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# **Submission to the Review of Australia's Automotive Industry**

May 2008

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# Table of Contents

<b>1.</b>	<b>EXECUTIVE SUMMARY .....</b>	<b>1</b>
<b>2.</b>	<b>CONTRIBUTION TO THE ECONOMY.....</b>	<b>9</b>
<b>3.</b>	<b>COMPETITIVE ENVIRONMENT .....</b>	<b>14</b>
<b>4.</b>	<b>CURRENT AUTOMOTIVE POLICY ARRANGEMENTS.....</b>	<b>23</b>
<b>4.1</b>	<b>Investment Support (ACIS) .....</b>	<b>23</b>
<b>4.2</b>	<b>Trade Policy, Market Access and Tariffs .....</b>	<b>30</b>
<b>4.3</b>	<b>Other Policy Issues .....</b>	<b>37</b>
4.3.1	<i>Fringe Benefits Tax.....</i>	37
4.3.2	<i>Luxury Car Tax.....</i>	39
4.3.3	<i>Workplace Relations.....</i>	41
4.3.4	<i>Skills and Training .....</i>	43
4.3.5	<i>Vehicle Design.....</i>	44
4.3.6	<i>Government Procurement .....</i>	45
<b>5</b>	<b>INNOVATION .....</b>	<b>46</b>
<b>6</b>	<b>ENVIRONMENT .....</b>	<b>50</b>



## **1. Executive Summary**

The Federal Chamber of Automotive Industries (FCAI) provides the following submission to the *Review of Australia's Automotive Industry*.

The FCAI is the peak industry organisation representing vehicle manufacturers and importers of passenger vehicles, light commercial vehicles and motor cycles in Australia.

This submission outlines the significant contribution that the automotive industry makes to the Australian economy and examines the far reaching changes to the competitive environment facing the industry in recent years.

The submission presents the FCAI's views on key aspects of future policy arrangements for the industry including investment support, trade policy, taxation, environmental policy and support for innovation.

### **Contribution to the Economy**

The automotive industry is of strategic importance to the Australian economy. Major macroeconomic factors such as growth, employment, technological progress and the rate of innovation are all strongly influenced by the automotive industry.

It is a key driver of economic growth and provides large benefits to the economy through the education and training of employees; the introduction of new technologies; design and engineering capabilities; operational and managerial concepts; and its contribution to further global integration.

It is a major customer for many other Australian industries such as steel, glass, rubber, electronics, plastics, paint and advanced textiles. While these linkages are well recognised perhaps the industry's most significant contribution is made to Australia's national innovation system and reputation as an exporter of advanced manufactured products.

### **Competitive Environment**

The competitive environment facing Australian vehicle manufacturers has changed substantially in the period since the completion of the previous review of the industry (December 2002).

Several factors stand out as having contributed to a significant shift in the competitive balance between imported and locally manufactured vehicles and the competitiveness of Australian automotive exports:

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

- Changing market segmentation, reflecting the impact of rising fuel prices and other influences on consumer preferences; and
- The impact of global restructuring and commercial pressures affecting international automotive producers and evolving global approaches to supply chain management.

The impact of these factors has seen a decline in the market share of locally made vehicles. Locally-built vehicles now account for around 20 per cent of light vehicle sales in Australia, compared with a market share of around 32 per cent in 2002 and 45 per cent a decade ago.

Over and above these developments, the Australian automotive industry is facing a major challenge to transition to the development and manufacture of more environmentally friendly vehicles which produce lower greenhouse gas emissions.

Meeting these challenges will require significant investment and innovation on the part of car manufacturers and their suppliers, as well as a globally competitive automotive policy framework.

## **Investment Support (ACIS)**

ACIS has been critical to the industry's ability to secure renewed international investment in the face of an extraordinary combination of competitive pressures. The industry has undergone significant structural adjustment in light of global industry reforms, a reduction in domestic tariffs, an adverse exchange rate and changing consumer preferences in the domestic market.

The structure of ACIS is compliant with Australia's WTO obligations and is also sufficiently flexible to accommodate the different business models adopted by the Australian vehicle manufacturers. It is technology neutral and encourages investment in capital and R&D.

The core elements of the existing ACIS program should be retained. However, reflecting the industry's growth in R&D services, investment and export, progressive changes to the modulation rate have reduced the value of ACIS credits to less than 65 per cent of their original value.

The impact of reductions and variability in the rate of modulation increases uncertainty about the value of future entitlements, undermining the effectiveness of the scheme.

The impact of modulation and the arbitrary stage caps should be removed to provide greater certainty and restore the value of ACIS' original policy intent.

### **FCAI Position:**

The FCAI submits that the value of ACIS support should be augmented and the program should be extended beyond 2015.

In particular:

- The impact of modulation and the arbitrary stage caps should be removed.
- The calculation of ACIS credits earned should be adjusted so that it is no longer directly based on the tariff rate.
- The broad scope of existing eligible activities for MVP participants (i.e. production and investment) should be retained.
- ACIS support should continue to be delivered through duty credits and the program should continue to operate on a legislated basis.

## Trade Policy, Market Access and Tariffs

The legislated tariff reductions in the passenger motor vehicle tariff introduced as part of the Government's measures following the 2002 Review were based, at least to some extent, on the expectation of an agreement at the Doha Round.

Vehicle manufacturers contend that to allow the scheduled tariff reduction to proceed in the absence of a resolution of these negotiations, Australia would be acting unilaterally, placing the local industry at a competitive disadvantage.

Vehicle importers however, offer a slightly different perspective. While they acknowledge the significant value that a local manufacturing capability brings to the Australian automotive industry, they support further reductions in automotive tariffs.

### FCAI Position:

#### **Local Vehicle Manufacturers' View**

Local vehicle manufacturers submit that the planned reduction in passenger motor vehicle tariffs should not proceed.

Local vehicle manufacturers acknowledge that further reductions in automotive tariffs will occur, however, they contend that the scheduled reduction in tariffs from 10 per cent to 5 per cent, from 1 January 2010, pre-empts multilateral reductions in industrial tariffs which might be achieved from a successful conclusion of WTO Doha Development Agenda negotiations.

Local vehicle manufacturers believe the timetable for future tariff reductions should be determined on the basis of the outcome of WTO multilateral negotiations and any future bilateral or regional trade agreements concluded by the Australian Government.

Local vehicle manufacturers are concerned that the legislated reduction in passenger motor vehicle tariffs is not currently matched by reciprocal improvements in market access for Australian automotive exporters.

They also note that the Australian Government is continuing to pursue bilateral and regional trade agreement negotiations with a number of significant trading partners. If resolved these negotiations could provide automotive manufacturers in these economies with preferential access to the Australian automotive market.

#### **Vehicle Importers' View**

Vehicle importers support further reductions in passenger motor vehicle tariffs.

While vehicle importers would not object to the provision of enhanced investment support for local vehicle manufacturers, under the Automotive Competitiveness and Investment Scheme, they believe that this should continue to be linked to a defined schedule for further reform of Australian automotive tariffs.

To this end, vehicle importers believe that there should be a clear timetable for the reduction of passenger motor vehicle tariffs to 5 per cent.



## **Environment and Motor Vehicle Emissions**

The FCAI and its members recognise that the automotive industry has a role to play in addressing climate change.

Passenger motor vehicles accounted for 7.8 per cent of Australia's total greenhouse gas emissions in 2005.

To focus regulatory attention only on the new vehicle industry fails to address the most significant contribution to motor vehicle emissions which is that of the existing vehicle fleet.

Australia will be among the first countries in the world to introduce an ETS which includes the transport sector. Other nations have been required to introduce second best regulatory options, such as mandatory emissions targets, in the absence of an ETS.

The FCAI is supportive of the establishment of an economy-wide ETS. However the FCAI urges the Australian Government to take account of the trade exposed nature of the Australian industry and the potential impact of an ETS on the cost competitiveness of local manufacturers.

The major attribute of an ETS is that it can efficiently determine the least cost method of emissions abatement. Introducing any secondary emissions strategies on the automotive industry assumes that a reduction of one tonne of CO<sub>2</sub> from a passenger motor vehicle is more important than a reduction of one tonne of CO<sub>2</sub> from any other sector of the economy.

There is no benefit to the environment if Australian vehicle production were to be relocated to countries with lower environmental standards.

### **FCAI Position:**

The FCAI supports the introduction of an economy-wide ETS as an efficient mechanism to determine the least cost emissions abatement pathway.

The FCAI urges the Australian Government to take account of the trade exposed nature of the Australian automotive industry and the potential competitive impact of increases in production costs in the design of its ETS.

The FCAI submits that the introduction of additional regulation of vehicle CO<sub>2</sub> emissions is unnecessary and inconsistent with the market based incentives of an ETS.

## **Green Car Innovation Fund**

The challenge of achieving a transition to the development and manufacture of more environmentally friendly vehicles will not be met through the emergence of a single technology. Global car manufacturers are pursuing a range of different technologies and approaches to reduce vehicle emissions.

The Green Car Innovation Fund should aim to promote the development or uptake of a broad range of technologies by Australian vehicle manufacturers, which move the industry toward a lower greenhouse footprint.

While participants may be encouraged to work with component manufacturers to achieve emissions reductions eligibility should be limited to Australian vehicle manufacturers for the development or uptake of technologies in Australian manufactured vehicles.

### **FCAI Position:**

In developing the framework for the Green Car Innovation Fund, FCAI recommends that:

- The program should be technology neutral and aim to achieve a reduction in the CO<sub>2</sub> emissions of Australian manufactured vehicles and be made available to all technologies that achieve this outcome;
- To ensure that the technologies developed through this program are commercialised into Australian manufactured vehicles, funding should be restricted to Australian vehicle manufacturers. Vehicle manufacturers should be encouraged to engage component manufacturers in the program;
- Funding should be in addition to existing programs available to the industry and benefits from the program should be issued on a grants basis, not in the form of duty credits;
- There should be a limit to the maximum amount of support available to any individual participant; and
- The proposed ratio of \$1 for \$3 of industry investment should be reviewed as it may not be sufficient given the level of risk associated with the desired investment.

## **Fringe Benefits Tax**

Fringe Benefits Tax (FBT) on motor vehicles was introduced because the Australian Government was concerned that the income tax revenue base could be undermined as a consequence of salary packaging of a range of expenses including motor vehicles.

In introducing the statutory formula for calculating FBT on motor vehicles, the government sought to use annual mileage as a proxy to estimate the proportion of the vehicle use attributed to business purposes.

FBT is a significant source of revenue for the Federal Government, raising around \$4 billion each year. The value of revenue receipts from FBT on motor vehicles is not readily available however; it would be a significant proportion of this revenue.

### **FCAI Position:**

The statutory formula represents an administratively simple and efficient method of calculating the value of fringe benefits of a motor vehicle, reflecting the mix business and private usage.

The statutory formula should be retained.

## **Luxury Car Tax**

In the recent Federal Budget, the Government announced that it proposes to increase the rate of the Luxury Car Tax (LCT) from 25 per cent to 33 per cent.

The FCAI opposes this measure and asserts that the LCT is a distortionary tax which should be abolished.

The retention of the LCT combined with the various taxation imposts on vehicles results in a high tax incidence on so called 'luxury' vehicles. The multiple taxation of cars includes:

- The imposition of the LCT/GST;
- Fringe Benefits Tax on the whole value of the vehicle, including the value not eligible for depreciation and on which the luxury tax falls;
- The inability to depreciate vehicles for taxation purposes above the car depreciation limit (set at the same level as the LCT threshold), and
- Stamp duties on the value of the vehicle.

The LCT threshold has failed to keep pace with the increase in vehicle prices and therefore has been applied to an increasing number of vehicles. As vehicle quality

improves, including the introduction of advanced emission reduction technologies, there will be an increasing number of vehicles which exceed the LCT threshold.

The LCT can also act as a disincentive to the fitment of safety features to vehicles to ensure they remain under the LCT threshold.

**FCAI Position:**

The FCAI opposes the proposed increase in the rate of the Luxury Car Tax and submits that the tax should be abolished.

The FCAI contends that the Luxury Car Tax constitutes a non-tariff barrier which discriminates against certain types of imports.

The FCAI argues that the Luxury Car Tax can also act as a disincentive for the uptake of improvements in vehicle specification, including advanced safety features, particularly for those vehicles near or just above the tax threshold.

The FCAI observes that indexation of the Luxury Car Tax threshold has not kept pace with changes vehicle prices. As a result, the negative impact of the tax and the number of vehicle brands and models affected has expanded over time.

**Conclusion**

The Australian automotive industry has undergone substantial transformation over a period of more than two decades and is now one of the most open and competitive markets in the world.

The industry is now faced with an emerging suite of challenges that will require further structural reform within the industry.

The sustained appreciation of the Australian dollar, rising fuel prices and shifting consumer preferences have all contributed to significant changes in the competitive environment now facing Australian vehicle manufacturers.

With appropriate policy arrangements and the efforts of the car manufacturers and their suppliers there is every reason to believe the Australian automotive industry will meet the challenges it is now facing.

## **2. Contribution to the Economy**

The automotive industry is of strategic importance to the Australian economy. Major macroeconomic factors such as growth, employment, technological progress and the rate of innovation are all strongly influenced by the automotive industry.

