strategies to be established within a long timeframe. Some of these changes include: global manufacturing strategies now dominating the industry; Australian produced cars having substantially higher levels of components sourced from overseas; Australian produced cars now accounting for a lower 19% of local vehicle sales; Government support facilitating a shift to imported cars and components; tariffs standing at 10%, and Automotive Competitiveness and Investment Scheme (ACIS) funding caps giving recipients around 65% of full credit entitlement.

Added to these characteristics is the substantially higher and sustained Australian dollar. Economic modeling has identified that economic outcomes from a tariff reduction are sensitive to dollar movements and the terms of trade, leading to negative results. Profit to sales ratios for the industry are at a near record low of 3.4% (compared with 7.2% for manufacturing overall), and the industry's business expenditure on R&D (BERD) has declined to 9.1% of all BERD. Management of greenhouse gas emissions from business operations on the environment has grown appreciably in importance; however there appears more to be done to change practice.

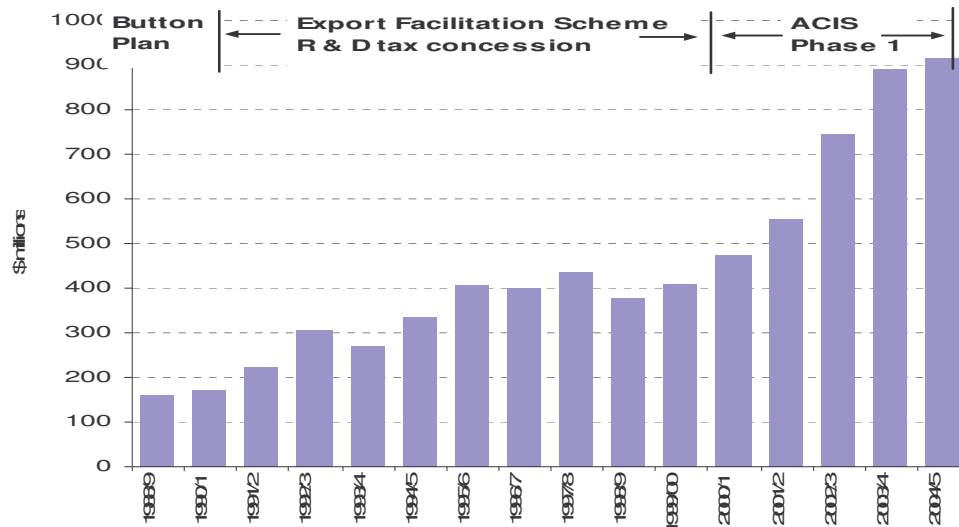
Despite the significant investment in tariff support and Automotive Competitiveness and Investment Scheme (ACIS) funding total \$2 billion under the current scheme, the rising intensity of global competition, the emergence of new car producers in China, Thailand and Korea, and the rising Australian dollar has punished the fortunes of the Australian industry. Consequently, there are fewer cars produced in Australia than in 2002, and the value of automotive exports has barely grown.

Nevertheless, the industry has responded positively to the R & D incentives offered under ACIS, with expenditure almost doubling over a four year period (Figure 1), a growth rate well in

¹ Victorian Government, Submission to the Automotive Review, 2008, p.7

excess of that achieved across the rest of manufacturing, making the automotive sector a key driver of innovation in Australia. Capital expenditure has also lifted under ACIS.

Figure 1: Growth in R & D expenditure in the automotive sector



If Australia is to attract investment from the overseas headquarters of the three Australian car manufacturers, it is imperative that the strategies and funding initiatives resulting from this review ensure the sustainability of vehicle manufacturing in Australia. This requires the Federal Government to:

- present a strong vision for the industry by setting, in conjunction with the industry, a long term operational framework spanning the next 15 years
- demonstrate its commitment to support the industry so the industry can maintain a viable operation in Australia,
- maintain automotive tariffs at a level that is consistent with our competitors and which provide for a capacity to negotiate improved access to foreign markets, and
- provide funding arrangements that reflect the current and future global automotive production environment.

Ai Group has recently undertaken a survey of members of the automotive components sector seeking current data on growth, changes, key issues, customer and supplier relationships, competitive pressures and innovation. While responses are still being finalised, it is important to note that 10% of companies surveyed who previously were part of the components sector (mainly Tier 2 or 3) stated they no longer supply to the automotive industry, basing their production around other products and sectors. This is reflective of the challenging environment facing component suppliers including higher materials costs, pressures to lower their own prices and to continually innovate.

In broader strategic terms, Ai Group and EEASA support the deliberate connection made by the Government between the automotive review and its major review of the National Innovation System. It is vital that challenges facing the automotive industry are viewed within the broader

context of innovation. Many examples of innovative solutions already exist in the car industry. As with the broader economy, introducing and strengthening key innovation initiatives for automotive suppliers, will be integral to international competitiveness and productivity. Whilst the automotive sector has specific needs in adjusting to a lower tariff regime, and ACIS exists to provide for structural adjustment, industry assistance must be seen within the overall context of our national innovation system.

As a consequence, we believe that many of the proposals put forward within Ai Group's submission to the Review of the National Innovation System to enhance the capacity of Australian industry, including public support for R&D and skills creation, will be of benefit to the automotive sector. Encouraging business innovation in the sector, creating regional foci for R&D, design and engineering, and boosting supply chain participation are all central industry issues and very relevant to automotive. Given our innovation submission's central importance to this review, a summary of Ai Group's proposed schema for a National Innovation System follows. However we encourage the review team to consider the proposals in detail, within the context of the automotive industry.

Ai Group's innovation submission focuses on a business innovation schema that reduces complexity of innovation initiatives, by streamlining current offerings and by establishing the means by which all parties – Governments, business and the research community – can work better together. Ai Group proposes five major streams of business innovation programs:

- **Research and Development:** strengthening business R&D reach and intensity;
- **Capabilities:** strengthening innovative capabilities in companies, managers and employees;
- **Commercialisation:** further supporting businesses to commercialise their R&D;
- **Collaboration:** building new connections and collaborative opportunities; and
- **Sector Initiatives:** supporting specific sector initiatives related to innovation.

Ai Group has proposed over 18 major initiatives that should drive the development of business innovation. Whilst details on all initiatives are outlined further in Ai Group's submission, seven initiatives in particular are new:

- R&D Step-Up Program, to provide improved tax incentives for companies to spend significantly more on R&D, and to encourage R&D in companies with no previous experience;
- A range of reforms to the education and training system to enhance innovation skills training among managers and employees, including:
 - a new network of appropriately skilled specialists to address identified skilling needs;
 - new engagement strategies for people with low literacy levels;
 - restructure funding of the training system to make training available more quickly, and encourage new delivery partnerships particularly around new technologies;
 - a focus by business advisers under Enterprise Connect on diagnosing and building innovation capabilities in companies; and
 - a new round of strategic thinking on the needs and future directions of management in companies.

- Encourage domestic innovation efforts through Government purchasing arrangements;
- A new 'Into the Market Program', that provides tailored assistance for companies seeking to commercialise their R&D;
- Collaboration Grants, that will support companies who wish to undertake collaborative innovation either with other companies, research institutions, or in regional clusters;
- The use of University Compacts to build collaborative research outcomes across Australia's universities; and
- A Centre for Innovation Excellence, to promote and support world class developments in innovation and to communicate these across industry;

Examples that highlight the ways in which Ai Group's initiatives would benefit companies in the automotive sector include:

- utilising the R & D Step-Up Tax Concession: the domestic car producers would be able to access the concession, whereas the current R & D Premium Tax Concession limits eligibility because of the lumpy nature of R & D expenditure;
- changing the definition of R & D to provide for a broader range of activities undertaken by the automotive industry to gain access to the tax concession;
- accessing the Collaboration Grants proposed: this would offer many new research collaboration opportunities that are not currently available;
- access to business advisers to support smaller component manufacturers in lifting productivity and competitiveness through Enterprise Connect;
- eligibility to apply for funding under the Clean Business Australia initiative, which will give the industry funding to implement eco-efficiency improvement;
- improved training and upskilling opportunities through VET and other training avenues through our skilling initiatives;
- benefits accruing from reforms to management education following the proposed national review, which will enhance the innovative skills of managers;
- ability to enter into partnerships with research universities through University Compacts; and
- benefit from the Government Purchasing proposal: this would have the effect of stimulating innovation and competitiveness within the automotive sector.

