Federation of Automotive Products Manufacturers

Senate Economic References Committee

Inquiry into the future of Australia's Automotive Industry

April 2015

Contents

Executive Summary

1. New Policy Context

The Australian automotive landscape is in the midst of unprecedented transformational change with the announcements by the three Australian Motor Vehicle Producers (MVPs) to cease volume vehicle manufacturing by the end of 2017. Policy development and response from government is crucial to maintain over 100 years of mature industry capability and must balance two key objectives:

i. Management of the industry to avoid an uncontrolled collapse before the end of 2017; and
ii. Provision of time and an environment to allow industry participants to either build a future in the post-2017 period that is not dependent upon local vehicle manufacture, or to plan for an orderly exit from the industry

If this is done well, it will allow time and opportunity for displaced workers to re-skill and find alternative employment and where possible, retain skillsets and technologies that have been built-up in the automotive supply chain, to continue to generate economic wealth for the country.

2. FAPM's 6 Point Policy Plan – Short Term Actions 2015-2017

The FAPM has developed a 6 point policy plan for immediate implementation to facilitate an orderly transition for the automotive industry in this new policy context.

It is proposed that the second, third and sixth points of the 6 point plan below, relating to funding for the ATS and ADP, would be funded by $200m of underspent ATS funding. Also implicit within this submission, is the application of $100m of "business as usual" ATS funding.

i. ATS Funding Certainty

No cuts to ATS funding out to 2020 to provide certainty to industry participants to plan for continuity of operations until the end of 2017; to help maintain access to banking finance in an increasingly stringent bank lending environment; and to be available to fund diversification activities

ii. Tailoring ATS to New Industry Paradigm

Changing the ATS rules so that they provide support for diversification initiatives in the industry, particularly in terms of both automotive and non-automotive products and in the provision of engineering services for third parties

iii. Enhanced Automotive Diversification Programme (ADP)

The current ADP needs to be enhanced in 4 key areas:

- $200m additional funding (sourced from ATS underspend) to allow additional high-merit ADP projects to be funded;
- expand the range of activities funded through ADP to include R&D, commercialisation, marketing and feasibility studies;
- 50:50 funding up to $100,000 p.a. for the appointment of export managers

- ADP to be continuously open, rather than being run in "funding rounds"

iv. New Model for Industry / R&D Collaboration

Utilising displaced automotive engineers and purchasing officers, universities and the FAPM, to bring global product and engineering opportunities into the Australian supply chain and R&D community (a tailored "*Fraunhofer*" model)

v. Maximise Transitional Markets

Governments to continue to pursue reciprocal trading conditions, including in relation to Non-Tariff Barriers (even in the presence of Free Trade Agreements), and to provide incentives for new investors in the Australian automotive industry.

Industry itself will assist in the transition by commitments to end-of-production timelines and providing linkages into global engineering and purchasing networks.

vi. FAPM Industry Triage Role

To aid an orderly transition for the industry, the FAPM seeks $1.5m of funding over 3 years to play an "industry triage" role in assisting supply chain companies to evaluate their future options and direct these companies to the most suitable advice, programs and services to aid their chosen transition pathways.

3. Long-Term Actions 2017-2020

In recognition of the scale and potential impact of the transition ahead for the automotive industry, that a review of the automotive industry be undertaken in 18 months' time, to provide the opportunity for further policy refinement.

4. Scope and Scale of Industry Beyond 2017

If the above policy prescription is actioned, the FAPM believes that, using a common industry assistance benchmark some 20,000 jobs that would otherwise be lost could be preserved and transitioned into new areas, compared to a continuation of current policy. This would provide significant opportunity for up to 80 businesses to transition to the post-2017 environment.

Recommendations

Automotive Transformation Scheme

Recommendation 1

To underpin the continuity of the industry out to 2017 and to support diversification opportunities, that the current level of ATS funding or an equivalent program be continued out to 2020.

Recommendation 2

In recognition of the important role that engineering services can play in a sustainable industry post 2017, that the ATS rules be changed to allow for the claiming of the R&D activity contained within engineering services activity across the registration categories, principal among these changes is changing regulation 1.20(4)(c), which in the case of supply chain ATS participants, excludes R&D conducted on behalf of any third party.