In total, it is estimated that the industry, (including retail, service and repair) produces annual turnover in excess of \$50 billion and generates employment for more than 400,000 people, with around 60,000 individual enterprises represented in the industry. Key sectors in the industry are:

- **Motor Vehicle Manufacturing:** Three Australian based vehicle manufacturers produce a range of passenger vehicles at multiple plants in Melbourne and Adelaide. The industry is a significant exporter and employs over 60,000 people.
- **Component Producers:** There are more than 200 firms producing automotive components for use as original equipment in new vehicles and for the replacement and accessories markets. There are around 500 firms providing specialised tooling to vehicle and component producers.
- **Vehicle Importers:** In 2007, almost 850,000 vehicles were imported into Australia. In addition to their production of vehicles in Australia, local manufacturer's imported more than 350,000 vehicles. A further 500,000 vehicles were imported by around 40 companies whose operations are principally focussed on vehicle import and distribution. The import and distribution of motor vehicles generates a substantial employment base in its own right.
- **Retail, Service and Repair:** The retail, service and repair sector of the automotive industry are significant employers in their own right with around 300,000 people employed across Australia and includes vehicle maintenance, repair of damaged vehicles, supply of aftermarket equipment and vehicle recycling.

The automotive industry is a key driver of economic growth and provides large benefits to the economy through the education and training of employees; the introduction of new technologies; design and engineering capabilities; operational and managerial concepts; and its contribution to further global integration.

The automotive industry plays the role of leading edge customer for significant parts of these supplier industries. It is a major customer for many other Australian industries such as steel, glass, rubber, electronics, plastics, paint and advanced textiles.

The automotive industry makes a number of significant direct contributions to the Australian economy. Some of these contributions, such as well paid full time jobs, have been traditionally recognised. However, the contribution the industry makes to Australia's national innovation system and Australia's reputation as an exporter of advanced manufactured products has only recently received attention by analysts.

## Production and Investment

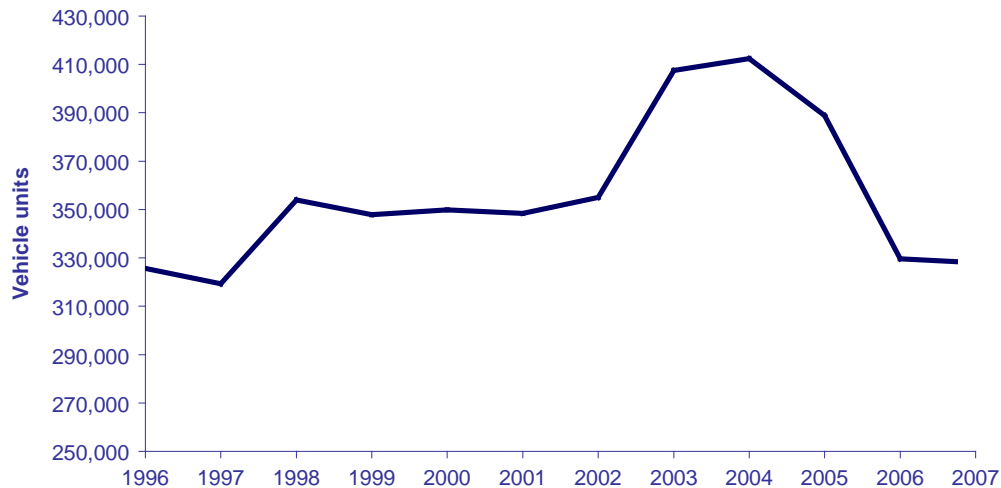
The automotive industry is the largest manufacturing sector in Australia and represents around 6 per cent of Australia's total value added manufacturing and contributes around 1 per cent of national GDP.<sup>1</sup>

Chart 2.1 highlights the changes in production of motor vehicles in Australia over the past decade. Vehicle production by the Australian automotive industry peaked in 2004 at around 412,000 vehicle units. However, in more recent years vehicle production has declined and in 2007 the industry produced around 330,000 vehicles.

The industry undertakes significant investment in new plant and equipment relating to production and development of new motor vehicles. Consistent with the model development cycle the amount of investment undertaken by each manufacturer varies significantly from year to year.

It is estimated that the industry has undertaken investment in plant and equipment worth around \$4.5 billion over the past 5 years. GM Holden and Ford Australia have invested more than \$1 billion each in new model development. In addition, Toyota has invested more than \$800 million to the development of the new Camry/Aurion range.

**Chart 2.1: Australian Motor Vehicle Production**



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<sup>1</sup> ABS, *Year Book Australia*, 2005.

## Exports

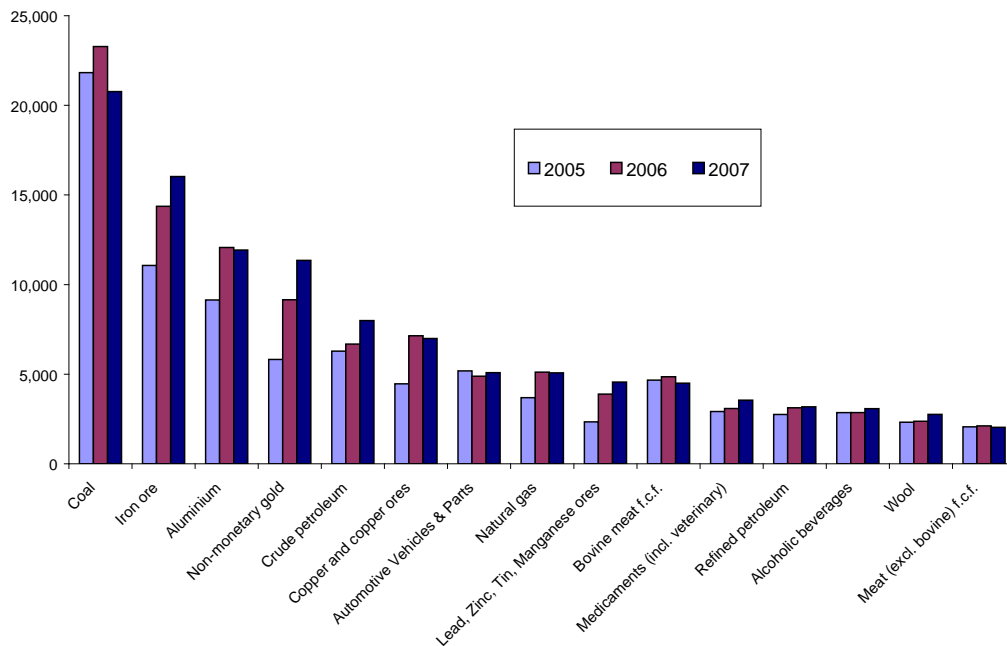
As automotive tariffs have been reduced in Australia, the local market has become increasingly competitive and the automotive industry has looked to build its export business.

The Australian automotive industry operates in one of the most open and competitive markets in the world. While imports account for slightly more than 80 per cent of the domestic sales, Australian vehicle manufacturers have demonstrated their competitiveness, exporting in excess of 40 per cent of local vehicle production to more than 21 markets in Europe, Asia, the Middle East and United States.

In 2007, Australia exported more than 140,000 vehicles. This compares with annual exports of around 50,000 vehicles only ten years ago. There is potential for future export growth.

The automotive industry is Australia's largest source of exports after mining, with annual export sales worth in excess of \$5 billion - more than any agricultural commodity (see Chart 2.2).

**Chart 2.2: Australian Merchandise Exports (\$ Million)**



Source: DFAT Composition of Trade 2007

Automotive component suppliers have also built their export businesses. In some cases very high proportions of total output are exported however, many second and third tier component suppliers remain heavily dependent on sales in Australia.

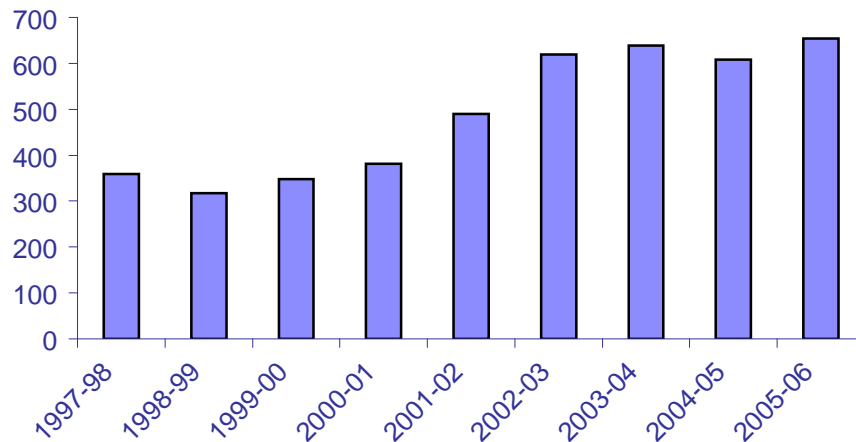
## R&D and Innovation

The Australian automotive industry is a key source of investment in R&D and a vital part of Australia's national innovation system.

The industry accounts for around 10 per cent of total business R&D and more than 20 per cent of R&D undertaken by the manufacturing sector.

Chart 2.3 below shows that investment in R&D by the industry has approximately doubled over the past decade and is now worth around \$650 million per annum.

**Chart 2.3: Automotive Industry R&D (\$ Million)**



Source: Australian Bureau of Statistics (2007) Research and Development Expenditure: Businesses

The Australian automotive industry is recognised worldwide for its capacity to deliver high quality engineering, technical and design skills. Australia is one of relatively few nations which possess the capability to fully design, engineer and manufacture vehicles.

GM Holden has global responsibility for the design and development of full size rear-wheel drive sedans across the General Motors range.

Ford Australia is also a world leader in the design and engineering of vehicles for global markets, particularly for the Asia Pacific region. The local company took the design and engineering leadership for a new light commercial vehicle that is sold in more than 80 countries in both left and right-hand drive, generating R&D revenues worth \$700 million. Ford also employs more than 1,000 designers and engineers at its plant locations in Broadmeadows and Geelong.



Toyota has established one of its few technical centres outside of Japan, within Australia.

These global projects could not have been undertaken in Australia without the skill and expertise harnessed through the development and production of locally manufactured vehicles.

## **Employment, Skills and Training**

The industry employs over 61,000 people with around 25,000 employed directly in vehicle manufacturing. The jobs that the industry provides are attractive, being relatively high wage in nature. The industry accounts for \$3.7 billion in wages and salaries each year, 7 per cent of the total for all manufacturing.<sup>2</sup>

The automotive industry has invested heavily in training and skills development for its workforce. This is recognition of the need for Australian vehicle manufacturers to achieve world class levels of performance in quality and price. This world class education and skills base is recognised throughout the world. This is evident through the trust and responsibility placed in Australian operations to carry out a number of international automotive projects for global markets and increasing export sales.

The automotive industry indirectly also helps keep thousands more people employed through various support industries such as retail, service and repair. These statistics do not take into consideration the employment generated by the automotive industry in related industries, for which the industry is a major customer, such as iron, steel, plastics, glass and rubber.

### **Key Points:**

The automotive industry is of strategic importance to the Australian economy.

It is Australia's largest manufacturing sector, representing around 6 per cent of total industry value added.

The industry is a key source for the uptake and development of new technologies and engineering and design skills. As such the industry plays a vital role in Australia's national system of innovation.

The industry also contributes substantially to Australia's export base. The industry is Australia's largest source of exports after mining, with annual exports worth in excess of \$5 billion.

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<sup>2</sup> ABS, Catalogue 8221.0 *Manufacturing Industry 2005 – 06*.

### 3. Competitive Environment

The competitive environment facing Australian vehicle manufacturers has changed substantially in the period since the completion of the previous review of the industry (December 2002).

Several factors stand out as having contributed to a significant shift in the competitive balance between imported and locally manufactured vehicles and the competitiveness of Australian automotive exports:

- *Exchange rate appreciation:* The sustained appreciation of the Australian dollar against other key currencies, in particular the United States dollar and the Japanese yen, in response to strong international demand for Australian resources, has increased the competitive pressure on other sectors, including automotive manufacturing.
- *Changing market segmentation:* Consumer buying patterns have undergone significant changes, reflecting the impact of rising fuel prices, the introduction of new brands and products across a range of market segments and changing patterns of vehicle specification and affordability.
- *Global industry restructuring:* Australian vehicle manufacturers have faced significant challenges in adapting to the competitive pressures facing many international automotive producers and evolving global approaches to supply chain management.

Indicators of the competitiveness of the Australian automotive industry include production volumes, sales to the domestic and export markets, productivity and profitability.