Add to this, the prospect of an Automotive Innovation Council being created after July, the continued work of the Automotive CRC, State Government initiatives, such as C21 Challenge in Victoria (to lift lean capability skills in the components sector), and the substantial initiatives of the domestic car producers themselves to improve their supply chain, and Ai Group's other recommendations set out below, there is a cause for optimism for a strong and vibrant automotive industry in Australia.

KEY FEDERAL INITIATIVES: TARIFFS AND ACIS

Notwithstanding the benefit to the automotive industry that would arise from Ai Group's overall innovation proposals to the Federal Government as part of the Innovation review, consideration of specific Federal initiatives is warranted as a result of the challenges to and importance of this sector to the Australian economy.

The automotive industry is a highly globalised sector with the major automotive manufacturers operating production plants in a range of countries, each competing for production, investment and R & D opportunities. For Australia to remain a significant manufacturing operation, the headquarters of car producers in Tokyo and Detroit need to be assured that there are significant incentives to maintain offshore operations in Australia compared to other highly competitive locations around the world.

In almost all countries with car and components producing facilities, there are significant tax and funding incentives offered by governments. In Thailand, while it maintains a free trade agreement with Australia with no tariffs on large passenger motor vehicles (and 30% on other motor vehicles), for other countries the tariff rate is set at 80%. Thailand is offering attractive tax arrangements which provide for a company tax holiday for eight years, attractive regional development incentives to establish outside Bangkok, and waiving of import duties on imported machinery. It has attracted operating facilities from GM, Ford, Toyota, and Mercedes Benz among others, and has announced new plants for Honda, Suzuki and Nissan, with seven more proposals in the pipeline.

In China, tariffs on imported passenger vehicles range from 25% to 43%, as well as the utilisation of non-tariff barriers which ensure significant distributional barriers in the marketplace. Since April 2006, China has implemented "whole vehicle character" regulations which impose a tax on imported automotive components equal to the tariff on a complete vehicle if the final assembled vehicle fails to meet certain local content requirements. As well, the local industry receives significant state and local government support either directly or by way of subsidised input costs, such as the cost of electricity.

The shift of global automotive production towards emerging economies, such as China, India, Thailand and Eastern Europe to take advantage of low cost production facilities and their booming markets for car sales means the Australian automotive industry will face further strong pressure to remain globally competitive. Australian car and component companies are doing much to improve their operations by lifting productivity through improved (lean) operational models, investment in new technology, the pursuit of global supply chains, and the upskilling of staff. But more needs to be done, and this requires the three major car producers to grow their operations through stronger domestic sales and more exports.

The Australian automotive sector receives significant funding from the Federal Government to facilitate structural adjustment from a previously high tariff regime to a low tariff regime. In the automotive sector, the Productivity Commission estimates a total assistance of \$1.255 billion in 2006/7, consisting of \$581.9 million in budget assistance (mainly ACIS), and the remainder through tariff assistance.

As a general principle, Ai Group and EEASA believe that where there is a case for government intervention, industry programs aimed at lifting the productivity and competitiveness of business

(whether that be through innovation, global supply chains, improved production techniques or skills enhancement) should be available to industry generally, as this minimises the likelihood of market distortions that can arise from sectoral strategies. This however is not to deny that there are particular instances where for structural adjustment purposes (such as automotive), or because of a sector critical importance to Australia's national and economic interests (such as, defence industries and ICT), that specific program support to a sector is warranted.

The automotive industry is at the forefront of such circumstances and it argues that it cannot make the appropriate long term investments unless government policy is more attuned to the global operational strategies of Holden, Toyota and Ford. In essence, the industry's arguments depend on the nature and level of the tariff regime, and the nature of funding support offered under ACIS.

Automotive tariff policy

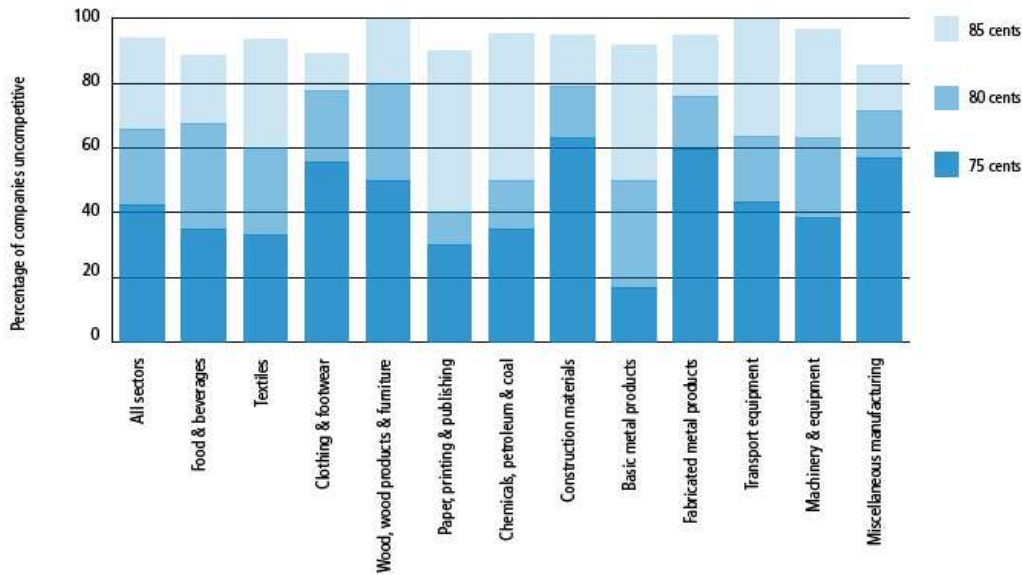
Tariffs are set to fall from 10% to 5% in the automotive sector from 2010. For a number of reasons, the automotive sector is calling for the Federal Government to freeze tariffs at their current level to give the industry greater confidence in the future.

First, it has been argued that the decision to lower tariffs from 2010 was made at a time when the Australian dollar stood at 56 cents to the US dollar. Today it is around 96 cents, and as a consequence, imports have become significantly cheaper, and exports more expensive. It is argued that retaining tariffs at their current levels would be one action the Government could take to ensure that the effects of movements in the Australian dollar are not compounded by lowering tariffs.

The outcome of the higher Australian dollar is a loss of competitiveness and profitability. Surveys undertaken by Ai Group have identified that for every one cent appreciation in the Australian dollar this translates to an approximate \$850 million decline in export earnings. After competition from overseas countries, the strength of the exchange rate was identified as the second most influential factor affecting export activity. Nearly two-thirds of the businesses surveyed (65.5 per cent) believe their exports are uncompetitive at an exchange rate of US\$0.80. Furthermore, 93.7 per cent of manufacturers believe that their exports become uncompetitive when the AUD exceed US\$0.85.

Chart 2 shows the various levels of the exchange rate at which Australian manufacturers become uncompetitive in global export markets; for all sectors and across individual sectors. In regard to the transport equipment sector (covering car and component manufacturers), two findings are evident. First, because of the highly sophisticated nature of manufacturing, the transport equipment sector is able to remain competitive at a higher threshold level than most other sector. Nevertheless, the effects of the exchange rate are increasingly harmful the higher becomes the level of the Australian dollar (relative to the US). At 75 cents, around 40% of manufacturers in the sector become uncompetitive; at 80 cents it rises to over 60%; and at 85 cents nearly every car and component manufacturing is uncompetitive².