Recommendation 3

That the definition of automotive services contained in regulation 1.9 be altered, particularly in relation to the exclusion areas such as aftermarket or customising processes or training mentioned in regulations 1.9(3)(e), (f) and (g). The concept of an eligible automotive service in regulation 1.9 should be broadened beyond passenger motor vehicles and light commercial vehicles. Consideration could also be given to including specialist vehicles mentioned in Chapter 84 of the Tariff (such as earthmoving equipment), and other industries such as rail vehicles and rolling stock mentioned in Chapter 86.

Recommendation 4

In recognition of the importance of diversification to the industry's future post-2017, that the ATS rules be changed to allow for the claiming of R&D relating to products or services for non-automotive industry sectors (subject to competitive neutrality rules).

Recommendation 5

That the existing 50% level of R&D incentives be continued under the ATS

Recommendation 6

As tooling investment is a key element of a diversification plan, that the benefit rate applicable to tooling be increased to 50%.

Recommendation 7

To allow for ease of movement between ATS registration categories as the transition within the industry unfolds, remove the "once a year" registration window currently provided for under regulation 2.14 and amend Part 2 of the ATS regulations to allow for seamless movement between ATS registration categories. Include the continued recognition of historic investment and sales under the previous registration category.

Recommendation 8

To avoid any malapportionment of the ATS funding pool between MVPs and non-MVPs, allow for the 55:45 split of the ATS pool to be amended should an MVP move to a non-MVP registration category.

Recommendation 9

To ensure that local Australian automotive supply chain businesses continue to have access to ATS to assist in their transition, that the rules be changed to allow historic OE supply chain players to remain within the Scheme, even in the event of declining OE production.

Recommendation 10

To assist in the diversification of the industry, that the ATS rules be changed so that R&D is claimable in respect of both OE and non-OE components, regardless of the level of OE remaining within the ATS registered business.

Recommendation 11

To assist the process of identifying and accessing new markets needed for diversification, that the R&D rules of ATS be amended to allow marketing and branding activities to be claimable.

Recommendation 12

To encourage an inwards investment plans for the industry, that ATS continue to be available for new entrants to the industry.

Recommendation 13

To avoid the 5% sales cap cutting in and reducing participants' ATS benefits to an artificially low level, that the 5% sales cap be abolished.

Recommendation 14

To assist with the transitional process, the FAPM recommends that ATS participants be given the choice of opting out of the moving average and have their ATS benefits calculated based on the actual eligible expenditure that occurs during each quarter. In such circumstances companies choosing this option would receive two elements within their quarterly ATS payments. Part A (quarter-by-quarter pay out), and Part B would comprise the ATS benefits attributable to each specific quarter from the quarter in which they opt-out.

Recommendation 15

That site relocation and/or site consolidation activities, including the costs of planning, moving and re-establishment of operations at an alternative location(s) be permitted as an eligible R&D activity under ATS

Automotive Diversification Programme

Recommendation 16

To allow more scope for funding high-merit projects, that $200m of ATS funding be made available for the ADP.

Recommendation 17

That ATS participants be given the choice of funding their diversification activities through the ADP or through their ATS return (noting the FAPM's recommendations about proposed changes to ATS to make it more supportive of diversification activities).

Recommendation 18

In recognition of the many aspects of a successful diversification initiative, broaden assistance to not only include capital spend, but to also support R&D, commercialisation, feasibility studies salary on-costs and marketing activities for both manufactured products and engineering services.

Recommendation 19

To assist in bringing an export focus to diversification, the provision of grants of up to $100,000 p.a. for the appointment of export and marketing managers on a 50:50 matched basis be made part of the ADP.

Recommendation 20

In recognition of the limited timeframe in which diversification within the industry must occur, that the ADP be open continuously and not in rounds.

Industry/R&D Collaboration

Recommendation 21

That funding is made available, potentially as another arm of the ADP, to support the establishment of a new model for industry/R&D collaboration.

Recommendation 22

That as part of this new model, Australian MVPs assist in placing displaced automotive engineers and purchasing personnel into regional engineering design "homerooms" to identify opportunities for manufacturing and/or engineering work ("entrepreneurial residence" concept).

Recommendation 23

That as part of this new model, specialists be appointed in key markets to provide support to these in-market engineers and focus on identifying other diversification opportunities.

Recommendation 24

That displaced Australian automotive engineers be placed into selected Australian universities as "D-end" experts, who in partnership with the FAPM, collaborate with research and commercialisation expertise and Australian automotive industry companies to access these global opportunities.