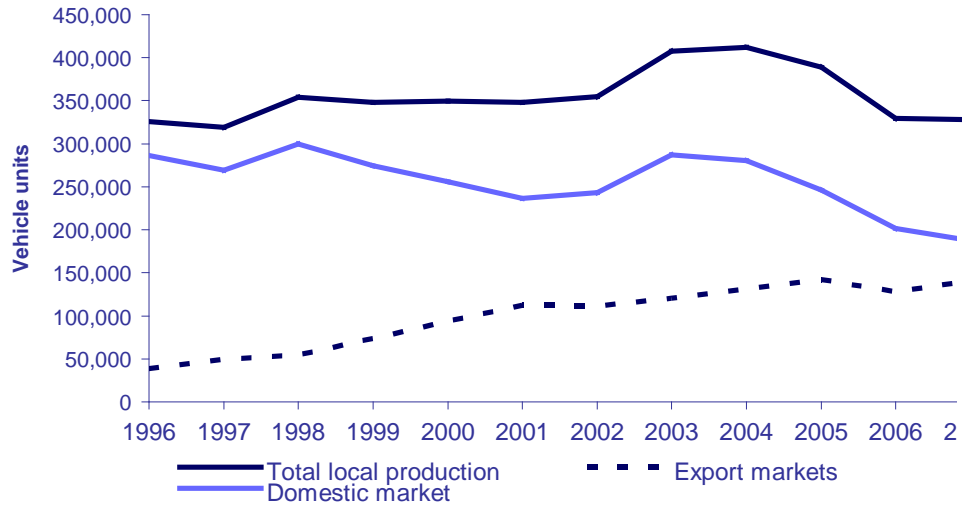
#### Production and Sales

The scale of production is an important indicator of the competitiveness of the local vehicle manufacturers. An increasing level of production, other things being equal, would suggest increasing competitiveness.

Australian vehicle manufacturers produce vehicles for both the Australian domestic market and export markets. The domestic market has historically underpinned the manufacturing operations, a function of the inward looking nature of the industry up until the 1980s. However, as tariffs have fallen, and the share of the Australian car manufacturers in the local market has decreased, exports have become critical to the future sustainability of the Australian automotive industry.

Chart 3.1 illustrates that the production of vehicles directed to export markets has experienced a strong upwards trend since 1996, averaging growth of around 12 per cent per annum. On the other hand, production of vehicles for the domestic market has experienced a downwards trend, especially since 2003-04, with an average contraction of 3.7 per cent per annum.

**Chart 3.1: Domestic and Export Sales of Australian Manufactured Vehicles**



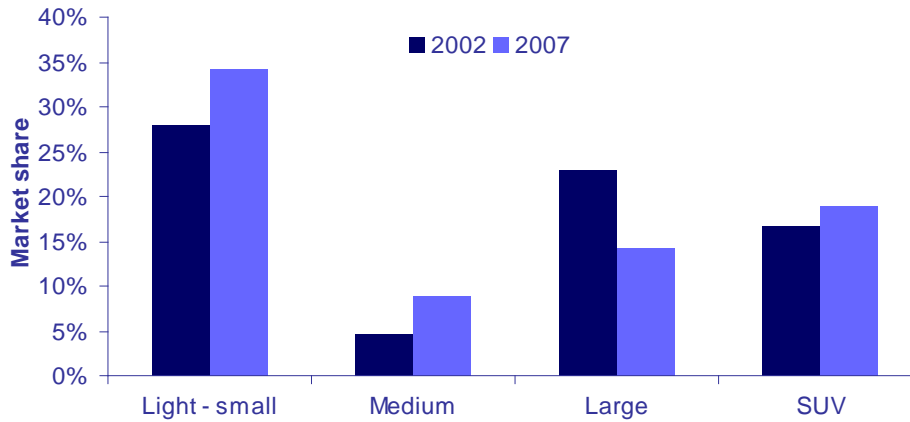
At the same time that the demand within the domestic market for locally made vehicles has been declining, the total market size has grown from around 955,000 vehicles in 2004 to over 1 million in 2007.

There has been a noticeable shift away from locally produced vehicles to all other vehicle categories since 2004.

Chart 3.2 illustrates that much of the loss in market share within the large vehicle segment, in which locally produced vehicles continue to dominate, has predominately been captured by smaller vehicles, and to a lesser extent medium-sized vehicles and SUVs.

These shifts in consumer preferences mean that exports are becoming increasingly important in maintaining and improving the competitiveness of the Australian automotive industry. The shift in consumer preferences within the domestic market have been a function of two key external factors, the exchange rate and fuel prices, as will be discussed further below.

**Chart 3.2: Percentage of Australian Market by Vehicle Segment**



Source: VFACTS

## Productivity

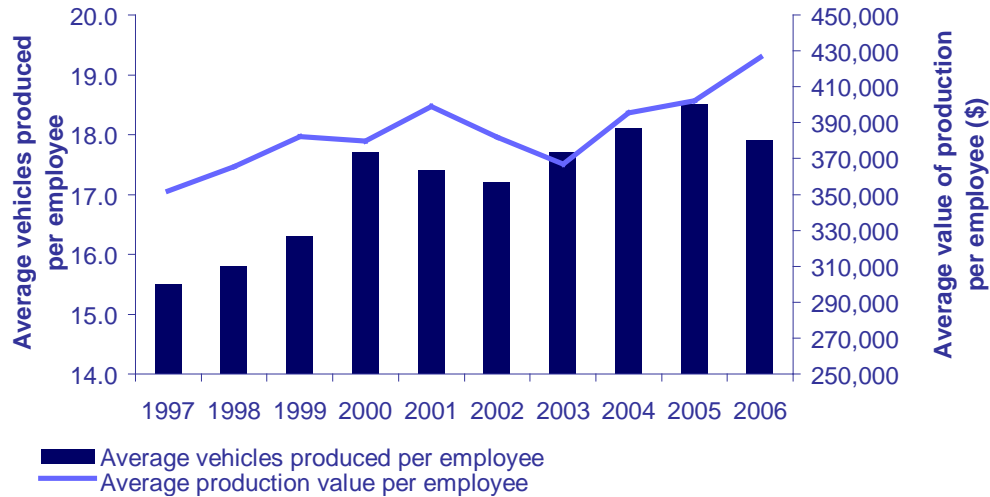
Productivity was a major area of concern for Australia's automotive industry prior to the microeconomic reforms which commenced in 1984 under the Button Car Plan, and is a key element of competitiveness.

The productivity of the Australian motor vehicle manufacturers has been improving, as illustrated in Figure 3.3. Vehicle production per employee per annum has increased by an average annual rate of 4.0 per cent since 2002, whilst the value of production per employee has increase by 11.5 per cent over the same period.

Also evident from the figure is that there is a distinct cycle in the measures, particularly the vehicle production per employee. This is likely to be linked to the model cycle of firms – when a new model is introduced productivity may decline initially because of the learning curve associated with new manufacturing processes.

It is difficult to compare these productivity measures to those in other countries because Australia is one of a small number of countries which has the capability to design, engineer and manufacturer a vehicle from scratch. Operations in many other countries only undertake manufacturing functions, and, all else being equal, would produce more vehicles per employee as they do not have the labour force undertaking design and engineering activities.

**Figure 3.3: Australian Vehicle Manufacturer's Labour Productivity**



Source: DIISR (2008)

## Profitability

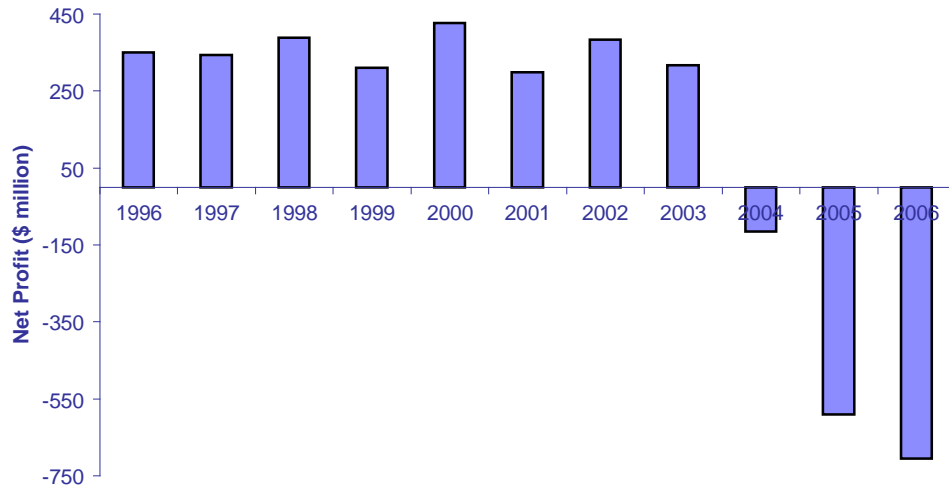
Profitability at the firm level within the automotive industry typically displays considerable swings depending upon where in the model cycle the firm is. In the lead up to a new model, considerable investment is made in the design and engineering of the new model and changes in the tooling and production system to accommodate the new model.

The combined profitability of Australian vehicle manufacturers is shown in Chart 3.4. The chart illustrates that up until 2003, vehicle manufacturing operations as a whole in Australia were profitable.

Since 2004 it is evident that the combined Australian vehicle manufacturing operations have not been profitable. A significant part of the fall in profitability since 2004 reflects the operating performance of Mitsubishi.

Since 2003, even when excluding the performance of Mitsubishi Australia which has recently closed its manufacturing operations, the three remaining vehicle manufacturers experienced a significant change in the profitability of local manufacturing performance as a result of the changed operating environment. There are a number of external factors which have contributed to the decline in profitability.

**Figure 3.4: Profitability of Australian Vehicle Manufacturers**



Source: DIISR (2008), Key Automotive Statistics 2006

## Exchange Rates and Fuel Prices

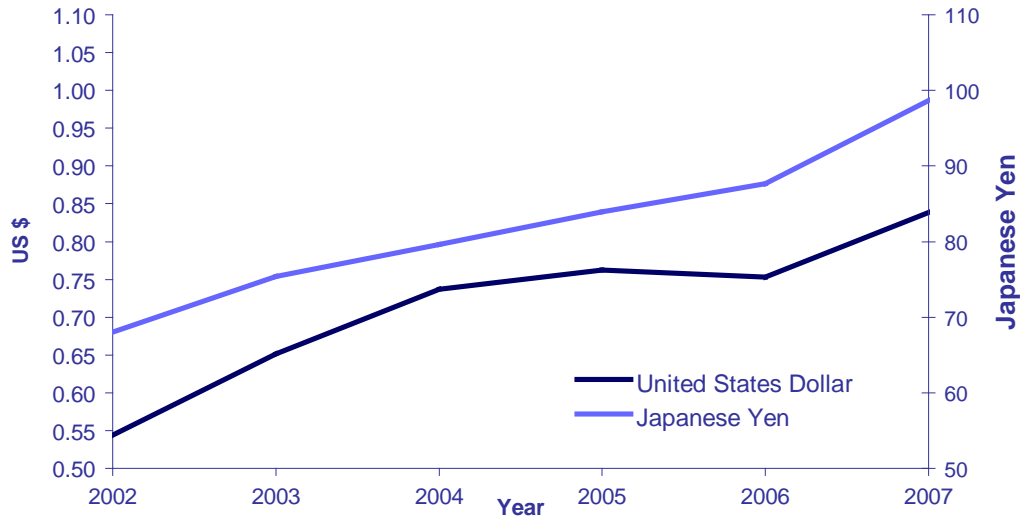
Two significant factors which have influenced production volumes and profitability of the local vehicle manufacturers have been the exchange rate and the rise in fuel prices.

The exchange rate has been a significant factor influencing the profitability of the local vehicle manufacturers. Although the rise in the value of the Australian dollar has, to some extent, shielded the industry and its domestic market production volumes from the full increase in fuel prices, it has significantly affected the profitability of the manufacturing operations.

Since the 2002 review, the Australian dollar has appreciated by over 60 per cent against the United States dollar and by more than 50 per cent against the Japanese Yen<sup>3</sup> – a result of the unprecedented level of demand for Australian resource commodities. Chart 3.5 illustrates the appreciation of the Australian dollar against these currencies since 2002.

<sup>3</sup> ABS, Jan 2008, *International Trade in Goods and Services*, cat. no. 5368.0

**Chart 3.5: Appreciation of Australian Dollar**



Source: ABS, Cat. no. 5368.0.

With over 40 per cent of total local production for export markets in 2007, the local vehicle manufacturers are highly exposed to the exchange rate, which adversely affects the profitability of the firms. The Australian industry's largest export contracts are to the Middle East, with most key markets in this region pegging their exchange rate to the US dollar. Therefore, with the Australian dollar almost on parity with the US dollar, in order to continue to remain competitive in these markets, Australian vehicle manufacturers must accept low or negative margins on vehicles in these markets.

Table 3.1 presents a hypothetical example of the impact of the exchange rate on the profitability of vehicle exports. By assuming a constant contracted supply price in US dollars, and accounting for the reduction in the production cost due to cheaper imported components, it is clear that in supplying export markets the Australian vehicle producers have seen a significant reduction in margins.

The exchange rate not only affects the competitiveness of the vehicle manufacturers in export markets, it also affects their competitiveness in the domestic market. Table 3.2 illustrates the impact of exchange rate movements and the tariff reduction on the cost competitiveness of Australian produced vehicles in the domestic market. The analysis suggests a reduction in the competitive advantage of Australian vehicles of around thirty per cent since 2002.