² Australian Industry Group, The Australian dollar and manufacturing exports: shaping earnings and prospects, June 2007, p.27

Figure 3: Impact of higher Australian dollar on competitiveness

Source: Australian Industry Group, The Australian dollar and manufacturing exports: shaping earnings and prospects, June 2007, p.27

FCAI has estimated that since 2002, the appreciation of the Australian dollar has contributed to a 30% reduction in competitiveness of Australian vehicles³. Ford in its submission to the review has noted that in 2002, an Australian built car then was 23% more competitive than a comparable yen sourced imported car. This represents about \$5,400. The combination of sustained currency appreciation and the high level of the Australian dollar mean an imported car now has an advantage of about 6% or more than \$3,500. This represents a severe deterioration in the competitiveness of locally manufactured cars of nearly \$9,000⁴.

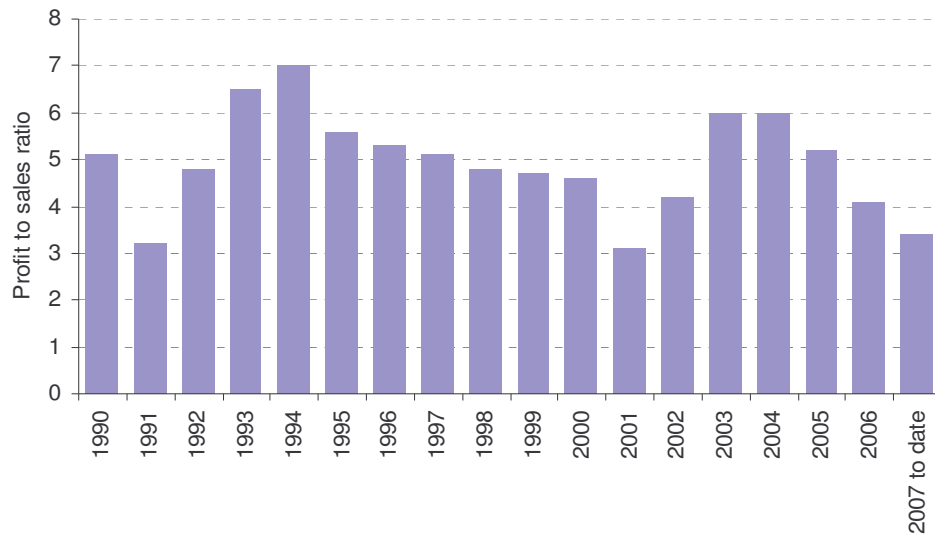
Chart 3 highlights profit (before tax) as a percentage of sales. The decline in competitiveness has contributed to profit margins being at their lowest level in six years. The chart highlights that such low profit margins have not been sustainable in the industry, and through a combination of restructuring and major changes to operations, the industry has worked toward improving profitability. Similar forces are again in play, with the closure of Mitsubishi, the use of overseas supply chains, the increasing adoption of lean practices and the introduction of new models into the industry.

A second factor contributing to the industry's call for a tariff pause is that a further lowering of automotive tariffs would deliver little net economic benefit (and maybe a small negative effect) to the Australian economy, because the optimum tariff rate is probably close to current levels. This is the preliminary finding of econometric modeling undertaken by Lateral Economics and Monash University for the Victorian Government⁵. Any gains from a tariff reduction may well be wiped out by countervailing effects on Australia's terms of trade.

³ FCAI, Submission to the Review of Australia's Automotive Industry, 2008, p.19

⁴ Ford Australia, Submission to the Bracks Review, 2008, p.20

⁵ Victorian Government submission to the Automotive Review, 2008, p.32

Figure 3: Profits as a percentage of sales, transport equipment sector

Source: Australian Automotive Intelligence Yearbook and Australian Bureau of Statistics

The argument is that when tariffs on imports are removed the quantity of imports expands and the quantity of exports also expands (we can think of the increased labour and capital available to export industries). The increased level of Australian imports is unlikely to change prices for the things we import. This is because we are not a big enough purchaser to influence the world price (i.e. we are a “price taker”). However, the expansion in our export quantities may influence the world price if we are a big enough supplier (relative to the market). We may be a price setter in some commodity markets and in some of our niche service and manufacturing markets (at least in the short to medium term and perhaps in the longer term too).

If our export prices fall relative to our import prices we then get the negative terms of trade effect on household incomes. This is an impact on household incomes in the opposite direction to the benefit to households being delivered by the current “favourable” terms of trade due to the minerals boom. In summary, this suggests that the gains from lower car prices with a reduction in the tariff could be outweighed by a loss in income from lower terms of trade.

It is important to note that if the allocative efficiency effect of the fall in tariffs is smaller, the change in behaviour in the domestic economy will also be smaller and there will be a lower increase in imports. In turn the terms of trade effect will also be smaller.

The absolute size of the terms of trade effect of a cut in tariffs will depend on the export demand elasticities. The results of the Productivity Commission’s economic modeling will be important in assessing these issues.

Third, it can be well argued that Australia should not lower its tariffs until other countries have taken action to improve access to Australian exports by lowering their tariffs and removing non-tariff barriers.

Australia has negotiated Free Trade Agreements with Thailand, United States and New Zealand (under the Closer Economic Relations agreement). These agreements have proved to be of mixed benefits to Australia's car and component manufacturers.

In the case of Thailand, the trade balance remains heavily in favour of Thailand. Under the agreement, Australia eliminated tariffs on all Thai passenger vehicles, off-road vehicles, utilities and other commercial vehicles, while Thailand eliminated its 80% tariff on large passenger vehicles and 60% tariff on goods vehicles, to be phased down to zero in 2010. Automotive exports to Thailand have remained modest despite the agreement, amounting to \$21 million in 2006/7. In contrast, automotive imports from Thailand have grown strongly from \$793 million in 2002/3 to \$2.9 billion in 2006/7. While the agreement has opened some opportunities for Holden and Ford for large car sales, Toyota has gained little benefit for its Camry sales as the agreement only provides preferential access for vehicles above three litres.

In the United States, implementation of the FTA in 2005 saw the US remove all tariffs on automotive products, including the elimination of the 25% tariff on commercial utilities. The US is a major market for Australian motor vehicle components. However, exports of vehicles and parts have declined from \$680 million in 2002/3 to \$148 million in 2006/7. In contrast, US imports have grown strongly from \$1.5 billion in 2002/3 to \$2.3 billion in 2006/7. Holden plans to sell its Commodore utility in the US market, rebadged as a Pontiac.

New Zealand continues to be an important market for exports for all three car manufacturers given the absence of a domestic automotive manufacturing sector in the country.

The Government is also currently in negotiation (at varying levels) for a range of other FTAs, including China, Japan, Malaysia, Republic of Korea, Gulf Cooperation Council, and Japan. An agreement with Chile has also recently been concluded.

The implications of FTAs with Japan, Korea and China are the most critical to the automotive industry. Japan's exports of passenger vehicles to Australia were worth \$6.2 billion in 2006/7, while exports of commercial vehicles rose by 19% to \$1.5 billion. Given the fact that Japan accounts for around 41% of imported cars to Australia, the prospect of an FTA would have serious implications for the ACIS Program as imports would carry no tariffs, making ACIS credits of limited use. This would be a similar outcome for Korean car imports, although they represent a much smaller share (6%) of the imported car market.

China is currently the fifth-largest global market for vehicles. In 2003, China's more than 100 car makers produced 4.44 million vehicles across the full model range. China also has over 4,000 component producers. Chinese automotive imports from Australia have grown at an average annual rate of 14.9% over the last decade to reach US\$46.3 million in 2003-2004, and Australian automotive imports from China over the same period have grown by an annual average rate of 21 per cent to reach US\$176.9 million. With China expected in time to emerge as an increasingly important source of imported cars, an FTA with China would also erode the value of ACIS credits in future years. The FTA could also be expected to lead to Australian component producers further increasing their investment in China.

As well, there is significant uncertainty surrounding the completion of the current Doha round of WTO multilateral trade negotiations.