Recommendation 25

That the FAPM be tasked with coordinating the introduction of supply chain companies to the "D" opportunities arising from the above process.

Recommendation 26

That as part of the new collaboration model, a specific study and educational campaign around the application of advanced manufacturing techniques to assist supplier viability is undertaken.

Recommendation 27

That as part of the new collaboration model, the learnings from the CSIRO's "Design for Manufacturing Competitiveness" program be actively diffused to the automotive supply chain.

Market Access

Recommendation 28

That the government advocates for mutually reciprocal trading conditions for Australia's automotive manufacturing industry and the role of these arrangements in attracting contract manufacturing models to Australia also be considered.

While the Australian industry is the most open in the world, local manufacturers face significant trade and non-tariff barriers in seeking to enter export markets.

These extend from particular duties and imposts through to less tangible barriers that create difficulties in selling Australian cars and components into various markets. It should be noted that these also apply to countries where Australia has existing FTAs, such as Thailand.

These barriers significantly impact the ability of the Australian manufacturing industry to gain economies of scale and key volume increases through export. The impressive track record that the industry boasts (despite these factors) highlights what could be achieved in this regard.

Recommendation 29

That the government ensures that new policy and program settings for the automotive industry continue to include incentives for the encouragement of new investment initiatives at both the MVP and ACP levels.

Recommendation 30

That the government addresses incentives for local MVPs to contribute to a soft landing for the supply chain, particularly through commitments to end-of-production timelines and providing linkages into global engineering and purchasing networks.

Recommendation 31

That the government provides $1.5 million of funding to the FAPM over 3 years to play and industry "triage" role in assisting supply chain companies to consider their future options and in guiding these companies to the most suitable advice and support to ensure smooth transition of the industry, through to 2017 and beyond.

This work is vital to maximise outcomes for 20,000 Australian workers in over 80 supply chain companies.

Recommendation 32
That a review of the automotive industry be undertaken in 18 months' time.

Introduction

This submission answers questions about which skills and capabilities of the Australian automotive supply chain can be retained and further developed following the cessation of volume vehicle manufacturing, and how a transitional path can be mapped by government to maximise the outcomes for Australian manufacturing.

The closure announcements by Toyota, Ford and GM fundamentally changed the context of the Productivity Commission (PC) inquiry, making it easier, at least on the surface, for the PC to argue for the cessation of the Automotive Transformation Scheme (ATS) in 2017 in line with the cessation of Australian vehicle manufacturing at this time.

The PC also took the opportunity to endorse the $500m of Mid Year Economic and Fiscal Outlook (MYEFO) ATS cuts announced by the new government, arguing that remaining ATS participants would still receive around 80 per cent of their planned ATS benefits.

In the May 2014 Federal budget, the government announced the closure of the ATS program at the end of 2017, which involved further savings of $400m, bringing the total cuts to the ATS program of $900 million.

These changes are not only detrimental to the prospects of the industry transitioning to a new paradigm, they will contribute to the loss of automotive manufacturing being a 'house of cards' scenario as opposed to a soft landing.

This submission therefore tries to chart a policy framework for the future direction of the Australian automotive industry, given these announcements.

The Federation of Automotive Products Manufacturers' (FAPM) approach in relation to developments that will take effect over the coming years will consider:

- Short term actions – 2015-2017
- Long term actions – 2017-2020
- Scope and scale of the industry – 2017 and beyond

The level of economic and strategic significance associated with the Australian automotive industry is substantial as is its ability to transform to having a greater focus around advanced manufacturing activities. This makes the challenge for policy makers now to retain as much of the industry and its capability as possible for the benefit of the nation's economic future.

New Policy Context

Given the announcements by the three vehicle manufacturers, the task for policy-makers now is to prescribe a policy response that balances a number of competing objectives.

In the first instance, any policy response must manage the industry to avoid an uncontrolled collapse before the departure of the Australian vehicle manufacturers.

In the second instance, any policy response must provide the time and the environment to allow industry participants to either build a future in the post-2017 period that is not dependent on local vehicle manufacture, or to plan for an orderly exit from the industry.