**Table 3.1: Exchange Rate Impacts on the Profitability of Vehicle Exports**

	Ex Rate 0.54 (2002)	Ex Rate 0.94 (2008)	Change in Competitiveness 2002-2008
Production cost (\$AUD)	20,000	17,574	2,426
Export value (\$US)	10,800	16,520	
Contracted supply price (\$US)	15,000	15,000	
Sales margin (\$US)	4,200	-1,520	-5,720
Sales margin (\$AUD)	7,777	-1,617	-9,394

Source: Deloitte analysis

**Table 3.2: Cost Competitiveness**

Dec Q 2002				
Imported Vehicle		Locally Made Vehicle		
Item	Cost (\$)	Item	Cost (\$)	Comp Adv (\$)
		Local content	14,000	
		Imported content	6,000	
Import value (fob) (\$US11,200/0.56)	20,000	Factory cost	20,000	
Tariff (@15%)	3,000	ACIS prod credit	-650	
Net cost	23,000	Net cost	19,350	3,650
Mar Q 2008				
Imported Vehicle		Locally Made Vehicle		
Item	Cost (\$)	Item	Cost (\$)	Comp Adv (\$)
		Local content	14,000	
		Imported content	3,600	
Import value (fob) (\$US11,200/0.92)	12,174	Factory cost	17,600	
Tariff (@10%)	1,217	ACIS prod credit	-425	
Net cost	13,391	Net cost	17,175	-3,784
Net change	9,609		2,175	-7,434

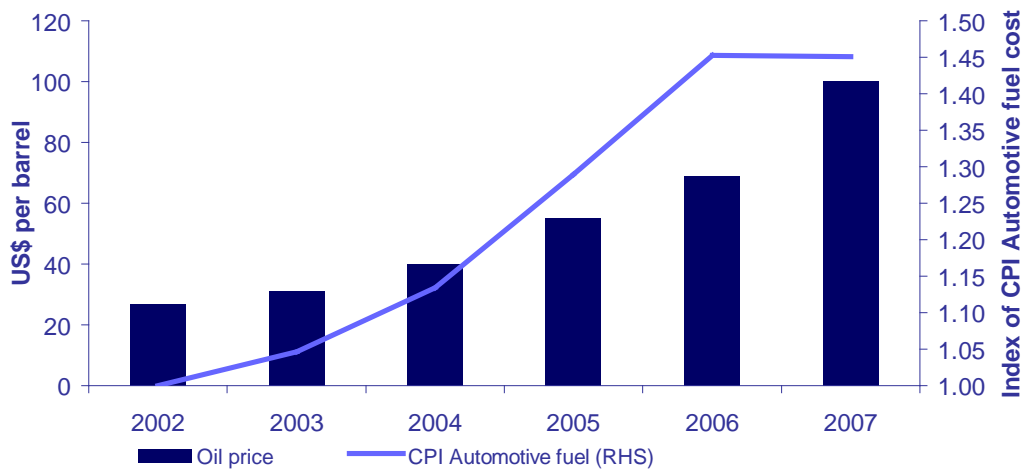
Source: FCAI



Oil prices and the associated rise in fuel prices are a key factor underlying the significant shift in consumer preferences towards smaller, more fuel efficient vehicles.

Since 2002 there has been a 400 per cent increase in the price of oil, from US\$25 per barrel to US\$100 per barrel. Australia has, to a degree, been shielded from these increases through the appreciation in the exchange rate, but there has still been a 33 per cent increase in the price of petrol in Australia since 2004, as illustrated in Chart 3.6.

**Chart 3.6: Oil Price and Automotive Fuel Increases**



Source: Australian Bureau of Statistics (2008), Consumer Price Index

## Conclusion

Meeting these challenges will require significant investment and innovation on the part of car manufacturers and their suppliers, as well as a globally competitive automotive policy framework.

The global strategy that underpins the structure of Australian vehicle manufacturing remains effective:

- the efficient scale of production for larger sized family cars is not as high as it is for small cars and is within the reach of the Australian car manufacturers;
- other countries have shown that a strategy that involves a high share of imports in the home market and a high share of exports can work for extended times;
- given the relatively low volume of production of Australian car manufacturers they only need to achieve relatively small shares of overseas markets in order to sustain substantial export sales; and

- Australian car manufacturers have achieved considerable recognition as specialists with deep knowledge in their global product niche which can be used in other areas to support projects in related companies.

**Key Points:**

The competitive environment facing local vehicle manufacturers has deteriorated markedly over the past five years. The extent of the competitive challenge facing local manufacturers has been exacerbated by a range of factors including:

- The appreciation of the Australian dollar against other key currencies, fuelled by strong international demand for Australian resources and rising terms of trade;
- Changing market segmentation, reflecting the impact of rising fuel prices and other influences on consumer preferences, and
- The impact of restructuring and commercial pressures affecting international automotive producers and evolving global approaches to supply chain management.

Combined these factors have undermined the cost and price competitive position of Australian vehicle makers in the domestic market and in key export markets.

It is essential that future policy arrangements seek to underpin the Australian industry's competitive position as a location for ongoing investment in the design development and production of vehicles and automotive components.

## **4. Current Automotive Policy Arrangements**

### **4.1 Investment Support (ACIS)**

ACIS has been critical to the industry's ability to attract renewed international investment in the face of an extraordinary combination of competitive pressures. The industry has undergone significant structural adjustment in light of global industry reforms, a reduction in domestic tariffs, an adverse exchange rate and changing consumer preferences in the domestic market.

ACIS is due to provide \$2 billion in capped support from 2006-2010 plus an estimated \$800 million in uncapped support. A further \$1 billion in capped support is due to be provided from 2011-2015. In Stage 2, \$150 million was set aside for a Motor Vehicles Producers R&D Scheme.

#### **Design of ACIS**

ACIS provides for the quarterly issue of import credits to be generated by car manufacturers in relation to a combination of production, investment in plant and equipment and R&D carried out for other parties. ACIS credits for automotive component producers were generated by a combination of their investment in plant and equipment and in approved R&D.

For the motor vehicle producers ACIS benefits are calculated on the basis of quarterly returns as follows:

- Up to 25 per cent of the value of production of motor vehicles, engines and engine components, multiplied by the automotive tariff rate;
- Up to 10 per cent of the value of investment in approved plant and equipment used to produce motor vehicles, engines or engine components; and
- In those instances where the motor vehicle producers produce automotive components (other than engines and engine components), automotive machine tools, automotive machine tooling, or automotive services to a third party, they are eligible for a 25 per cent investment incentive and a 45 per cent R&D incentive.

Given the way the eligible ACIS benefits are calculated the greater proportion of the benefits tend to come through the value of production element. Broadly speaking, the value of production element accounts for over three quarters of the ACIS benefits. The attractiveness of ACIS from the viewpoint of the car manufacturers is that the production element provided a relatively stable and predictable base.

Providing support for investment in plant and equipment encourages the upgrading of production operations and can lead to productivity improvements, quality improvements and where capacity is increased greater economies of scale. These aspects all improve the competitiveness of the car manufacturers.

Providing support for R&D encourages the development of innovative new products and processes, and can improve the competitiveness (in terms of quality, performance, reliability) of Australian automotive products. As in most high income countries, increasingly, innovation is seen as the main means for ensuring longer term competitiveness.

The targeting of investment and R&D by ACIS aimed to directly address the competitiveness gap that existed. These investments can be viewed as improving the underlying performance of the industry over the medium to longer term – the benefits would be delivered through future higher value creation and cost savings.

### **Separate Funding Pools**

When first established, there was a single pool of funding against which both motor vehicle producers and component suppliers were able to claim support. However, the shift away from production credits to support for production, investment and R&D meant that there was a much larger range of activities for which component producers were eligible to claim support.

The motor vehicle producers believe that an unexpected consequence of the provision of R&D support to the components industry by ACIS was that component producers were claiming more credits than what had been expected.

Greater claims than expected by the components industry meant that there was now a greater overall claim on ACIS funding than what had been expected, and a greater share of the funding was being captured by the components industry.

Combined with the impacts of modulation (refer below), motor vehicle producers were receiving a significantly lower level of support under ACIS than expected. In order to ensure that the motor vehicle producers' share of ACIS did not continue to be eroded, it was agreed that the total ACIS funding pool would be split in two. Motor vehicle producers were allocated 55 per cent of ACIS support and 45 per cent was allocated to the components industry.

### **Import Duty Credits**

ACIS essentially provides an incentive through import duty credits that reduce import duties payable on certain automotive products imported into Australia.

The industry believes that this existing mechanism has worked well over a long period. The link between ACIS credits and import duty reinforces the trade

facilitating nature of the program. Current analysis indicates that there is sufficient availability of import duty credits to fund ACIS, even with the removal of the constraints of modulation. Moreover, this mechanism ensures that the program operates on the basis of a 'closed loop', with the availability of duty credits providing an effective cap on the long-term cost of ACIS.

The industry favours the retention of duty credits as the preferred mechanism for the delivery of investment support.

### **The Impact of Modulation**

The limiting of credits in the capped pool is achieved through a process called modulation which limits all claims duty credits, to ensure that claims do not exceed the five year funding cap. The capacity to 'modulate' was intended as a risk management measure, to limit the cost to revenue.

Modulation was only expected to exert a significant impact upon the level of support provided to the industry during its later stages.

However, by the third quarter of 2001, the first year of ACIS, the modulation rate was already at around 25 per cent, that is, the import credits provided by ACIS were only 75 per cent of the value of claims made. Under Stage 2 the impact of modulation has been even more stringent, with the value of capped credits averaging only around 63 per cent of the benefit claimed.

### **Assessment of ACIS**

ACIS has provided incentives for the vehicle manufacturers to produce vehicles for the domestic and export markets, to invest in plant and equipment and undertake research and development in Australia.

Investment in R&D has doubled since the introduction of ACIS and substantial growth in exports and production has resulted in a growth in projected claims on the capped ACIS pool.

The motor vehicle producers believe that ACIS has been, and remains, critical to their Australian operations. It is central to their ability to continue their transition, and is the one current policy that they can point to with their parent companies to show the Australian Government is committed to the automotive industry and thus justify further investment in their Australian operations.

The capacity to 'modulate' was intended as a risk management measure, to limit the cost to revenue and has developed into a significant constraint on the program that is "well in excess of levels anticipated in planning the scheme."<sup>4</sup>

The impact of reductions and variability in the rate of modulation increases uncertainty about the value of future entitlements, undermining the effectiveness of the scheme.

This uncertainty to the value of ACIS credits is particularly damaging in an industry which is reliant on long-term policy consistency due to the long term time horizons of investment decisions. The 2002 Review of the industry sought to achieve a decade of certainty for the industry however, the impact of modulation has had the opposite effect.

The impact of modulation and the arbitrary stage caps should be removed to provide greater certainty and restore the value of ACIS' original policy intent.

## **The Future Design of ACIS**

One of the main challenges the industry faces is in the transition to emerging technologies for vehicles to achieve reductions in greenhouse gas emissions. The challenges the industry are facing in terms of a transition to improve environmental performance is not unique to Australia. Ensuring that Australia is at the front of this move will assist the industry to remain competitive.

Whilst the contribution of the Green Car Innovation Fund will be critical to achieving this objective, ACIS also has a vital role to play.

ACIS provides strong incentives to invest in R&D and has been demonstrated to have doubled R&D investment within the industry. Investment in R&D however, should not be seen as the end objective of ACIS or any other innovation program.

A strength of the existing ACIS program is that it rewards investment in the production of vehicles in Australia which, in combination with the incentives provided to invest in R&D, reward innovative companies that are able to commercialised new technologies and processes into the production of Australian made vehicles. Commercialisation of new technologies is essential to achieving value from public expenditure on R&D.

The production and export of vehicles is also a guide as to the relevance and success of innovation. The market place is the best judge of the relevance of product innovation.

Notwithstanding the artificial distinction between MVP production sold in the Australian and New Zealand markets and production sold in other markets, the

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<sup>4</sup> Australian National Audit Office, *The Administration of the Automotive Competitiveness and Investment Scheme*, June 2003.

industry firmly maintains that production credits are extremely effective in attracting investment.

The calculation of ACIS credits is currently linked to the rate of tariffs. Vehicle manufacturers are of the view that this relationship creates uncertainty as to the future value of credits and should be removed.

Consideration of proposals to link access to ACIS funds with the achievement of broad social or environmental objectives has been rejected in previous industry reviews.

In its 2002 report, *Review of Automotive Assistance*, the Productivity Commission considered a proposal to reduce assistance to vehicle manufacturers based on production.

The Productivity Commission concluded "it does not follow that vehicle producers own use R&D is deterred because it is an ineligible activity. Given the fungibility of duty credits, it may not matter a great deal whether the basis for earning credits relates to production, R&D or investment in plant and equipment. Indeed, the survey of all of the vehicle producers (Deloitte Touche Tohmatsu 2002), found that, while ACIS does not reward own use R&D activity, 'ACIS benefits are in fact being applied to this activity'."

The Commission also concluded that ACIS was not the desirable tool to achieve broader goals. "In the first instance, these objectives would generally be more appropriately met directly through, for example, emissions/fuel standards." Indeed making ACIS support conditional on the achievement of particular targets could even lead to counterproductive outcomes.

## Conclusion

ACIS has been critical to the industry's transition in the face of an extraordinary combination of competitive pressures. The industry has undergone significant structural adjustment in light of global industry reforms, a reduction in domestic tariffs, an adverse exchange rate and changing consumer preferences in the domestic market.

The FCAI maintains that the existing ACIS arrangements including the provision of duty credits along with the balance of incentives for production, investment and R&D factors should not be changed.