A number of our proposed FTA partner countries and many others also maintain significant non-trade barriers which limit the entry of Australian goods and services. This may include tax incentives; non-tax subsidies; loans from state-owned enterprises at non-market rates; price controls or subsidies for raw materials and inputs; sector-specific industrial policies; land grants; subsidised utility charges, government procurement procedures favouring domestically owned companies; and other forms of 'guidance'

Some of these non-trade barriers were highlighted in an Ai Group study into Australian industry engagement with China, with a high percentage of companies with business/export dealing with China listing one or more of the following seven key issues, in descending order of frequency;

- Lack of intellectual property (IP) protection (49%);
- Lack of transparency in legal and financial systems (44%);
- Inconsistent enforcement of import duties (42%);
- Inconsistent interpretation of provincial laws (38%);
- Varying customs requirements (35%);
- Unique technical standards (34%);
- Restrictions on foreign investment (23%); and
- Quarantine controls (19%).

IP rights infringement by Chinese companies remains the greatest concern of not only Australians exporting to and investing in China, but for companies supplying the Australian and third country markets. Almost half (49%) of firms exporting to China identified shortcomings in China's IP protection as the number one issue of concern among all China's non-tariff barriers. This was consistent for firms of all sizes.

Companies in the automotive and electrical products sectors in particular, identified numerous factories illegally copying their products. When they have taken action with local authorities to shut these plants down, they find that other infringers rapidly spring up in other locations. Many companies see enforcement of their IP rights in China as a futile endeavour and intentionally withhold innovative designs or products from the Chinese market⁶.

Overall, Ai Group and EEASA acknowledge that the three arguments for a tariff pause are not straight forward, and the benefits that would accrue to the automotive sector in terms of jobs, exports, domestic production and sales must be weighed against the on-going costs to be born by the rest of industry and consumers generally.

In the longer term, the maintenance of current automotive tariffs is no panacea for a sustainable automotive industry in Australia, as the industry must maintain operations in their own right that are globally competitive. This means that as soon as practical automotive tariffs should move to the general tariff rate applying across all other industries. The question of when this should occur depends on the net balance of economic benefits and costs, the importance the Government places on the industry, and the expectations of the three car producers in having a favourable policy environment to encourage further investment from parent companies.

⁶ Australian Industry Group, Australia and China, Deeper Engagement, August 2006, p.30

The ACIS Program

The other element of assistance to the Australian automotive industry is the ACIS Program. Funding under ACIS is set to halve in 2010, from \$2 billion (over 5 years) to \$1 billion, and end in 2015.

Given that the process of structural adjustment has been more difficult and competition more aggressive (under a stronger dollar) than anticipated in 2002, when global manufacturing strategies by the multinational car producers were in their early days and China was yet to make its mark, the automotive industry has argued for ACIS funding to be increased to eliminate modulation and this funding continue beyond 2010.

Ai Group and EEASA understand the automotive industry's argument that if Australia wants to maintain a viable automotive sector, because of its importance to national R & D, investment and manufacturing capabilities, then the Australian Government, like other governments around the world, needs to support the industry, especially if it is to attract foreign investment to Australia

Of course this is not just a matter relating to tariffs, but for many multinational companies (which characterise much of the Australia automotive sector) it relates to a complex range of factors, including the business tax regime, investment incentives, the workplace relations environment, the pool of skills and innovative talent, and the quality of major infrastructure facilities, such as ports and road networks.

The Australian car industry must compete with others countries for investment funds from parent companies, and this is a highly contested market. Programs such as the ACIS program can make a clear difference. As the Victorian Government in its submission highlights, "previous economic modelling from a range of sources concluded that ACIS has had a substantial impact on the success of the industry in driving new investment and innovation during a period of unprecedented worldwide competition⁷".

The importance the industry attaches to the role of Government support through ACIS in ensuring a competitive automotive industry in Australia so that investment decisions made from the global headquarters of General Motors, Ford and Toyota remain favourable to Australia are highlighted in both Ford and Toyota's submission to this review. Ford stated:

"Australia is now very much part of a global automotive industry. It increasingly produces similar products, reflects a strong global culture and, in many cases, shares common corporate ownership. Most major investment decisions are made globally. Australia's ability to participate in these decisions is based on its own competitiveness, capability and profitability⁸".

Toyota in its submission made the link even more explicit:

"The future level of ACIS funding will be critical in enabling Toyota Australia, and the broader industry, to compete for global automotive industry investment. Toyota Australia is studying the next phase of local investment, which could be worth in

⁷ Victorian Government submission to the Automotive Review, 2008, p.33

⁸ Ford Australia, Submission to the Bracks Review, 2008,p.16

excess of \$1 billion, and ACIS is a critical consideration in the decision making process⁹.

Finally, Holden in its submission which is aptly titled, "Making Australia an Attractive Place for Global Investment" states:

"Regardless of the form and extent of Government support for the industry, it must take into account the need for the Government policy environment itself to be internationally competitive. As discussed, it is well accepted that developed and developing countries worldwide value ongoing investment in their automotive industries. If Australia is to be viewed by international investors as a competitive location, it must be seen as a country that supports its car industry. In this context, it will be vital that the decisions from the current Review send the appropriate messages. ¹⁰".

Ai Group and EEASA acknowledge the case for ongoing support to the automotive sector beyond 2010. The design and content of such support raises many complex issues. In relation to design, there is a major issue that particularly affects component manufacturers. ACIS appears to have had a perverse effect in facilitating greater imports over domestic production. Under the program, ACIS gives import credits on the following basis:

Motor Vehicle Producers

- 25% of the value of production of motor vehicles, engines and engine components, multiplied by the automotive tariff rate;
- 10% of the value of investment in approved plant and equipment used to produce motor vehicles, engines or engine components; and
- in those instances where MVPs produce automotive components (other than engines and engine components), automotive machine tools, automotive machine tooling, or automotive services to a third party the firm will be eligible for a 25% investment incentive and a 45% R&D incentive.

Automotive Component Producers/ automotive Machine Tool and Tooling Producers/automotive Service Providers

- 25% of the value of investment in approved plant and equipment; and
- 45% of the value of investment in approved R&D.
- No participant will be permitted to receive benefits exceeding 5% of its annual sales in the preceding year.

A high dollar (making imports cheaper), the global purchasing practices of the car companies and ACIS have all combined to accelerate a decline in local content. A number of component companies have experienced contracts being lost to overseas competitors and sales diminished as imported cars represent a larger share of total domestic sales.

Some have argued that ACIS should be changed to stop the program giving an incentive to further imports by changing the credit to, for example, a tax credit. Others have argued that the tax credit could be used to offset payment of payroll and other state taxes, with the Federal Government compensating State Governments for loss of revenue. However, unless the tax credit was restricted to offsetting GST on the purchase of domestic inputs (contrary to World Trade Organisation local content rules), then such a change would have little effect.

⁹ Toyota Motor Corporation Australia Submission to the Automotive Industry Review, 2008, p.33

¹⁰ GM Holden Submission to the Review of Australia's Automotive Industry, 2008, p.37

As well, as previously highlighted, if Australia proceeds to have an FTA with Japan, then ACIS will either need to be reformulated, or car tariffs retained under an FTA.

FAPM¹¹ in its submission to the review has raised the possibility of a public campaign to better inform consumers of the local content of cars sold in Australia. This was recommended by the Federal Standing Committee on Employment, Workplace Relations and Workforce in 2006. FAPM has raised the idea of a local content sticker being placed on the windscreen of new cars sold. While the proposal has merit, its effectiveness would be dependent on its capacity to accurately measure all inputs sourced from overseas right across the supply chain, and not just from the car manufacturers.

¹¹ FAPM Submission to the Automotive Review, 2008, p.9

OTHER FEDERAL INITIATIVES

While Ai Group and EEASA understand that the automotive sector has specific needs in adjusting to a lower tariff regime, and that ACIS is primarily aimed at supporting such structural adjustments, industry assistance must be seen within the overall context of our national innovation system. This highlights the importance of enhancing the capacity of Australian industry through public support for R&D and skills creation.