In short, the new policy setting must allow the maximum time and opportunity for:

- Displaced workers to re-skill and find alternative employment

- Supply chain businesses to diversify and find new business opportunities
- Other supply chain businesses to plan for an orderly exit from the industry
- Skillsets and technologies that have been built up in the automotive supply chain and motor vehicle producers to continue to generate economic wealth for the country from the global automotive supply chain and/or other industries

To achieve the above objectives, the FAPM is presenting in this submission, a 6 point plan to help the industry successfully navigate this new industry paradigm:

1. ATS funding certainty
2. Tailoring ATS to new industry paradigm
3. Enhanced Automotive Diversification Program
4. New model for industry/R&D collaboration
5. Maximise transitional markets
6. FAPM industry triage role

Given the lead times in this industry, this plan needs to be implemented quickly to facilitate this urgent, transition process.

FAPM's 6 Point Policy Plan - Short term actions 2015-2017

1 ATS Funding Certainty

The $500 million funding cuts that were proposed through the MYEFO process for the ATS and the $400 million of further cuts that were proposed through the Budget should not proceed. In this regard, the FAPM has welcomed the recent announcements made by Minister Macfarlane that the ATS Amendment Bill 2014 will be withdrawn from government policy.

The industry urgently needs funding certainty to maximise its chances of charting a path to the cessation of Australian volume vehicle production without an uncontrolled collapse of the supply chain.

As the industry operates on a just-in-time basis, continuity of production fundamentally depends upon all members of the supply chain continuing to operate right up to the finalisation of local vehicle production, so certainty of funding provides a fundamental cornerstone of this requirement.

Further, with the commercial banking system employing ever more stringent lending practices to this industry, the importance of the certainty that ATS funding provides to the supply chain is even more important than ever.

The other key policy rationale for the continuation of ATS funding is the critical role that the availability of these funds will play in allowing supply chain companies to plan and take action to diversify their businesses out to 2017 and beyond. It is for this reason that the existing ATS funding envelope should continue out to 2020 as originally planned.

Recommendations:

1. To underpin the continuity of the industry out to 2017 and to support diversification opportunities, that the current level of ATS funding or an equivalent program be continued out to 2020.

2 Tailoring ATS to New Industry Paradigm

The planned departure of the three Australian vehicle manufacturers fundamentally changes the policy objectives of ATS.

As discussed above, the most pressing objective in the short term is to ensure a high level of certainty around the level of ATS funding out to the end of 2017. This is to support an orderly wind-down of vehicle production and an avoidance of an uncontrolled collapse of the industry.

Equally important in this new paradigm is the medium term objective to retain and nurture those elements of the supply chain which have a sustainable future beyond 2017.

In this regard, there would appear to be a number of areas where supply chain capabilities can continue and prosper, provided these players are given certainty around their transitional timeframe and policy settings that acknowledge the new paradigm. Some examples of sustainable supply chain elements could include:

- Development and manufacture of Original Equipment (OE) products for export markets or post-assembly fitment to imported vehicles
- Development and manufacture of non-OE products for export and/or domestic markets
- Modification of imported vehicles
- Sale of engineering services into domestic and export supply chains
- Development and manufacture of non-automotive products with due regard to competitive neutrality considerations. (Note that the application of the same principles that would apply to Tariff Concessional Orders could provide the relevant safeguards here).

The tailoring of the ATS rules in a number of areas will be critical in allowing the existing rules to be amended to achieve the necessary outcomes.

ATS R&D "on Behalf of" Rules

The ability of ATS registered entities to claim for engineering services is currently curtailed under the current ATS rules.

Motor Vehicle Producers (MVPs) cannot claim R&D for their own production of motor vehicle engines or engine components,[1] but can claim for R&D services supplied to others, provided the other party is not an ATS participant (e.g. exported automotive design services are currently ATS eligible in the hands of an MVP).[2]

- Automotive Component Producers (ACPs) can claim R&D relating to an automotive product they manufacture themselves,[3] but in contrast to MVPs, R&D services provided to a third party are generally <u>not eligible</u> for ATS benefits, even if the other party is not an ATS participant.[4]

[1] *Automotive Transformation Scheme Regulations 2010* (Cth) reg 1.20(3)(i).
[2] Ibid reg 1.20(4)(c)(ii).
[3] Ibid reg 1.20.
[4] Ibid reg 1.20(4)(c)(i).