The concern of vehicle manufacturers is that that the quantum of funding available through the ACIS program and the related impacts of modulation, have impaired the effectiveness of the program.

This appears to be borne out by the assessment of the Australian National Audit Office, which noted "[t]he level of modulation is well in excess of levels anticipated in planning the scheme".<sup>5</sup> The capacity to 'modulate' was intended as a risk management measure, to limit the cost to revenue and has grown to become a hindrance to its objectives.

Moreover, vehicle manufacturers observe that the capped level of funding was based on long out of date estimates of the value of the preceding Export Facilitation Scheme, as the Government's original commitment was for a program of equivalent value. The capped level of funding has not taken into account the growth in the value of industry output, export performance, investment and design/engineering.

Indeed, as the Productivity Commission observed "current ACIS funding is not based on any 'science'." <sup>6</sup>

The impact of reductions and variability in the rate of modulation increases uncertainty about the value of future entitlements, undermining the effectiveness of the scheme.

The capping of ACIS, and therefore the impact of modulation, should be removed to provide certainty for investors and allow the value of eligible ACIS activity to return to its original value.

Furthermore, the calculation of ACIS credits is currently linked to the rate of tariff duty. Vehicle manufacturers are of the view that this relationship creates uncertainty as to the future value of credits and should be removed.

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<sup>5</sup> Australian National Audit Office, *The Administration of the Automotive Competitiveness and Investment Scheme*, June 2003.

<sup>6</sup> Productivity Commission, *Review of Automotive Assistance*, August 2002, Page 173.



**FCAI Position:**

The FCAI submits that the value of ACIS support should be augmented and the program should be extended beyond 2015.

In particular:

- The impact of modulation and the arbitrary stage caps should be removed;
- Calculation of ACIS credits earned should be adjusted so that it is no longer directly based on the tariff rate;
- The broad scope of existing eligible activities for MVP participants (i.e. production and investment) should be retained, and
- ACIS support should continue to be delivered through duty credits and the program should continue to operate on a legislated basis.

## **4.2 Trade Policy, Market Access and Tariffs**

The automotive industry is a major participant in global international trade. The leading automotive producing countries tend to be both importers and exporters of automotive products.

The reality is that the global economy is by no means perfect in terms of entry conditions for automotive products. Tariffs remain significant in some developed countries and even more so in emerging countries where non-tariff barriers are often present. The major regional trading blocs of the EU, NAFTA and ASEAN - AFTA ensure that the automotive producers have to have strategies which position them within these important regional trading blocs.

The Australian market is now one of the most open and competitive automotive markets in the world. The effective nominal rate of tariff is only around 6 per cent and there are few if any substantive non-tariff barriers.

Australian automotive exporters however, continue to face significant barriers to trade in foreign markets, with many other vehicle producing nations maintaining tariff rates of 25 per cent or greater.

Developing export business is of central importance for the Australian car manufacturers as they seek to position themselves within the global networks of their parent companies and to achieve the necessary scale of production to be internationally competitive.

### **The WTO Doha Development Agenda**

The current round of WTO multi-lateral trade negotiations, the WTO Doha Development Agenda, has been underway since November 2001.

At the initial Doha meeting, trade ministers from the WTO members agreed to initiate negotiations to further liberalise trade on NAMA goods by addressing tariff peaks, high tariffs, tariff escalation and non-tariff barriers. The non-agricultural products negotiating framework includes a non-linear (harmonising) approach to reducing tariffs. Using a formula to reduce tariff rates is seen by the members as more efficient, transparent and equitable than direct negotiation.

Recent discussion has included the use of the 'Swiss formula' to calculate tariff reductions.<sup>7</sup>

Based on the most recent draft modalities text, the maximum tariff in developed countries would be less than 8 per cent or 9 per cent, depending on the coefficient agreed. On the basis of Table 4.2.1 this would mean Australia's bound tariff for passenger motor vehicles would be reduced from 40 per cent to between 6 per cent and 8 per cent.

A key concern is the additional flexibility proposed to be afforded to developing countries. Under the proposed modalities developing country members would only be required to apply tariff reductions on the basis of a coefficient of between 19 and 23. Moreover, it is proposed that developing members be able to shelter a given percentage of their most sensitive industrial tariff lines from the full effect of the formula. In many cases this is likely to include tariffs on automotive products.

As a consequence it is likely that even a successful outcome from the Doha negotiations will reinforce a significant competitive advantage for automotive producers in developing countries, such as Thailand, China and India.

Table 4.2.1 (below), illustrates the application of Swiss formula under various coefficients, highlighting the impact on the final bound tariff in the Australian context.

**Table 4.2.1: Swiss Formula: Calculation of Final Bound Tariffs**

<b>Initial Bound Tariff</b>	<b>Final Tariff</b>			
<b>%</b>	<b>C = 15</b>	<b>C = 10</b>	<b>C = 8</b>	<b>C = 6</b>
50	11.54	8.33	6.9	5.36
40	10.91	8	6.67	5.22
25	9.38	7.14	6.06	4.84
20	8.57	6.67	5.71	4.62
15	7.5	6	5.22	4.29

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<sup>7</sup> Algebraically, the Swiss formula is:

$$Z = \frac{AX}{(A + X)}$$

where Z is the resulting lower tariff

A is a coefficient and the maximum final tariff rate

X is the initial tariff rate

## **Bilateral and Regional Trade Agreements**

The FCAI has long supported efforts by the Australian Government to achieve improved market access for Australian exporters through the multilateral channels of the WTO.

While the Australian automotive market has been progressively opened up to a greater degree of international competition and integration with the global industry, Australian automotive exporters continue to face significant barriers to access in key markets.

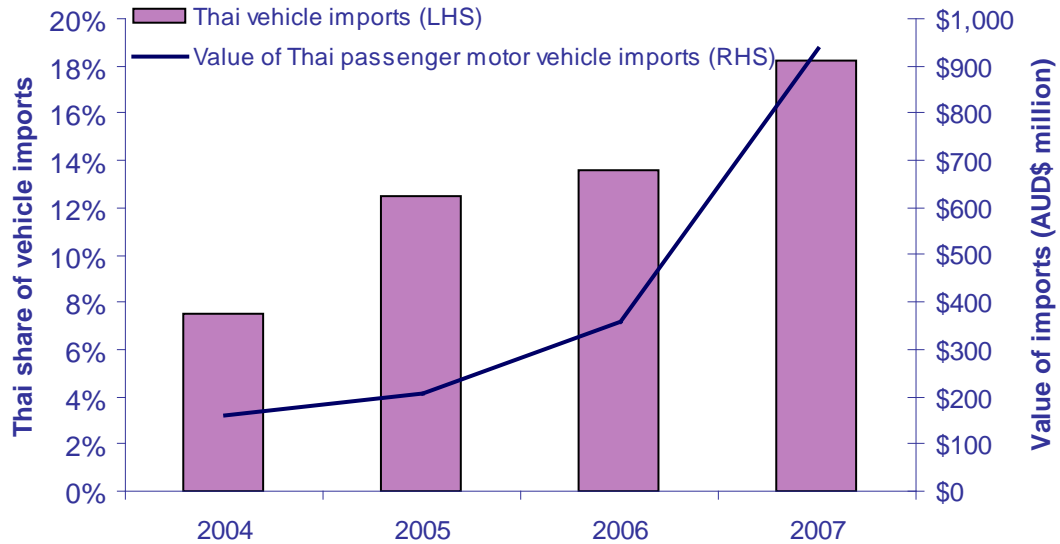
The pursuit of bilateral and regional trade agreements should complement the multilateral negotiations under the WTO. Bilateral and regional Free Trade Agreements (FTAs) can facilitate the reduction of global market distortions in a sometimes more timely manner than multilateral action. They provide a mechanism to address the issues of traditional market access barriers (tariffs and quotas) and non-tariff barriers with strategically important trading partners and regions in advance of WTO agreement.

Of the three FTAs Australia has established since the 2002 automotive review, the FTAs with Thailand and the United States are most significant for the Australian automotive industry.

The Thai FTA reduced the tariff on vehicles entering Australia from Thailand were reduced to zero. The consequence of this has been a 90 per cent increase in vehicle imports from Thailand in the past two years (2005 -2007) as displayed in Chart 4.2.1.

Similarly, the FTA with the United States sees a 3 per cent tariff applied in 2008, falling to zero in 2010, for vehicles imported from the US. The US-Australia FTA has brought with it benefits in terms of improved access for Australian car manufacturers to the US market.

**Chart 4.2.1: Passenger Motor Vehicle Imports From Thailand**



Source: FCAI, VFACTS, available at [www.fcai.com.au](http://www.fcai.com.au) and DFAT, 2007, Composition of Trade Australia 2006-07, Note: Vehicle sales based upon calendar years and value based upon financial year.

Australia – Thailand FTA: “One Way Traffic”:

The completion of an FTA with Thailand resulted in both countries agreeing to remove automotive tariffs for trade between the two countries.

While tariffs facing Australian car manufacturers in the Thailand market are falling, excise taxes that increase with engine size has meant that the Australian car manufacturers have achieved no real improvement in access to the Thailand automotive market. The Thailand car manufacturers on the other hand have obtained improved access to the Australian market and are using it to considerable effect.

There is an increasing push for FTAs to also consider non-tariff barriers. Non-tariff barriers are becoming increasingly important for the automotive industry. Some of the non-tariff barriers that are of particular interest in the automotive industry are:

- discriminatory and punitive taxation arrangements which, in some instances, are having the same impact as tariffs;
- intellectual property protection;
- local content arrangements, and
- vehicle design, safety and environmental standards.

Protection of intellectual property is a critical issue that needs to be addressed through FTAs and is particularly important for the automotive industry, given the high levels of R&D and the development of technologies which underpin a company's competitive advantage. Access to the very latest technologies will underpin the future competitiveness of Australian vehicles and manufacturing processes. If the intellectual property is not protected, products will be copied and undermine the industry's international competitiveness and its ability to attract investment.

Given the very substantial proportion of Australia's exports that are directed to Middle Eastern markets, a high priority for the Australian automotive industry is to see that the negotiation of an FTA with the Gulf Cooperation Council states can be drawn to a timely and successful conclusion.

A further high priority for the Australian automotive industry is to achieve improved access to the automotive markets of ASEAN countries. This would provide the industry with the opportunity to become part of the division of labour that is now being established within this region. Australia's exclusion from serious participation in the ASEAN automotive industry weakens its prospects to become globally competitive. It also means it is necessary for the Australian automotive industry to develop export markets much further from Australia, where market access can be achieved, e.g. the Middle East and the United States.

### **Tariff Policy**

Australian vehicle manufacturers note that past analysis undertaken by the Productivity Commission (2002) concluded that "with assistance to the industry now much lower, the purely 'allocative' gains likely to ensue from assistance reductions are commensurately smaller. Indeed, the quantitative modelling undertaken for this inquiry suggests that these static allocative gains could be outweighed by small, but adverse, shifts in the aggregate price of Australia's exports relative to its imports – known as 'terms of trade' effects".<sup>8</sup>

The Productivity Commission went on to state that the resource allocation gains of the 2005 reduction in tariffs "would be very modest" with a "negligible impact[s] on household income" however the "projected impacts for the automotive industry were potentially more significant."

In response to the Productivity Commission's 2002 *Review of Automotive Industry Assistance*, the then Government noted that "the Productivity Commission will undertake a further [automotive industry] inquiry in 2008 to

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<sup>8</sup> Productivity Commission, *Report on Automotive Assistance*, August 2002, Page 142.

determine whether changes are warranted to the legislated tariff reductions in view of conditions in the international trade environment."<sup>9</sup>

Expectations at that time were that the WTO Doha round would deliver an agreement and Australia would be required to reduce import tariffs on a variety of goods, including passenger motor vehicles.

However, in the absence of a resolution of these negotiations, vehicle manufacturers contend that Australia has acted unilaterally, placing Australian industry at a competitive disadvantage.

Achieving trade agreements through the WTO is a time consuming process. The number of countries involved (more than 150), their different stages of economic development and their competing national interests, means that reaching agreement is difficult. Recognising this constraint the Australian Government has pursued additional bilateral and regional trade agreements to complement the often slow progress of negotiations at a multilateral level.

While several agreements have been concluded in recent years, vehicle manufacturers hold the view that the practical results in terms of increased market access have not met expectations.

Vehicle importers however, offer a slightly different perspective. While they acknowledge the significant value that a local manufacturing capability brings to the Australian automotive industry, they support further reductions in automotive tariffs.

While vehicle importers would not object to the provision of enhanced investment support for local vehicle manufacturers, under the Automotive Competitiveness and Investment Scheme, they believe that this should continue to be linked to a defined schedule for further reform of Australian automotive tariffs.

To this end, vehicle importers believe that there should be a clear timetable for the reduction of passenger motor vehicle tariffs to 5 per cent.

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<sup>9</sup> Costello, P., 2002, Response to Productivity Commission report on Automotive Assistance.

**FCAI Position:**

***Local Vehicle Manufacturers' View***

Local vehicle manufacturers submit that the planned reduction in passenger motor vehicle tariffs should not proceed.