Increasing access to the R&D tax concession

Expenditure by the automotive industry on R&D has increased in recent years, which is in part due to the support received through ACIS. R&D deemed as eligible under ACIS has a broader scope than the criteria for eligibility under the R&D tax concession.

Given the change in business practices since the introduction of the R&D tax concession in 1985, it is considered that the concept of 'innovation', for the purposes of the R&D tax concession is too narrow.

Where innovation resides in design, creativity and individuality, much activity is frequently considered ineligible for the R&D tax concession because such activity is not considered scientific or experimental.

It is recommended that the definitions be broadened to include business process innovation and design which may include principles outside of science or engineering. Such a change would provide greater opportunities in areas such as tooling. Other examples of activities that may incorporate innovative efforts include changes to:

- production systems and processes;
- management capabilities and techniques;
- supply chain and logistics management;
- ecosustainability systems of operations; and
- product design and assessment.

Innovation should include a simple novelty consideration of whether the variation makes a contribution to the working of the material, product, process, device or service. This may involve a solution to a problem of a single step in the process that is "non-obvious" at the time of development.

Strengthening industry capabilities

Now is a key time to seek ways to strengthen the capabilities within the industry, in order to take advantage of the increasing demand for products in this sector on a global scale. In this regard, it is recognised that the suppliers play a critical role to car companies.

ACIS has provided funding for some supplier development initiatives. For example, Toyota has developed a program which was trialed with 10 key suppliers in 2007 costing \$2.2 million. This program is planned to be extended to 30 suppliers. In Victoria, the State Government has developed a C21 Challenge program. Specialist business advisers, diagnostic reviews, introduction of lean production principles, mentoring, production and workforce planning and networking opportunities are all elements which could be built into the centre to help lift the

capabilities of Tier 2 and 3 suppliers. The C21 Challenge is demonstrating that companies can become more innovative if they possess the relevant capabilities.

Similar services are provided through the Federal Government's new Enterprise Connect program, part of which involves business advisers undertaking business reviews across Australia to help Australian businesses become more innovative and boost productivity. However the specialist needs of the automotive industry call for a specialist centre to focus on sector issues. Enterprise Connect will involve the creation of 10 Manufacturing and Innovation Centres to support businesses in their efforts to become more productive, better able to compete in global markets, and in their abilities to adopt modern business and innovative practices. Under this initiative, business advisors have been successful in engaging small to medium enterprises to review their operations and to consider a range of business improvements.

The other element of Enterprise Connect is the creation of four Innovation Centres: Clean Energy, Creative Industries, Remote, and Regions. The Centres will support new and existing businesses by connecting them to other companies, by providing incubators, access to experts, scientific advice and the latest technology, access to prototyping and testing facilities, assisting them to identify new markets. With the proposed Automotive Centre for Innovation Excellence complementing this development, Ai Group and EEASA believe that these Centres could be a model for the future development of innovation skills and capabilities.

Ai Group has proposed in its Innovation Submission the establishment of Centre for innovation Excellence. The Centre would be modelled on successful developments in South Australia (the SA Centre for Innovation) and previous initiatives in Victoria, such as the Innovation Insights Program, to offer a range of services to the automotive industry. These services could include seminars and workshops; best practice training; regular company visits to learn from best practice; collaboration and networking initiatives; the development of new products and services; support for mentoring initiatives, and assistance in commercialisation. The Centre would become a "one-stop" shop for companies wanting to learn more about the best in innovation, and build their expertise. The Centre can also sponsor overseas missions on innovation, as well as promote international R&D collaborations.

Ai Group and EEASA would support the proposed Centre for Innovation Excellence giving considerable focus of pursuing excellence in the automotive centre. As well, there is a strong case for boosting funding for the expansion of the supplier development initiative under ACIS. While Enterprise Connect will assist in lifting overall innovative and management capabilities within the automotive sector, a specialist program on lean practices is warranted.

Opportunities for innovation arising from environmental imperatives

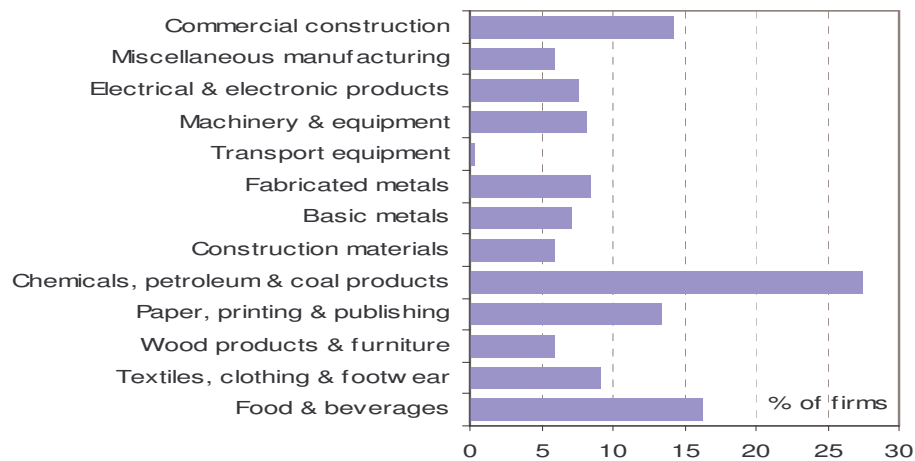
The automotive industry is a key target in the search for solutions to the growing global urgency to address climate change. With the correct balance of assistance and innovation, companies can meet the calls for social responsibility, recognise they must also be eco-efficient, control costs and improve competitiveness.

The automotive industry has specific targets to meet in this area, for example the existing vehicle emissions targets aimed at lowering fleet average fuel consumption for passenger cars by 18% by 2010. However further environmental strategies can be adopted within company

operations using the findings from Ai Group's 2007 study into *Environmental Sustainability and Industry, Road to a Sustainable Future*¹², which is equally relevant across all industry areas. The study identified that 78% of the 810 companies (with sales revenue in excess of \$41 billion) surveyed believe they had a responsibility to contribute to greenhouse reductions, even if it added some costs to the business. Despite this, only one in ten companies were aware of the greenhouses gases emitted by their operations, either directly or indirectly. Because of this low awareness, only one in six manufacturing enterprises is taking action to lower their use of electricity and other energy resources.

In particular the study found that companies in the Transport Equipment sector had the lowest awareness of the volume of greenhouse gases they emitted (Figure 2). An awareness of emissions is clearly the first step in understanding where action can be taken to improve management practice.

Figure 2: Awareness of greenhouse gases emitted by sector



Source: Australian Industry Group, *Environmental Sustainability and Industry*, 2008, p.30

Savings in resource usage by those companies who had undertaken a reduction activity in 2005-06 were substantial: 5.8% in electricity, 4.8% in gas, 8.3% in water, and 7.5% in solid wastes. Much of the savings achieved were largely through changes in behaviour rather than large capital expenditures. For example in electricity, 60 per cent of savings were achieved through better practice. Examples of electricity savings include:

- Turning off lights and appliances when not in use;
- Installing energy efficient globes;
- Installing skylights and improved lighting systems;
- Power factor correction;
- Putting time clocks on heaters;
- Acquiring more efficient equipment and plant;
- Moving to a more eco-efficient site;
- Exploring installation of co-generation plant;

¹² Australian Industry Group, *Environmental Sustainability and Industry, Road to a sustainable future*, September 2007, p.30

- Reduce air conditioning use and lowering settings;
- Rewiring of factory premises;
- Reduce air leaks from compressors;
- Changing manufacturing processes (lean manufacturing);
- Using solar power; and
- Introducing off-peak manufacturing.

The clear message from the study is that there is a strong opportunity for more companies to achieve significant savings by being more innovative and adopting environmental sustainable practices. What is needed is better understanding of the sources of greenhouses gases and the options available for companies to lower usage.