Other supply-chain registration categories (Automotive Service Providers (ASPs) and Automotive Machine Tool Producers (AMTPs)), experience the same impediments when seeking to claim R&D relating to engineering services provided to third parties.[5]

It is critical to note that once MVPs cease vehicle production, they would have to move to a new ATS registration category which generally do not allow for the claiming of R&D services (i.e. the problematic regulation regarding the on-behalf-of test (reg 1.20(4)(c)(i)) would apply to the MVPs, should they need to move to a non-MVP registration category).

Clearly, a continuation of high-value and high-skill engineering services by an on-going OE presence in Australia would be highly desirable for the country, as would similar services provided by other supply chain players.

A key policy conclusion is that the ATS rules will need to change to allow for the claiming of the R&D activity contained within engineering services activity across the registration categories.

Principal among these changes is to alter the ATS "on behalf of rule" contained in regulation 1.20(4)(c) which, in the case of supply chain ATS participants, excludes R&D conducted on behalf of any third party. This severely curtails the claiming of R&D services.

Broader R&D Definition to Support Diversification

- Currently, none of the ATS participants can claim R&D relating to non-automotive products or services. Clearly, in the new post-2017 industry paradigm, an ability to claim R&D relating to products or services in non-automotive industry sectors will be a key to industry survival.

  A further policy conclusion is that the ATS rules will need to change to allow for the claiming of R&D relating to products or services for non-automotive industry sectors, subject to the application of strict competitive neutrality provisions.

  To achieve this, in addition to amending the overarching R&D definition in regulation 1.20, the automotive services definition in regulation 1.9 would also need to be altered, particularly in relation to the exclusion of such areas as aftermarket or customising processes or training mentioned in regulations 1.9(3)(e), (f) and (g).

  The concept of an eligible automotive service in regulation 1.9 also needs to be broadened beyond passenger motor vehicles and light commercial vehicles to cover any kind of vehicle mentioned in Chapter 87 of the Tariff (such as large trucks), or that has the essential character of such vehicles.

  Consideration could also be given to including specialist vehicles mentioned in Chapter 84 of the Tariff (such as earthmoving equipment), and even rail vehicles and rolling stock mentioned in Chapter 86. This will provide the opportunity for the automotive sector's engineering services to be expanded into adjacent sectors, providing opportunities for the preservation of these core skills within the economy.

- This concept could be applied wider still and cover any new sector where the automotive industry's specialised engineering skills could be adapted and used in providing engineering services.

[5] Ibid.

Another area where ATS could be tailored to better underpin the diversification path that the industry must traverse is to amend the ATS rules to allow marketing and branding activities, and feasibility studies to be ATS claimable – preferably as a new category under the R&D definition.

For example, on the marketing and branding side, being able to claim an offset in relation to travel costs for attending a "global design homeroom" of an offshore OE would be extremely important in facilitating the regional engagement that will be necessary to identify and follow through on diversification leads.

On the feasibility side, participants should be able to claim for studies for new products and services, including investigations into:

- Market opportunity
- Route to market
- Early stage feasibility engineering
- Profitability analysis
- Business case development
- Logistics analysis
- Regulatory compliance issues
- Training requirements and skills gaps.

- The FAPM strongly supports the continuation of the ATS R&D benefit rate at 50%, as this is an appropriate level in terms of incentivising much needed diversification R&D spend.

Minimum OE Requirement

- Eligibility of R&D relating to non-OE automotive products is limited by the requirement to have a minimum level of OE activity within the business. Clearly, the range of automotive products and markets will need to be far broader in the new post-2017 industry paradigm, spanning OE for export or for fitment to imported vehicles, and parts and accessories or aftermarket products for domestic or export markets.

  Additionally, many ATS participants will struggle to continue to meet OE eligibility thresholds in the lead-up to the cessation of Australian vehicle manufacturing due to falling volumes. 'All time buys' need to be taken into account to allow historic OE supply chain players to remain within the Scheme, even in the event of declining OE production. R&D must be claimable in respect of both OE and non-OE components, regardless of the level of OE remaining within the business.

  Without this flexibility, existing players in the supply chain will not have the certainty they need to invest in the R&D programs required to carry them into the sustainable automotive market segments that are still open to them.

Plant and Equipment

As tooling investment is a key element of a diversification plan, the FAPM recommends that the applicable benefit rate be increased to 50% from the existing rate of 15%.