Local vehicle manufacturers acknowledge that further reductions in automotive tariffs will occur, however, they contend that the scheduled reduction in tariffs from 10 per cent to 5 per cent, from 1 January 2010, pre-empts multilateral reductions in industrial tariffs which might be achieved from a successful conclusion of WTO Doha Development Agenda negotiations.

Local vehicle manufacturers believe the timetable for future tariff reductions should be determined on the basis of the outcome of WTO multilateral negotiations and any future bilateral or regional trade agreements concluded by the Australian Government.

Local vehicle manufacturers are concerned that the legislated reduction in passenger motor vehicle tariffs is not currently matched by reciprocal improvements in market access for Australian automotive exporters.

They also note that the Australian Government is continuing to pursue bilateral and regional trade agreement negotiations with a number of significant trading partners. If resolved these negotiations could provide automotive manufacturers in these economies with preferential access to the Australian automotive market.

***Vehicle Importers' View***

Vehicle importers support further reductions in passenger motor vehicle tariffs.

While vehicle importers would not object to the provision of enhanced investment support for local vehicle manufacturers, under the Automotive Competitiveness and Investment Scheme, they believe that this should continue to be linked to a defined schedule for further reform of Australian automotive tariffs.

To this end, vehicle importers believe that there should be a clear timetable for the reduction of passenger motor vehicle tariffs to 5 per cent.



### 4.3 Other Policy Issues

#### 4.3.1 Fringe Benefits Tax

In the early 1980s, the Australian Government was concerned that the income tax revenue base could be undermined as a consequence of salary packaging of a range of expenses including motor vehicles.

To address this issue, the Government introduced the Fringe Benefits Tax (FBT) requiring maintenance of a log book to account for and acquit all business and personal related travel.

This log book system was prohibitively complex, particularly for small business.

In 1986, the Government introduced the statutory formula for calculating FBT on motor vehicles as an administratively simpler alternative.

**Table 4.3.1.1: The 2008 Fringe Benefits Tax Rates and Thresholds**

Total kilometres travelled during the year	Statutory percentage
Less than 15,000	26%
15,000 to 24,999	20%
25,000 to 40,000	11%
Over 40,000	7%

\*Source: [www.ato.gov.au](http://www.ato.gov.au)

In introducing the statutory formula, the government sought to use annual mileage as a proxy to estimate the proportion of the vehicle use which was for business purposes.

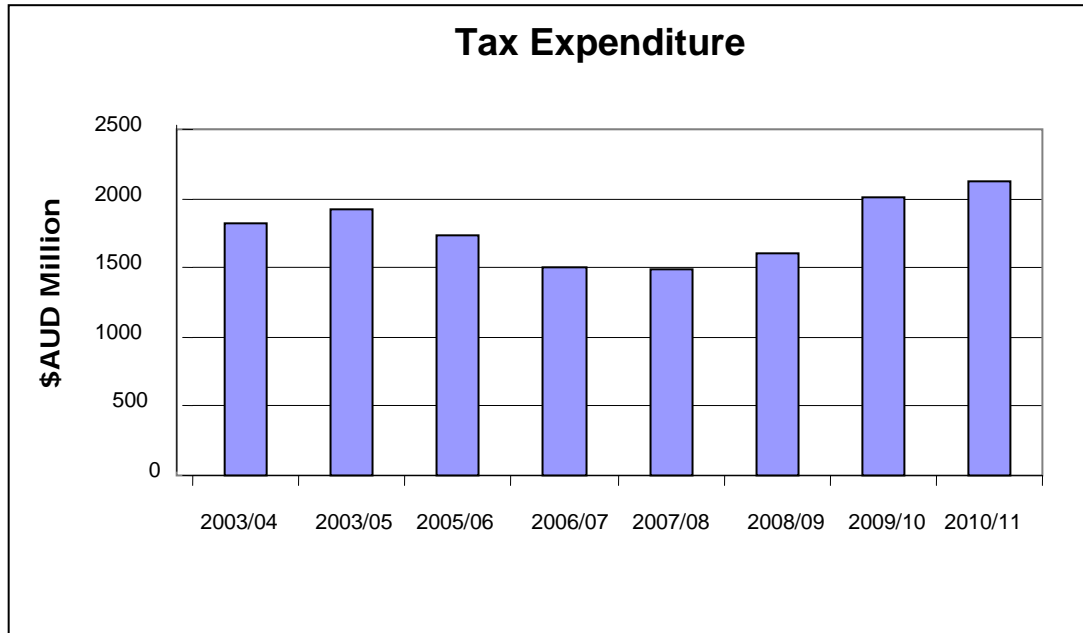
FBT is a significant source of revenue for the Federal Government, raising around \$4 billion<sup>10</sup> each year. The value of revenue receipts from FBT on motor vehicles is not readily available however, it would be a significant proportion of this revenue.

The 2007 *Tax Expenditure Statement*, released by the Department of Treasury in February 2008 shows that the cost of the FBT treatment of motor vehicles has declined by over 11 per cent in the three years to 2006-07. This decline is due to legislated reductions in personal income tax. Chart 4.3.1.1 below shows the decline in the cost of the FBT Concession on motor vehicles over the past three years.

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<sup>10</sup> Budget Paper Number 1, 2006/7 Federal Budget.

**Chart 4.3.1.1: 2007 Tax Expenditure Statement**



\* Source: Department of Treasury, "Tax Expenditure Statement 2007, Page 150

It is incorrect to conclude from this Chart 4.3.1.1 that the cost of the statutory formula is \$1.5 billion per year in lost revenue. If the statutory formula was abolished business would revert to using the 'log book' method of calculating FBT.

Moreover, these calculations assume that, in the absence of the FBT concession, that the full value of the vehicles otherwise packaged, would be received as income and taxed at the highest marginal rate in the hands of the recipient. This means that the estimated cost is potentially grossly overstated.

The expected rise in the cost of the FBT treatment of motor vehicles from 2007-08 to 2010-11 is due to the expectation that average income tax rates will increase over this time.

**FCAI Position:**

The statutory formula represents an administratively simple and efficient method of calculating the value of fringe benefits of a motor vehicle, reflecting the mix business and private usage.

The statutory formula should be retained.

#### **4.3.2 Luxury Car Tax**

In the recent Federal Budget, the Government announced that it proposes to increase the rate of the Luxury Car Tax (LCT) from 25 per cent to 33 per cent.

The FCAI opposes this measure and asserts that the LCT is a distortionary tax which should be abolished.

The retention of the LCT combined with the various taxation imposts on vehicles results in a high tax incidence on luxury vehicles. The multiple taxation of luxury cars include:

- The imposition of the LCT/GST;
- Fringe Benefits Tax on the whole luxury vehicle, including the value which is not eligible for depreciation and on which the luxury tax falls;
- The inability to depreciate vehicles for taxation purposes above the LCT threshold, and
- Stamp duties on the value of the vehicle.

The LCT threshold has failed to keep pace with the increase in vehicle prices and therefore has been applied to an increasing number of vehicles. As vehicle quality improves, including the introduction of advanced emission reduction technologies, there will be an increasing number of vehicles which exceed the LCT threshold.

The LCT can also act as a disincentive to the fitment of safety features to vehicles to ensure they remain under the LCT threshold.

The retention of the LCT is contrary to the thrust of industry policy by successive Australian Governments to lower barriers to trade. It is considered by some countries to be a non-tariff-barrier to trade.

**FCAI Position:**

The FCAI opposes the proposed increase in the rate of the LCT and submits that the LCT should be abolished.

The FCAI contends that the Luxury Car Tax constitutes a non-tariff barrier which discriminates against certain types of imports.

The FCAI argues that the Luxury Car Tax can also act as a disincentive for the uptake of improvements in vehicle specification, including advanced safety features, particularly for those vehicles near or just above the tax threshold.

The FCAI observes that indexation of the Luxury Car Tax threshold has not kept pace with changes vehicle prices.

As a result, the negative impact of the tax and the number of vehicle brands and models affected has expanded over time.

### **4.3.3 Workplace Relations**

In response to the changing nature of the automotive industry's operating environment, both local and international, the Australian automotive industry has become much more focused on the need for it to build areas of sustainable competitive advantage. In order to carve out a viable position in the global industry, the Australian manufacturers have been repositioning their operations to build and leverage skills in innovation and flexible manufacturing.

The move towards becoming a 'smarter' industry is also broadening the industry's connections and contributions to the wider Australian economy. The policy environment should be supportive of this transition to greater flexibility and knowledge intensity.

The ability to implement work practices to support flexible manufacturing systems is crucial to the strengthening the competitiveness and ongoing viability of the Australian industry. Australian manufacturers will continue to pursue improvements in these areas. The process of workplace practice change must and will continue.

The industry must obtain the labour flexibility and productivity gains needed to compete globally while at the same time avoiding major industrial disputes that could threaten crucial export contracts.

It is essential that the industry retain flexibility to undertake product runs in a cost effective way and to rapidly alter production plans to capitalise on emerging niche market opportunities.

Existing arrangements provide the opportunity for a third party, adversely affected by an unnecessary disputation or industrial action involving other parties in the supply chain, to seek a suspension of the bargaining period.

This facility is vital given the concentrated nature of the automotive supply chain. This reduces the risk that the industry can be brought to a halt by industrial action.

**FCAI Position:**

The FCAI notes that, over a long period, vehicle manufacturers and their employees have maintained a constructive approach to workplace relations in the automotive industry.

FCAI is concerned to ensure that the risk of disruption or harm as a result of unnecessary industrial action is minimised and that effective remedies are preserved to underpin the security of supply throughout the industry.

To this end FCAI supports existing provisions in the *Workplace Relations Act* which ensure that:

- Protected action can only be approved by a properly supervised and genuine secret ballot;
- There are effective sanctions and remedies to mitigate the risk of unprotected industrial action; and
- That a suspension of a bargaining may be provided in the event that industrial action threatens significant harm to third parties.

#### **4.3.4 Skills and Training**

Automotive Training Australia Limited (ATA) is the national industry training advisory body for the automotive industry. The company was formed in 1990 by the Motor Trades Association of Australia (MTAA), the Federal Chamber of Automotive Industries (FCAI) and the Australian Council of Trade Unions (ACTU) to formulate nationally consistent, high quality training for the manufacturing and retail, service & repair sectors of the automotive industry.

Whilst ATA is not currently part of the Industry Skills Council (ISC) structure, it receives the full support of the industry in maintaining its primary functions of overseeing the formulation of nationally consistent high quality training on behalf of the industry.

The ATA has experienced ongoing problems due to a lack of consistent Government funding.

The automotive industry (FCAI, MTAA and the ACTU) has refused to merge the ATA with existing ISC's due to the administrative problems persistent in these institutions, the finite nature of the industry and its training needs and the willingness of the industry to provide financial support to the ATA in the absence of appropriate government funding.

The existing funding arrangements are however, unsustainable.

##### **FCAI Position:**

The FCAI submits that the development and continuous improvement of automotive training packages needs to be formally incorporated and recognised within the national training arrangements.

The FCAI seeks an urgent resolution of the long standing impasse between the industry and the Australian Government in relation to this issue.

#### **4.3.5 Vehicle Design**

National uniform regulation of standards for road vehicles is achieved under the provisions of the Motor Vehicles Standards Act 1989 (MVSA). The Act provides a legislative base for the Australian Design Rules (ADRs) that set standards for vehicle safety, emissions and anti-theft performance. The ADRs are largely harmonised with leading international standards.

The Australian Government is a signatory to the 1958 and 1998 Agreements. These Agreements establish international vehicle standards, commonly referred to as the UN-ECE Regulations

The drive to harmonise the ADRs with international standards, predominately the UN-ECE Regulations, has been a focus of the Australian Government. The industry looks forward to continuing to work with the Australian Government on this ongoing task.

The competitive nature of the automotive industry requires a world's best practice regulatory environment to ensure that the Australian industry is able to compete in both the domestic and export markets, particularly against countries which have little or no regulatory cost.

Vehicle manufacturers produce vehicles for a global market. Australian manufacturers export between 30 per cent and 40 per cent (by value or volume) of their annual production. Around 80 per cent of vehicles sold in the Australian market are manufactured overseas to international standards.

Regulation must be kept to a minimum, be the most effective method of achieving the objective and be internationally consistent to ensure that consumer choice is not limited and that Australian manufacturers are able to service both the domestic and international markets.

The industry is concerned with the potential for a "break out" of individual state based-vehicle standards.

Prior to introduction of new regulations, which are inconsistent with international standards, a rigorous process needs to be conducted to ensure the most cost effective options to achieve the desired outcomes are implemented.

**FCAI Position:**

The FCAI urges the Australian Government to reaffirm its commitment to internationally consistent, national vehicle design requirements.