In order to remedy this problem, Ai Group has argued that small grants should be available to SMEs who wish to undertake an audit of their business, with an emphasis on innovation. The audit would identify solutions to lower greenhouses gases, which often will be no more than simple changes to operational procedures, and enable companies to improve agility by implementing the recommendations.

The Federal Government has indicated it will introduce a \$75 million Clean Business Australia initiative, to help companies to improve their production processes, reduce their environmental footprint and cut carbon emissions. Grants of between \$10,000 and \$500,000 will be available to SMEs, with the government funding up to a third of the cost of each project. In Victoria, the Government has announced a Greening the Supply Chain initiative, developed by Holden, aims to encouraging Holden's suppliers to manage their waste in a more environmentally friendly way, lower their energy and water use, and reduce their impact on air and water flowing from their operations

Ai Group and EEASA welcome these initiatives as an important element of the national innovation system. It will complement work being undertaken to introduce the national emissions trading scheme.

The Green Car Fund

Ai Group and EEASA are supportive of the Federal Government's initiative to invest \$500 million in a Green Car Partnership over a five year period from 2011. Whilst this initiative may have environmental drivers, it is a key area in which innovation around new engineering solutions has the potential to increase demand for fuel efficient, Australian made vehicles. This fund is expected to generate \$2 billion in investment to develop and build fuel efficient cars in Australia – securing jobs while tackling climate change. Such an initiative will need to be taken into account in regard to any changes to the ACIS program.

Ai Group and EEASA however are aware that there are some concerns that funding incentives under the Fund are not as compatible as that provided under ACIS. . The \$3 company expenditure for \$1 government funding formula means that the incentive is less than that offered under ACIS for research and development. As well, if Australia is successful in securing the production of a Toyota Hybrid Camry, along with the already announced plan by Holden to produce a hybrid Commodore from 2010, there may be a need the consider supplementing the Fund.

Ai Group and EEASA understand that the car companies are currently in discussion with the Federal Minister on this matter. An early resolution will ensure that the industry can make the change to low emission car production from 2010.

Skills for an innovative automotive industry

Innovation and productivity improvements will be the main influences on the survival and long term employment growth in the automotive component sector. Achieving employment growth through innovation will in part be dependent on the capabilities and skills of people working in the industry. Particularly important for this industry will be the development and ongoing maintenance of higher level technical skills. However as with other industries, both management capabilities, and soft skills will be necessary to foster innovation.

For all automotive businesses to be innovative, it is critical that they have the right mix of capabilities – capabilities among employees, capabilities among managers, and overall organisational capabilities. The latter encompasses culture, environment, external relationships and the inter-play between corporate units, organisational systems and people.

Skill levels, as measured by the proportion of the workforce with post-school qualifications, have lifted across most industry sectors over the past two decades. In manufacturing, for example, percentages have risen from 40% in the mid-1980s to 50% in the early 2000s. Higher skills levels are vital if industry is able to adopt the latest technology and production methods.

Ai Group's recent survey on *Skilling for Innovation* highlighted some clear messages from Australian industry.¹³ The findings pointed to the need for an increased effort in innovation skills training, with an overall finding that without the relevant skills, firms are constrained in their ability to be innovative and to pursue global business opportunities.

Other significant findings show:

- Businesses regard soft skills as important innovation enablers, however these skills are lacking in many organisations;
- Knowledge management practices, seen as levers for organisational innovation, are used to varying degrees by businesses;
- A majority of businesses use upskilling to increase their skills levels and their ability to innovate;
- Businesses do not have a high degree of confidence that they possess the skills to take advantage of emerging technologies;
- Firms are finding it most difficult to secure appropriately skilled tradespeople and technicians; and
- The restriction through skills shortages on the ability to be innovative was greater for small businesses.

Skills shortages are regarded as one of the infrastructure inhibitors of innovation.¹⁴

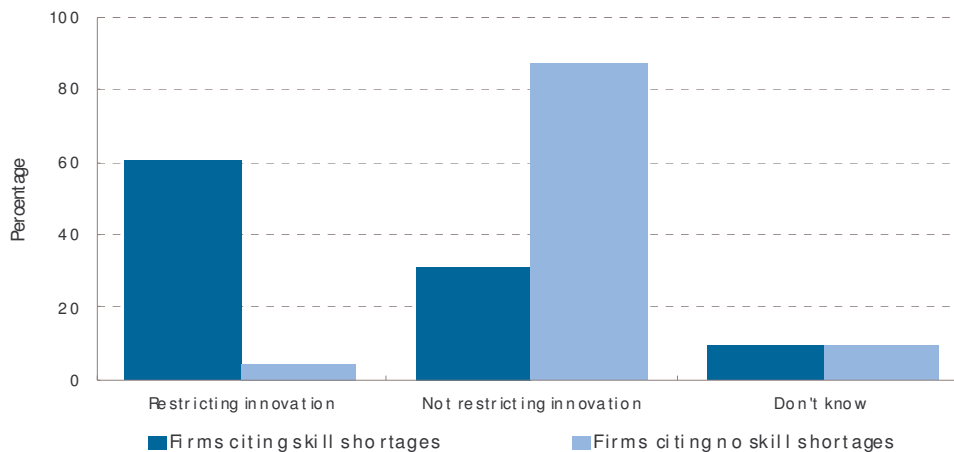
¹³ Australian Industry Group, *Skilling for Innovation*, April 2008

¹⁴ Innovation and Business Skills Council, *Blueprint for Action on Innovation* 2007

Skilling for Innovation recorded skills gaps across all sectors of industry. The clear link between skills and a lack of innovative ability in businesses suggests that policies which help lift the nation's skills base will have direct and positive effects on business innovation in Australia. With more than two-thirds of companies citing impacts from skills shortages and 60% of those companies considering that this is restricting innovation the key priority is to increase the quantum of industry in-demand skills in the Australian workforce (Figure 3).

Ai Group and EEASA believe Government support should be extended to automotive companies – especially small companies - to assist them to access the expert guidance they need to determine the best skilling options and to navigate the training system. This could be done through a network of appropriately skilled specialists with public funding for the diagnostic work and the existing public/private funding for the identified skilling needs.

Figure 3: Skills shortages and impacts on innovation



Source: Australian Industry Group, *Skilling for Innovation*, 2008

Current education and training reforms must result in an industry-led VET system that delivers quality skilling outcomes. Recent Government announcements including the establishment of *Skills Australia* are an excellent first step, but must be supported by high-level industry engagement arrangements. A national strategy to re-invigorate the country's VET workforce is urgently needed and a comprehensive profile of Australia's training infrastructure must be undertaken to identify pressing needs and opportunities for Government/industry/TAFE partnerships.

In this context it is an imperative that the automotive manufacturing and retail, service and repair sectors join an appropriate industry skills council to gain the benefits of both product reform increased enterprise-based service delivery in the VET sector. The manufacturing industry skills council, Manufacturing Skills Australia, is clearly the only appropriate ISC.

The VET system must become more agile in the way in which it relates to emerging technologies – Ai Group and EEASA are of the view that Government must restructure funding of the training system to promote change so that relevant training is available more quickly, new delivery partnerships are implemented, and existing requirements around training structure and student numbers encourage early engagement with new technologies.

WORKPLACE RELATIONS

A harmonious workplace relations environment

At present, industrial disputation in the automotive industry and other industries is at a record low level. It is vital that this harmonious environment is not put at risk by ill-conceived proposals purportedly aimed at “improving workplace relations in the industry” or “reducing the risk of widespread industrial action”. Such catch-cries have long been used by the unions to pursue damaging workplace relations approaches in the automotive industry which would dramatically increase union power.

Two areas in particular stand-out:

- The manufacturing unions’ unsuccessful attempts over many years to remove genuine enterprise bargaining in the automotive industry and replace it with an industry agreement, or pattern agreements which operate consistent with an industry framework agreement;
- The manufacturing unions’ lengthy and unsuccessful attempts to establish an employee entitlement trust fund along the lines of Manusafe (later renamed NEST).