Movement Between ATS Registration Categories

As the diversification process unfolds, a key aspect of the administration of ATS that will need to change is the ease of movement between registration categories. Currently, the ATS only provides for a "once a year" registration window, whereby regulation 2.14 requires applications for ATS registration to occur for an ATS year, to be received by AusIndustry by 31 December of the preceding year. This is a severe impediment to mid-year movements between registration categories that will be required as the industry transitions.

The other related issue is the ease with which ATS participants can change registration categories. At present, the annual re-registration requirement would pose an impediment, but there is also doubt about whether a participant's ATS investment and sales history would also move across to a new registration category. This aspect requires a number of changes to be made to Part 2 of the regulations in particular.

A further related change is to allow for the 55:45 split of the ATS pool between MVPs and non-MVPs (mentioned in Division 2 of the regulations and in the ATS Order), to be altered should an MVP move to a non-MVP registration category. In this way, an MVP moving into a non-MVP registration category would not "crowd-out" ATS claims being made by other non-MVP ATS participants.

Support for New Industry Entrants

It is important that the ATS rules continue to support and encourage any interest that may be shown by a new entrant into the Australian automotive industry.

Policymakers should remain open to the prospect that a new entrant may want to enter the Australian market, given the sophisticated automotive and advanced manufacturing capability that still exists in Australia.

Companies such as Mahindra Reva, Magna Steyr, Valment and Gordon Murray Design incorporate a low volume model of manufacturing contract manufacturing techniques and the flexibility to accommodate multiple model types, such models are suitable for the high value, strong engineering capability of Australia

Sales Cap

A design aspect of ATS which is now redundant since the announced departures by the three OEs is the 5% sales cap. The original policy rationale for the 5% cap related to WTO considerations (which have since been superseded) and to play a "smoothing" role in funding allocations. Given the declining volumes and sales in the industry, the 5% sales cap on ATS participant's annual benefits will increasingly cut in at a very low level, choking off ATS claims at artificially low levels. Accordingly, the 5% sales cap should be abolished.

ATS Moving Average

A further design feature of the ATS which needs to be reconsidered is the moving average basis on which ATS benefits are calculated. The moving average can act as an impediment to investment decisions as an ATS entitlement earned in the current quarter, is "drip-fed" to a participant over the ensuing 12 quarters through the moving average. Some businesses will need their ATS benefits up-front to be able to move with the requisite speed and certainty to take advantage of diversification opportunities which present themselves.

At the same time, it must be noted that some companies may be in a different position, and may prefer to have the moving average as the basis for the calculation of their benefits maintained.

The FAPM recommends that ATS participants be given the choice of opting out of the moving average and have their ATS benefits based on the actual eligible expenditure that occurs during each quarter. In such circumstances companies choosing this option would receive two elements within their quarterly ATS payments. Part A would be the quarter-by-quarter pay out of their ATS entitlements that were attributable to their historic moving average expenditures. Part B would comprise the ATS benefits attributable to each specific quarter from the quarter in which they opt-out of the moving average process.

Site relocation / consolidation

Supply chain companies have often tailored their geographic production footprint to achieve proximity to the vehicle manufacturers, or to other up and downstream suppliers. Consequently, with the cessation of vehicle manufacturing, many suppliers have multiple sites which no longer make economic sense.

Without the geographic proximity imperatives, it will often make more sense to consolidate geographically diverse operations onto one or two sites to improve operating efficiency. This can often be a key ingredient in moving these businesses onto a more sustainable footing, however, the costs associated with moving and re-establishing equipment at a consolidated location(s) can be an inhibitor to this crucial step being undertaken.

Hence, a key area where ATS incentives could assist would be to make site consolidation activities eligible as an R&D cost.

The removal of this requirement to have manufacturing operations in close proximity to vehicle manufacturers also presents opportunities for some city based manufacturers to move to outer city or even regional locations, where costs of land, rates and labour can be somewhat lower, improving the chances of business success.

This option can also be attractive in a site consolidation context, as consolidating to a new greenfields site can allow plant to be laid-out in an optimal configuration, without legacy constraint issues to deal with. The FAPM would argue therefore, that consolidation to a totally different site should also be incentivised through the ATS.