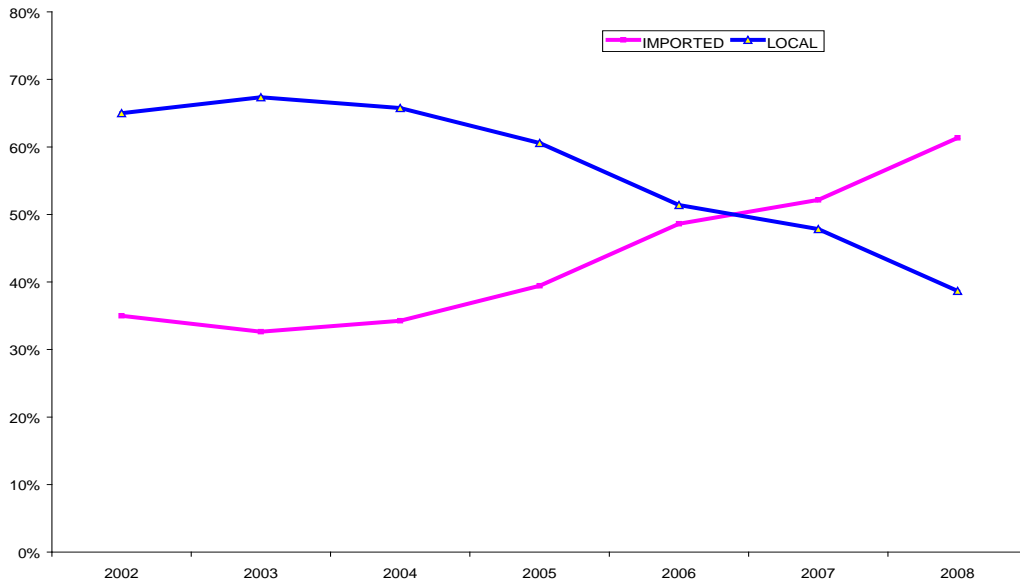


### 4.3.6 Government Procurement

Changes in government fleet purchasing policies appear to have contributed to recent decline in the sale of local manufactured vehicles.

Locally made passenger cars have accounted for just 40 per cent of government purchases in 2008 to date, compared with 65 per cent in 2002 (see Chart 4.3.6.1). For passenger car sales, locally made vehicles have accounted for 61 per cent of total government fleet purchased in 2008, down from 84 per cent in 2002. This decline amounts to a loss of around 16,000 locally made vehicle sales in 2007 alone.

**Chart 4.3.6.1: Government Purchases of Passenger Vehicles (as % of Total Government Vehicle Purchases)**



Source: FCAI VFACTS

The decision by some state governments to implement policies which effectively exclude many Australian made vehicles from their government fleets has been a key driver of this change. Unfortunately the decision to exclude Australian made vehicles appears to have been made without consideration for safety, local employment or value for money.

**FCAI Position:**

Government purchasing decisions should take full account of their impact on local employment, the environment, safety and value for money.

## **5. Innovation**

The future of the Australian automotive industry lies in its capacity for innovation. Given Australia's standard of living, the automotive industry cannot rely on a low cost production strategy. It must be able to deliver superior value to customers whether they are located in Australia or in overseas markets.

Innovation is not just about improved products through design and engineering, although that is very important, it must also deliver production process improvements, faster and more effective model development systems and for that matter improvements throughout the complete value chain.

The reality is that the automotive industry is one of the largest investors in business R&D wherever it is located. For example, in Western Europe the automotive industry accounts for about 30 per cent of total business R&D. Four of the world's largest corporate spenders on R&D in 2006 were car manufacturers.<sup>11</sup>

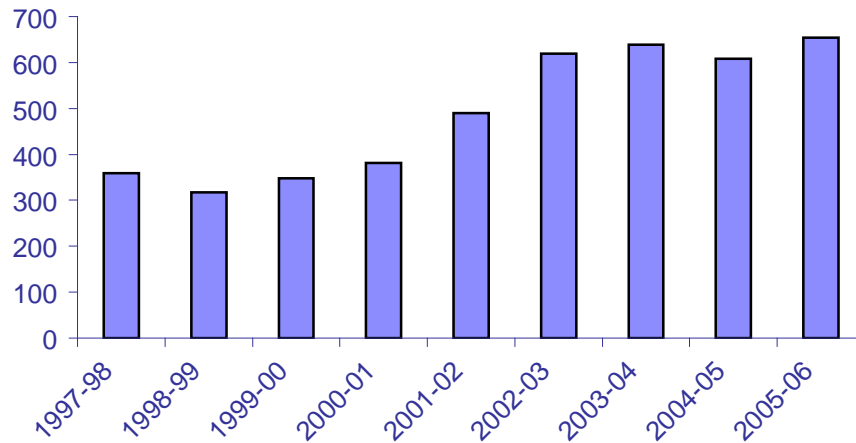
Innovation is not just about R&D. There are many other elements that go into innovation whether it has to do with improved products, better production processes and more effective organisational and supply chain methods. However, data on innovation is not readily available and hence there is an understandable focus on R&D expenditure as a good proxy for innovation.

ABS Business Expenditure on R&D data shows that over \$650 million was invested in motor vehicles and parts in 2005-06. In the first few years after the introduction of ACIS in 2001, the level of R&D expenditure by the Australian automotive industry increased, as shown in Chart 5.1 prior to ACIS, the level of automotive R&D was steady at around \$300 million per annum. It now appears as if a new minimum level of automotive R&D investment has been reached at around \$600 million per annum.

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<sup>11</sup> Booz Allen Hamilton (2007), Global study shows corporate R&D spending on the rise, but linkage between R&D investment and financial performance remains poor, media release 17 October 2007.

**Chart 5.1: Automotive Industry R&D (\$ millions)**



Source: Australian Bureau of Statistics (2007) *Research and Development Expenditure: Businesses*

The automotive industry in Australia accounts for about 10 per cent of total business R&D in Australia and over 20 per cent of business R&D in the manufacturing sector.

In addition to R&D expenditure, other evidence of an increase in innovation by car manufacturers is provided by their ability to attract global R&D projects. The three car manufacturers all have design and engineering facilities and are either leading or taking part in global model development projects.

GM Holden's established Holden's Innovation in 2003 and in 2004 Toyota opened the Toyota Technical Centre Asia Pacific in Melbourne. Ford's Product Development team has taken on an enhanced role as an engineering and design centre of excellence for the Asia Pacific and Africa region.

Vehicle manufacturers draw upon the broader Australian national innovation system to underpin their strengths in intellectual property, design and engineering. A significant example of this is the CRC for Advanced Automotive Technology (AutoCRC) which started on December 2005 and is expected to invest \$100 million in automotive R&D over seven years.

Vehicle manufacturers also undertake significant innovation in their manufacturing operations which are not reflected in R&D investment figures. For example, they all apply the principles of lean manufacturing which are based on the need to achieve continuous improvement in processes.

## Green Car Innovation Fund

On 15 March 2007, the ALP announced the Green Car Innovation Fund, a program "designed to generate \$2 billion in investment to secure jobs in the automotive industry and tackle climate change by manufacturing low emission vehicles in Australia."<sup>12</sup>

The initiative sought for industry to invest \$1.5 billion to receive a government contribution of \$500 million, on a three-to-one dollar basis, commencing from 2011.

The objective of the program was described as "creating Australian cars that are both energy efficient and reduce greenhouse gas emissions in the transport sector."

Australian car manufacturers (and the supplier industry) face significant challenges in successfully competing for investment from their parent companies due to the changes that are occurring in the world automotive industry, most notably, the large flows of investment that are being directed at establishing vehicle manufacturing capability in the major emerging automotive producing countries, and the challenge to improve the environmental performance of Australian made cars.

The fact that the three car manufacturers are branches of global automotive manufacturers means that the key investment decisions on manufacturing and new model development are taken by the parent companies.

In effect, there is intense competition to attract and retain investment going on within the operations of the global automotive manufacturers.

Unless the criteria for eligible activities is sufficiently broad there is some doubt whether the proposed funding ratio of \$1 for every \$3 will be sufficient given the level of risk associated with these types of investment. R&D incentives under ACIS have provided a greater incentive than has initially been proposed through the Green Car Innovation Fund.

In distinction from the operation of ACIS, industry considers that assistance provided through the Green Car Innovation Fund should be provided through direct outlays rather than duty credits.

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<sup>12</sup> ALP Media Release: [www.alp.org.au/media/0307/msCCiiloo150.php](http://www.alp.org.au/media/0307/msCCiiloo150.php)

The challenge of achieving a transition to the development and manufacture of more environmentally friendly vehicles will not be met through the emergence of a single technology. Global car manufacturers are pursuing a range of different technologies and approaches to reduce vehicle emissions.

The Green Car Innovation Fund should aim to promote the development or uptake of a broad range of technologies by Australian vehicle manufacturers, which move the industry toward a lower greenhouse footprint.

While participants may be encouraged to work with component manufacturers to achieve emissions reductions eligibility should be limited to Australian vehicle manufacturers for the development or uptake of technologies in Australian manufactured vehicles.

**FCAI Position:**

In developing the framework for the Green Car Innovation Fund, FCAI recommends that:

- The program should be technology neutral and aim to achieve a reduction in the CO<sub>2</sub> emissions of Australian manufactured vehicles and be made available to all technologies that achieve this outcome;
- To ensure that the technologies developed through this program are commercialised into Australian manufactured vehicles, funding should be restricted to Australian vehicle manufacturers. Vehicle manufacturers should be encouraged to engage component manufacturers in the program;
- Funding should be in addition to existing programs available to the industry and benefits from the program should be issued on a grants basis, not in the form of duty credits;
- There should be a limit to the maximum amount of support available to any individual participant; and
- The proposed ratio of \$1 for \$3 of industry investment should be reviewed as it may not be sufficient given the level of risk associated with the desired investment.

## 6. Environment

Road transport and passenger road transport, is integral to economic development and has “dramatically enhanced mobility, economic prosperity and quality of life for billions of people”.<sup>13</sup>

The growth in demand for passenger vehicles in Australia and globally, and increased use will deliver greater benefits. The challenge for the industry and governments is to enable future road transport demands to be met in a sustainable and environmentally responsible way.

The FCAI acknowledges that the growth in road transport contributes to global greenhouse gas emissions and that the automotive industry, internationally and in Australia, has a responsibility to contribute to efforts to mitigate the impact of climate change.

Australian passenger motor vehicles accounted for 7.8 per cent of Australia's total greenhouse gas (GHG) emissions in 2005.<sup>14</sup> Australia has one of the oldest average fleets among developed economies with an average vehicle age of 9.7 years<sup>15</sup>. Consequently, as new vehicle technologies are developed and become available to the market benefits take a long time to diffuse through the vehicle stock.

Globally, automotive manufacturers are investing heavily in a range of technologies and advance in vehicle design that have the potential to make further significant contributions to reducing motor vehicle CO<sub>2</sub> emissions. Some of the key approaches being pursued include:

- Development of advances in electric vehicle capability and design, including advanced battery technologies;
- Improvements in vehicle design, including increased thermal efficiency in engines; reduced friction loss; enhanced aerodynamics; reduced rolling resistance; and reductions in vehicle weight;
- Advances in hybrid vehicle technology;
- Development of enhanced alternative fuels capability, including new generation renewable biofuels.
- Hydrogen fuel cell vehicles.

Significant opportunities exist for the uptake and the further development of a range of these technologies by the Australian automotive industry.

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<sup>13</sup> Julia King, *The King Review of Low Carbon Cars (UK)*, March 2008, Page 3

<sup>14</sup> Australian Greenhouse Office, April 2007, *State and Territory Greenhouse Gas Inventories 2005*

<sup>15</sup> Australian Bureau of Statistics, 2007, *Motor Vehicle Census, catalogue no. 9309.0*

## Australian Industry Performance

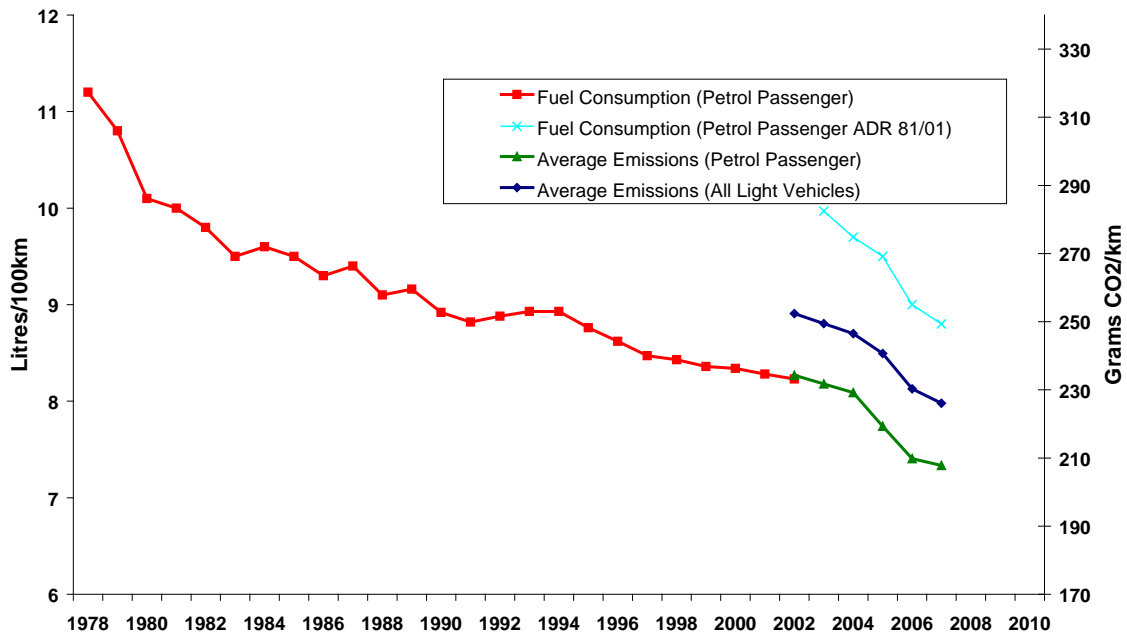
The three Australian vehicle manufacturers are members of the Australian Government's Greenhouse Challenge Plus program which enables companies to form working partnerships with the Government to improve energy efficiency and reduce greenhouse gas emissions.