It would be disastrous for the automotive industry if the unions were allowed to succeed with such strategies or if the current Review of the Automotive Industry gave any oxygen to such approaches. Far from increasing industrial harmony, the unions’ proposals would put at risk the current very harmonious industrial environment. The unions’ proposals would impose substantial costs upon business, hamper productivity improvement, decrease competitiveness and are highly risky.

Whilst it is true that the “just-in-time” supply arrangements in the industry mean that an industrial dispute in a single components manufacturer can quickly disrupt the whole industry, strong laws are in place to address such situations if they occur. The existing laws and approaches are working very effectively as evidenced by the current harmonious environment.

Pleasingly and importantly, the current Federal Government has committed to retaining the laws which: ban industrial action in pursuit of pattern agreements; require secret ballots before industrial action can be taken; permit immediate access to courts if unlawful action is taken; ban secondary boycotts; and allow bargaining periods to be terminated if a dispute threatens to damage an industry.

The current harmonious industrial environment stands in stark contrast to the situation five to seven years ago:

- In 2001 and 2002, disputes at Tristar Steering and Suspension and Walker Australia, over the establishment of a union trust fund called Manusafe, brought the automotive industry to a halt. As set out in the Productivity Commission’s 2002 *Review of Automotive Assistance Inquiry Report*, “estimates of the cost of lost production from these two disputes have been as high as \$300 million and \$130 million, respectively”;

- In 2003, the manufacturing unions pursued a pattern bargaining campaign (which they called *Campaign 2003*) and the automotive component sector was specifically targeted. While the automotive industry did not completely stop, there were many close calls and the provisions of the *Workplace Relations Act* which allow bargaining periods to be suspended or terminated due to threatened damage to an important part of the economy, were utilised on several occasions.

There are a large number of workplace agreements in the automotive industry expiring in the first half of 2009, but there is no reason to believe that widespread industrial disputation will occur if the existing enterprise-based bargaining arrangements remain in place. Very little industrial action occurred during the 2006 bargaining round.

These issues are discussed in more detail in the sections which follow.

Genuine enterprise bargaining in the automotive industry

In order for Australia's automotive industry to remain internationally competitive, it is imperative that vehicle manufacturers and component suppliers continuously improve productivity, efficiency and cost effectiveness. Enterprise bargaining has played an important role over the past 15 years in assisting companies in the automotive sector to remain globally competitive.

Despite the successes achieved to date, there is a great deal more that needs to be done. In many workplaces, more flexible and productive work practices are needed.

Enterprise bargaining remains an essential tool for driving work practice reforms and maintaining harmonious workplace relations.

Industry agreements/industry framework agreements/pattern bargaining

The manufacturing unions, most notably the Australian Manufacturing Workers Union (AMWU), have long pushed for genuine enterprise bargaining to be abandoned in the automotive sector and replaced with industry bargaining. Such an outcome would be highly damaging for the industry.

The unions would appear to prefer a single industry-wide agreement to replace enterprise agreements in the automotive component sector. If this is not achievable, then they appear to support each automotive component company having a pattern agreement with a common expiry date which operates in accordance with an "industry framework agreement".

Many employers in the industry would not realise the interpretation that the unions typically place on the term "industry framework agreement". The term itself could mean many things to many different people, but the unions have consistently used this term over time in the context of pattern bargaining and therefore it needs to be given meaning in that context in considering union proposals. In contrast, the use of the term by any employers should not be assumed to constitute support for the unions' approach.

Since 1993 when introduced by the Keating Labor Government, the federal workplace relations legislation has recognised the importance of bargaining taking place at the **enterprise** level.

The need to refocus the system away from industry-wide and national outcomes was widely recognised as being essential in order to achieve and maintain productivity growth and international competitiveness. This imperative still exists.

In the construction industry, union pattern bargaining campaigns have led to the implementation of very excessive industry-wide improvements in wages and working conditions and overly restrictive work practices, at great economic cost. A lengthy and very costly industry-wide pattern bargaining dispute in Victoria in 1999/2000 led to a 36 hour week being introduced in the industry and other excessive improvements to conditions of employment. Over the following few years these conditions flowed-on to construction workers in other States via pattern bargaining.

Unions in various other industries followed suit. In the automotive and manufacturing industries, the unions pursued pattern bargaining campaigns in 2000/2001 and 2003 (which they called *Campaign 2000/2001* and *Campaign 2003*). Ai Group devoted vast resources to opposing the unions' attempts to entrench pattern bargaining during these campaigns. Ultimately the unions did not succeed but the campaigns caused significant disruption.

During *Campaign 2003*, the unions specifically targeted the automotive industry and the industry came to the brink of being shut down 8-10 times. The industry would have almost certainly shut down were it not for the extensive efforts of Ai Group and various members of the Australian Industrial Relations Commission (AIRC) during these disputes.

While the industry did not shut down in 2003, the unions' campaign was very costly and disruptive and almost certainly influenced the decisions which were subsequently made by the automotive assembly firms to develop overseas sources of supply for components.

If industry-bargaining or pattern bargaining becomes entrenched in the automotive industry, as is the unions' apparent aim, the opportunity for innovative workplace relations practices in the industry will be stifled and global competitiveness will be severely impeded. Also, every time the industry or pattern agreement expires, the industry will be faced with a major threat unless it capitulates to the unions' demands.

In his final report arising from the Royal Commission into the Building and Construction Industry, Commissioner Cole argued that industry/pattern agreements need to be stamped out because they:

- Deny employers and employees input into the essential terms of the agreement covering their employment relationship;
- Deny employers the capacity for flexibility, innovation and competitiveness;
- Deny employees the capacity to reach agreement with their employer regarding their own employment conditions (eg. flexible working hours and flexible leave arrangements);
- Assume that all businesses and their employees operate in the same fashion, have the same objectives, adopt common approaches to working arrangements, and are content with uniformity;
- Assume that third parties such as unions understand better than the employer and employees what the business model of the enterprise is and what the wishes of employees are; and

- Assume that employees are not capable of negotiating on their own behalf¹⁵.

The above reasons why industry and pattern bargaining approaches are not beneficial are equally relevant to Australia's automotive industry.

Ai Group was instrumental in convincing the Federal Government to implement the pattern bargaining protections which are now contained within the *Workplace Relations Act*. These protections include:

- A definition of "pattern bargaining" (s.421);
- Criteria to be used in assessing whether pattern bargaining is occurring (s.421(4));
- A specific prohibition on the taking of industrial action in pursuit of pattern bargaining (s.439);
- A requirement that the AIRC suspend or terminate the bargaining period if a party is engaging in pattern bargaining (s.431); and
- A requirement that the AIRC be satisfied that pattern bargaining is not occurring before granting a secret ballot order (s.461).

The above provisions have been highly effective and, as set out earlier, Ai Group is very pleased that the Federal Government has committed to maintaining the anti-pattern bargaining and secret ballot laws.

It is vital that genuine **enterprise** bargaining be maintained in the automotive industry.

Protection of employees' entitlements

Over the past seven years, the automotive industry has been targeted by unions as part of a campaign to implement costly and damaging arrangements for the protection of employees' entitlements in the event of insolvency, and to increase union power.

In 2001 and 2002, disputes at Tristar Steering and Suspension and Walker Australia, over the establishment of a union trust fund called Manusafe (later renamed NEST), brought the automotive industry to a halt. As set out in the Productivity Commission's 2002 *Review of Automotive Assistance Inquiry Report*, "estimates of the cost of lost production from these two disputes have been as high as \$300 million and \$130 million, respectively".

Given the level of industrial disputation which was occurring and being threatened in the automotive and other industries in 2001, Ai Group urged the Federal Government to introduce the General Employee Entitlements and Redundancy Scheme (GEERS) which came into operation in September 2001.

Ai Group and EEASA strongly support GEERS. The scheme has been very successful in allaying employee fears about the loss of their entitlements.