Recommendations:

2. In recognition of the important role that engineering services can play in a sustainable industry post 2017, that the ATS rules be changed to allow for the claiming of the R&D activity contained within engineering services activity across the registration categories, principal among these changes is changing regulation 1.20(4)(c), which in the case of supply chain ATS participants, excludes R&D conducted on behalf of any third party

3. That the definition of automotive services contained in regulation 1.9 be altered, particularly in relation to the exclusion areas such as aftermarket or customising processes or training mentioned in regulations 1.9(3)(e), (f) and (g). The concept of an eligible automotive service in regulation 1.9 should be broadened beyond passenger motor vehicles and light commercial vehicles. Consideration could also be given to including specialist vehicles mentioned in Chapter 84 of the Tariff (such as earthmoving equipment), and other industries such as rail vehicles and rolling stock mentioned in Chapter 86.

4. In recognition of the importance of diversification to the industry's future post-2017, that the ATS rules be changed to allow for the claiming of R&D relating to products or services for non-automotive industry sectors (subject to competitive neutrality rules)

5. That the existing 50% level of R&D incentives be continued under the ATS
6. As tooling investment is a key element of a diversification plan, that the benefit rate applicable to tooling be increased to 50%
7. To allow for ease of movement between ATS registration categories as the transition within the industry unfolds, remove the "once a year" registration window currently provided for under regulation 2.14 and amend Part 2 of the ATS regulations to allow for seamless movement between ATS registration categories. Include the continued recognition of historic investment and sales under the previous registration category.
8. To avoid any malapportionment of the ATS funding pool between MVPs and non-MVPs, allow for the 55:45 split of the ATS pool to be amended should an MVP move to a non-MVP registration category.
9. To ensure that local Australian automotive supply chain businesses continue to have access to ATS to assist in their transition, that the rules be changed to allow historic OE supply chain players to remain within the Scheme, even in the event of declining OE production
10. To assist in the diversification of the industry, that the ATS rules be changed so that R&D is claimable in respect of both OE and non-OE components, regardless of the level of OE remaining within the ATS registered business
11. To assist the process of identifying and accessing new markets needed for diversification, that the R&D rules of ATS be amended to allow marketing and branding activities to be claimable.
12. To encourage an inwards investment plans for the industry, that ATS continue to be available for new entrants to the industry
13. To avoid the 5% sales cap cutting in and reducing participants' ATS benefits to an artificially low level, that the 5% sales cap be abolished
14. To assist with the transitional process, the FAPM recommends that ATS participants be given the choice of opting out of the moving average and have their ATS benefits calculated based on the actual eligible expenditure that occurs during each quarter. In such circumstances companies choosing this option would receive two elements within their quarterly ATS payments. Part A (quarter-by-quarter pay out), and Part B (comprising the ATS benefits attributable to each specific quarter from the quarter in which they opt-out).
15. That site relocation and/or site consolidation activities, including the costs of planning, moving and re-establishment of operations at an alternative location(s) be permitted as an eligible R&D activity under ATS.

3 Enhanced Automotive Diversification Programme

The Automotive Diversification Programme (ADP) is an important support initiative for the industry to diversify. The FAPM is of the view that this programme should be continued and enhanced to facilitate much needed diversification activity within the industry.

However, the FAPM is concerned that due to a constraint on funding, high merit projects will not be funded. The FAPM is also concerned that a number of activities like R&D, commercialisation, marketing, etc. are not rewarded through the ADP.

The FAPM believes that ATS participants should have the choice of either claiming their diversification activities through the ATS program or accessing the ADP.

With this in mind, the FAPM makes the following recommendations:

Recommendations:

16. To allow more scope for funding high-merit projects, that $200m of ATS funding be made available for the ADP.
17. That ATS participants be given the choice of funding their diversification activities through the ADP or through their ATS return (noting the FAPM's recommendations about proposed changes to ATS to make it more supportive of diversification activities).
18. In recognition of the many aspects of a successful diversification initiative, broaden assistance to not only include capital spend, but to also support R&D, commercialisation, feasibility studies, site relocation and/or site consolidation activities, including the costs of planning, moving and re-establishment of operations at alternative locations, salary on-costs or marketing activities for both manufactured products and engineering services.
19. To assist in bringing an export focus to diversification, the provision of grants of up to $100,000 p.a. for the appointment of export and marketing managers on a 50:50 matched basis be made part of the ADP.
20. In recognition of the limited timeframe in which diversification within the industry must occur, that the ADP be open continuously and not in rounds.

4 A new model for industry/R&D collaboration

A key theme of the Senate Committee's terms of reference is consideration of how policy settings can be made which retain and develop the core skills and capabilities of the Australian automotive industry for the benefit of the economy and workers.