The Australian industry also has a long history of pursuing voluntary targets to reduce fuel consumption, dating back to the 1970s.

Most recently, in 2005, the FCAI established a voluntary target to reduce National Average Carbon Emissions (NACE) for all new vehicles (under 3.5 tonnes) to 222 grams of CO<sub>2</sub>/km by 2010. The NACE has improved continuously since data was first collected in 2002 from 252 grams CO<sub>2</sub>/km to 226.1 grams CO<sub>2</sub>/km in 2007, a reduction of more than 10 per cent (see Chart 6.1).

Current trends suggest that this National Average Carbon Emissions target will be achieved.

**Chart 6.1: Fuel Economy and Emissions in Australia**



Note: There is a break in the fuel consumption data in 2003 due to the introduction of a new measurement standard and test cycle)

The current industry NACE target was established in 2005 and replaced a fuel economy target (NAFC) of 6.8 litres per 100 kilometres by 2010. This target was based on a number of assumptions including that by 2010 that the minimum fuel quality standard in Australia would be 95 RON with a maximum 10 ppm sulphur (i.e.

Euro 4 standard).<sup>16</sup> Furthermore, in 2003 the 'test cycle' used for calculating fuel consumption in Australia was changed to harmonise with the new European drive cycle.

The impact of the change in test cycle, which now included increased city driving time, was that the average fuel consumption changed from 8.82 l/100 km in 2002 to 9.97 l/100km in 2003 (this is highlighted in Chart 6.1 above). Increased city driving will increase fuel consumption as internal combustion engines need to use more fuel to accelerate a vehicle from rest than to maintain a constant speed on the highway.

Consequently, the FCAI sought to establish a new industry target for 2010 based on average CO<sub>2</sub> emissions, allowing the inclusion of a range of fuel types (petrol, diesel, LPG, etc.) in a single summary measure of industry performance.

In mid-2005, the industry agreed to target a reduction in CO<sub>2</sub> emissions to 222 grams CO<sub>2</sub>/km by 2010; a 12 per cent reduction from the 2002 level of 252 g CO<sub>2</sub>/km. The original NAFC target of 6.8 l/100 km had anticipated a 17 per cent improvement in fuel consumption over the same period however, it was determined that without an improvement in fuel quality within this timeframe the target could not be achieved.

At the request of the Australian Government, the 2010 target was also expanded to include all vehicles under 3.5 tonnes, not just passenger vehicles, and therefore includes SUVs and light trucks. Obviously, with these larger vehicles any new target for reduction in CO<sub>2</sub> emissions becomes more challenging.

## **International Comparisons of Carbon Emissions**

International comparison of average vehicle CO<sub>2</sub> emissions is fraught with difficulty.

While Australia has adopted the new European drive cycle for measurement of fuel economy and emissions other countries, notably the United States, Canada, Japan and China, use a variety of different standards.

To compare emissions or fuel economy data between countries the following factors need to be taken into consideration:

- Differences in test cycles: The proportion of city or highway travel and idling undertaken in the test procedures (e.g. acceleration, top speed, braking and time idling or at speed) has a significant impact on the results;
- Differences in fuel quality: There is a direct relationship between the quality of fuel used with the engine technology that can be employed and subsequently the pollutant emissions and fuel consumption. The same vehicle will have greater

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<sup>16</sup> The RIS for 'Vehicle emissions and fuel quality standards for the post 2006 period', prepared by the Australian Department of Transport and Regional Services concluded that "applying the sulphur limit to regular unleaded or lead replacement petrol is not warranted on cost benefit grounds."



fuel consumption and higher emissions if tested with a lower quality of fuel. Fuel quality standards vary between countries.

- Different sample group: The FCAI NACE target includes light commercial vehicles up to 3.5 tonnes. The EU, which uses the same test cycle as Australia, reports a emissions value for passenger cars only, which excludes many SUVs and light commercial vehicles (utes, vans etc). The US has a separate standard for 'pick-ups'.
- Differences in consumer preferences: Consumers preference varies between countries and is dependent on factors such as the level of urbanisation, geography and standard of living. Differences in average emission values between countries reflect differences in customer purchasing behaviour as well as vehicle technology.
- Mandatory safety requirements: as additional safety features are added to a vehicle its weight increases and therefore increases fuel consumption.

As raised above, mandatory emissions targets have been adopted in overseas markets, in the absence of an economy-wide ETS. They have however, been shown to be a crude and ineffective method of reducing emissions.

In 1998 the EU set a very ambitious NACE target of 140 g CO<sub>2</sub>/km by 2008 and failed to achieve this target. Despite this failure the EU intention is for a more ambitious target of 120 grams CO<sub>2</sub>/km by 2012 which the industry has described as unachievable through vehicle technology improvements alone. The EU industry warns that improved safety measures, including pedestrian safety requirements, have increased the weight of vehicles and therefore emissions.

Since 2004 the European NACE has remained relatively constant at around 160 g CO<sub>2</sub>/km. Since emissions data has been recorded in Australia (2003) average emissions have declined by 10 per cent.

Finally, the automotive industry is a global industry which produces vehicles for the global market. Around 80 per cent of vehicles sold in Australia are imported and Australia has one of the greatest varieties of vehicle brands, including most European and Asian brands and recently a number of US marques. Around 40 per cent of Australian manufactured vehicles are exported to the world. Therefore the technology available in Australia is ostensibly similar to the rest of the world.

The NACE should be used as a tool to monitor and compare emissions from new vehicles overtime.

## **Emissions Trading**

The Australian Government intends to introduce an emission trading scheme (ETS), including the transport sector, in 2010.

Australia will be among the first countries in the world to develop an emissions trading scheme which includes the transport sector.

The FCAI supports the Australian Government's position that an ETS is the preferable solution as it leads to control of the level of emissions entering the atmosphere through market pricing of greenhouse gases. However the FCAI urges the Australian Government to take account of the trade exposed nature of the Australian industry and the potential impact of an ETS on the cost competitiveness of local manufacturers.

An ETS impacts on the automotive industry in two distinct ways, firstly the cost of emitting carbon would be incorporated into fuel prices, affecting consumers' driving behaviour and vehicle purchasing decisions. Secondly, an ETS will increase the cost of energy and without adjustment will therefore impact on the competitiveness of Australian manufacturing.

One of the major benefits of an ETS over other forms of emissions abatement options is that an unconstrained ETS will allow the market to provide efficient emissions reductions by exploiting the least cost opportunities.

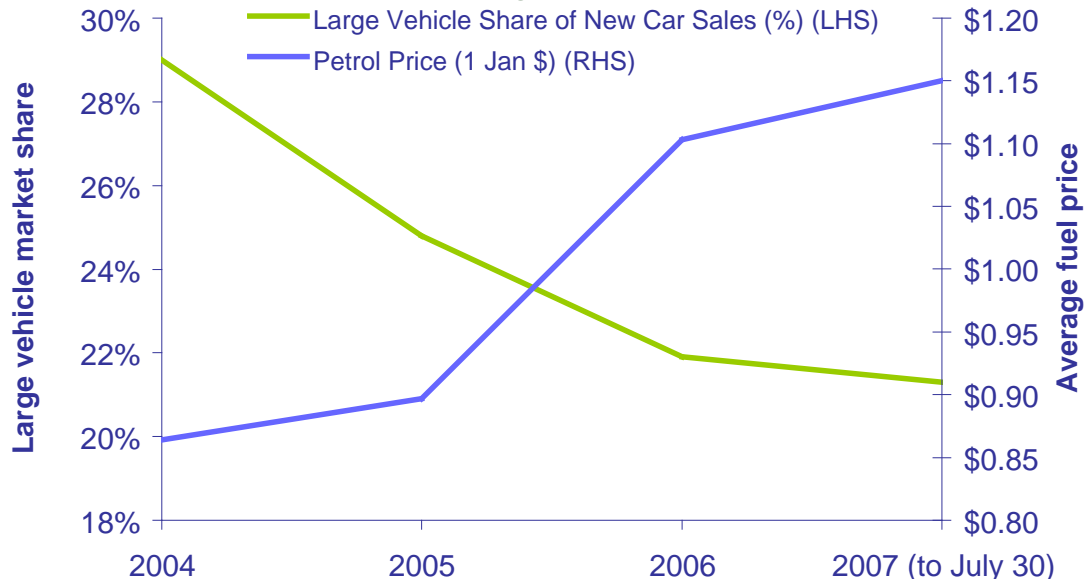
The major attribute of an ETS is that it can efficiently determine the least cost method of emissions abatement. Introducing any secondary emissions strategies on the automotive industry assumes that a reduction of one tonne of CO<sub>2</sub> from a passenger motor vehicle is more important than a reduction of one tonne of CO<sub>2</sub> from any other sector of the economy.

Countries including Japan, the United States and the EU have implemented a range of different vehicle emission strategies, including mandatory emissions targets. The situation in those countries however, is not comparable to Australia. The nations concerned have not implemented an ETS that includes the passenger transport sector. They have introduced second best measures in the absence of a more efficient, market based measure such as an ETS.

Based on recent evidence, an increase in the price of fuel as a result of the establishment of an ETS, will drive emissions reductions both by reducing vehicle use and by inducing consumers to buy smaller cars. As illustrated in Chart 6.2 below, increases in petrol prices over the last few years have resulted in a significant shift in market segmentation, suggesting a link between petrol prices and new vehicle purchasing decisions.

There is no benefit to the environment if Australian vehicle production were to be relocated to countries with lower environmental standards.

**Chart 6.2: Petrol Price Versus Large Vehicle Sales**



FCAI VFACTS and Department of Innovation, Industry, Science and Research: Australian Petroleum Statistics. Note: Large vehicles comprise of those vehicles classified as Large, Upper Large, People Movers, SUV Large, SUV Luxury and Vans in the FCAI data.

An ETS is designed to increase the cost of energy, which is an essential component to the manufacture of motor vehicles and their components. Vehicle manufacturing is also heavily reliant on a number of other industries, which are also significant energy users, including aluminium, steel and plastics. Increases in the cost of production of these commodities will flow through to the cost of vehicle manufacturing.

The Australian automotive industry is highly trade exposed. Of the 1.05 million vehicles sold in 2007, domestic production accounted for only 19 per cent of sales.<sup>17</sup>

Of the countries from which Australia imports vehicles, three of the top five countries (by volume) are Annex II countries under the Kyoto Protocol (Thailand which is ranked second, Korea which is third and South Africa which is fifth) which are not bound to reduce greenhouse gas emissions. Together, these countries represent 28.2 per cent of vehicle sales in Australia.

In addition, the local industry exports 40 per cent of vehicle production to countries including in the Middle East, the United States, New Zealand, Korea and South Africa. These markets are also highly competitive and any increase in costs in the Australian industry can compromise its future prospects.

The Australian Government is considering what criteria might be applied to mitigate the competitive impact of an ETS of those industries which are deemed to be trade exposed emissions intensive.

<sup>17</sup> Federal Chamber of Automotive Industries, 2007, Vehicle Sales

The FCAI maintains that the classification of these industries should be undertaken on a case by case basis. This would avoid establishing arbitrary criteria which may not adequately reflect the competitive impact on individual industries or sectors. The case by case approach can also take into consideration the existence of an ETS, or equivalent, in competing nations.

## **Conclusion**

The FCAI and its members recognise that the automotive industry has a role to play in addressing climate change.

Passenger motor vehicles accounted for 7.8 per cent of Australia's total greenhouse gas emissions in 2005.

To focus regulatory attention only on the new vehicle industry fails to address the most significant contribution to motor vehicle emissions which is that of the existing vehicle fleet.

Australia will be among the first countries in the world to introduce an ETS which includes the transport sector. Other nations have been required to introduce second best regulatory options, such as mandatory emissions targets, in the absence of an ETS.

The FCAI is supportive of the establishment of an economy-wide ETS. However the FCAI urges the Australian Government to take account of the trade exposed nature of the Australian industry and the potential impact of an ETS on the cost competitiveness of local manufacturers.

The major attribute of an ETS is that it can efficiently determine the least cost method of emissions abatement. Introducing any secondary emissions strategies on the automotive industry assumes that a reduction of one tonne of CO<sub>2</sub> from a passenger motor vehicle is more important than a reduction of one tonne of CO<sub>2</sub> from any other sector of the economy. There is no benefit to the environment if Australian vehicle production were to be relocated to countries with lower environmental standards.

### **FCAI Position:**

The FCAI supports the introduction of an economy-wide ETS as an efficient mechanism to determine the least cost emissions abatement pathway.

The FCAI urges the Australian Government to take account of the trade exposed nature of the Australian automotive industry and the potential competitive impact of increases in production costs in the design of its ETS.

The FCAI submits that the introduction of additional regulation of vehicle CO<sub>2</sub> emissions is unnecessary and inconsistent with the market based incentives of an ETS.