¹⁵ Final Report of the Royal Commission into the Building and Construction Industry, Volume 5, p.53.

GEERS does not operate in isolation. Under the *Corporations Act*, Directors of companies have a legal duty not to trade insolvently and become personally liable for debts incurred if they do. Directors of a company also have a legal duty to ensure that care is taken in managing a company. This includes regularly reviewing the company's financial position. The *Corporations Act* was amended on 30 June 2000 to penalise companies and company directors who enter into transactions with the intention of avoiding the payment of employee entitlements (maximum penalty 10 year gaol term and/or \$110,000 fine).

Under Australian accounting standards, companies are required to provide for the amount of long service leave and annual leave that is due and is expected to be paid in the future. Further, if it is known that employees will be made redundant then the relevant amount of redundancy pay must be provided for. These amounts appear in a company's accounts and the amount of profit earned in the year is reduced accordingly.

The success of these mechanisms is obvious - 99.9% of employers pay entitlements when due.

The existing legislative provisions and other arrangements are operating effectively and provide appropriate protection for employees' entitlements.

However, now that GEERS has been in operation for nearly seven years it would be worthwhile to enshrine the scheme within legislation. Such an approach would undoubtedly attract wide public support. Further, it would negate consistent union criticism that the scheme is administrative in nature and could be amended or abolished at any time.

Current union push for an entitlement protection scheme

The unions are currently pushing for a framework agreement¹⁶ seeking to better protect employee entitlements and conditions. Under the proposal:

- The unions would reach agreement with employers on “an industry initiative” to protect employee entitlements;
- To the extent that the cost of ensuring employee entitlements is prohibitive, the Government would fill the gap and ensure entitlements are paid in full to any employee made redundant in the automotive industry over the next several years.

The damaging nature of the unions' proposal is not immediately apparent from the scant wording used in their submission.

Firstly, the immediate question arises of how the unions' “industry initiative” would be implemented and enforced at the enterprise level. As set out above, the use of the term “industry framework agreement” by the unions has long been another way of saying “abolish enterprise bargaining in the industry and replace it with pattern agreements”. Most likely the unions have in mind that each company in the industry would be required to include a pattern provision in its workplace agreement relating to the “industry initiative”.

¹⁶ A Plan for the Australian Auto and Component Industry: 2008 – 2020, May 2008

Secondly, the question arises of what the unions have in mind as their “industry initiative”.

Most likely they have in mind some form of trust fund like the discredited Manusafe / NEST scheme. Such schemes would seriously impact upon the cash flow of 100% of companies when only an extremely small percentage of companies fail to pay entitlements when due. As set out above, GEERS addresses this small percentage of cases in an appropriate way without impacting upon other companies.

In pursuing Manusafe/NEST between 2000 and 2003, the AMWU:

- Tried to force employers to pay into the scheme via two major union bargaining campaigns involving many hundreds of companies (*Campaign 2000/01* and *Campaign 2003*);
- Organised unlawful industrial action in support of the scheme which stopped the car industry twice at a cost of hundreds of millions of dollars in lost sales;
- Organised a 7 week strike at one company in Sydney;
- Organised industrial action in numerous other workplaces;
- Seriously damaged Australia’s reputation overseas as a reliable supplier of vehicles and components.

Despite intense industrial pressure, employers remained totally resolute in their opposition to trust funds such as Manusafe/NEST. It is extremely important that this damaging idea is not allowed to be resurrected via the current Review of the Automotive Industry. Such schemes would result in huge sums being withdrawn from the automotive industry and locked-up in trust funds, largely controlled by unions. This would inevitably have a disastrous impact on cash flow and would inhibit investment in new technology. Far from protecting entitlements, the unions’ proposal would almost certainly lead to a higher rate of insolvency and increased job losses in the automotive industry.

The unions’ trust fund proposals are also typically linked to other damaging union claims such as the creation of a portable long service leave scheme for the automotive industry where service would be based on time served in the industry not with one employer (this would be very unfair on employers who may only employ someone for a short time) and severance pay schemes which provide benefits whenever an employee leaves a company, not just when made redundant.

Along with pushing trust funds to protect employee entitlements, at various points in time, the unions have pushed bank guarantees, insurance bonds and insurance schemes funded by employer levies. All of these options are costly, fraught with difficulties and would be counter-productive.

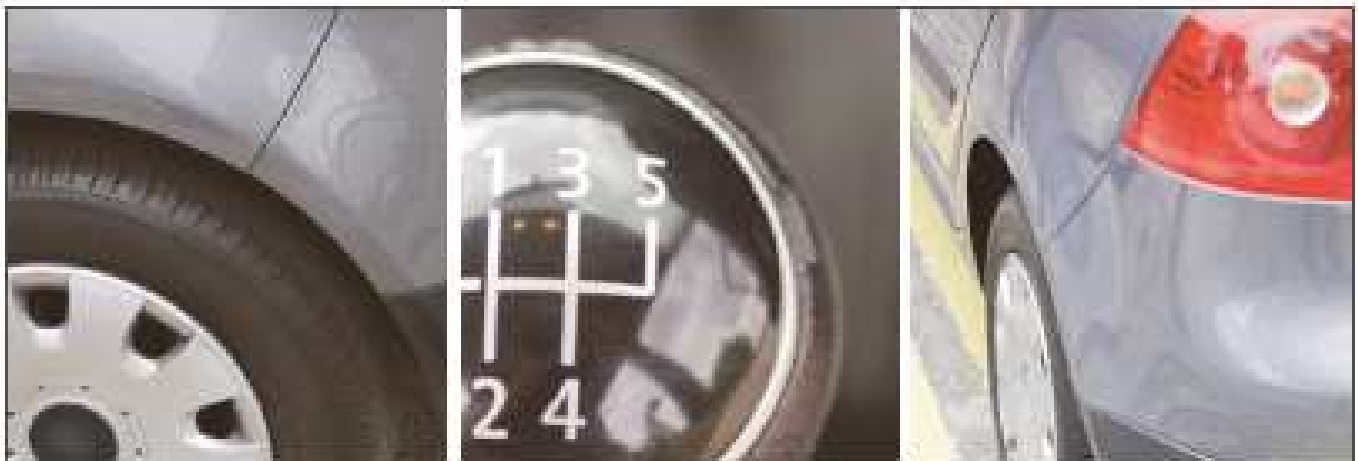
In the automotive sector, it is very common for workplace agreements to provide for redundancy payments of three or four weeks per year of service, with no ceiling. These redundancy packages are usually negotiated under industrial coercion and insolvency would not cross the minds of most managers and union officials who negotiate them. Redundancy packages are typically negotiated when a business needs to adjust staffing levels to remain efficient and competitive. The focus of management is on preserving and growing the business and union officials are usually focused on deterring companies from making hasty decisions to shed staff. The idea that every employee would some day become entitled to the package would not be contemplated or intended. Redundancy pay is different to annual leave and long

service leave. It is a contingent entitlement. That is, it only becomes an entitlement if an employee is made redundant. The cost of protecting generous over-award redundancy “entitlements”, of the kind which are common in the automotive sector, would be enormous.

In addition to the points raised above, the unions’ proposed “industry framework agreement” (including its entitlement protection proposal) is inappropriate for the following reasons:

- It focuses on a perceived outcome of mass redundancies not positive measures to improve performance to mitigate against reductions in employment levels;
- It requires consultation with unions when many workplaces in the industry have no union members;
- A high degree of flexibility, responsiveness to customer needs, uninterrupted supply of high quality products and cost effectiveness are all ‘must haves’ for the component sector. The initiatives to deal with them will vary from company to company depending on size, the nature of competition and the stage of development of exports. A framework agreement will not deliver these outcomes.

GEERS is working effectively and has addressed the entitlement protection issue in a responsible and appropriate way. The unions’ proposed “industry framework agreement” and entitlement protection proposal should be roundly rejected. It is the antithesis of what the industry needs.



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