In this regard, in addition to the other recommendations in this submission, the FAPM offers the concept of a new model for collaboration between R&D centres and industry, based on the successful Fraunhofer method.

The concept involves utilising the core knowledge and skills of displaced (or soon to be displaced) automotive engineering and purchasing staff to identify opportunities and build business cases for new product development. This process is designed to provide SMEs with access to skills and know-how previously beyond their reach.

These skills are expensive to develop and maintain, and are in demand internationally. Without an ability to spread those costs across the SMEs in Australia's manufacturing sector, quality business cases will remain beyond the practical reach of all but a handful of SMEs.

In broad terms this concept involves placing Australian engineers and purchasing people from the automotive sectors into strategic global design "homerooms" tasked with identifying opportunities for engineering services or componentry supply suitable for the Australian industry. These personnel could be put forward by the Australian MVPs who are in a strong position to facilitate and support this activity.

These outplaced engineering and purchasing personnel would drive the product development process. Access to further market opportunities and building of Australia's broader manufacturing brand may be supported by Austrade or other government officials in key markets.

In Australia, displaced automotive engineers should be partnered with select universities and the FAPM. This partnership would bring together skills, cutting edge research and advocacy on behalf of sector as a whole. As a partnership, smaller individual elements are brought into a powerful whole, able to compete on the global stage with standalone companies of far greater size. Identified opportunities are evaluated, products are developed, business connections are made, markets become available, research is commercialised, and students are trained through practice in a globally competitive development process.

This alone provides a pathway out of 'commodity', and an ability to stand tall with large companies in global markets.

Other opportunities may be more straightforward and may be readily referred onto a supply chain player through the FAPM's network.

It is considered that this new model would address two pressing policy objectives.

The most immediate impact would be to efficiently identify diversification opportunities through the global automotive industry that can be taken forward by the Australian supplier network, or through the Australian MVPs' engineering centres.

The second policy objective that this process would be supporting is to create a structure through which the high-end engineering capability of the Australian automotive industry can be preserved, nurtured and grown. This sector has been trained to develop world class IP, in the hyper competitive global automotive sector. Retaining these skills and redirecting them wisely should be considered a prudent investment in Australia's manufacturing sector.

The Government's new Industry Growth Centres Initiative should also provide opportunities for the exploration of connection opportunities between the R&D sector and automotive manufacturing industry. The Growth Centres are ideally suited to provide a natural home for the proposed new model for industry and R&D collaboration.

Displaced OEM engineers would not just bring expertise to this endeavour, but a global network of current contacts that can be leveraged to the benefit of Australian SMEs

The transition of the Australian automotive supply chain should be focus of the Advanced Manufacturing Industry Growth Centre.

Recommendations:

21. That funding is made available, potentially as another arm of the ADP, to support the establishment of a new model for industry/R&D collaboration.

22. That as part of this new model, Australian MVPs assist in placing displaced automotive engineers and purchasing personnel into regional engineering design "homerooms" to identify opportunities for manufacturing and/or engineering work ("entrepreneurial residence" concept).

23. That as part of this new model, specialists be appointed in key markets to provide support to these in-market engineers and focus on identifying other diversification opportunities.

24. That displaced Australian automotive engineers be placed into selected Australian universities as "D-end" experts, who in partnership with the FAPM, collaborate with

research and commercialisation expertise and Australian automotive industry companies to access these global opportunities.

25. That the FAPM be tasked with coordinating the introduction of supply chain companies to the "D" opportunities arising from the above process.

26. That as part of the new collaboration model, a specific study and educational campaign around the application of advanced manufacturing techniques to assist supplier viability is undertaken.

27. That as part of the new collaboration model, the learnings from the CSIRO's "Design for Manufacturing Competitiveness" program be actively diffused to the automotive supply chain.

5 Maximise Transitional Markets

A key feature of the policy settings required to retain as much of the automotive supply chain capability as possible, is to maximise awareness of, and access to markets that will still be open to the industry after 2017.

The new model for industry/R&D collaboration set out above, provides one very important avenue for achieving this goal.

There are however, other avenues that can be pursued.

The FAPM sees this as occurring at two levels:

1. Government facilitation of market access
2. Industry facilitation of market access.

In addition to our collaboration model set out above, The FAPM's recommendations are as follows:

Recommendations:

<u>Government Facilitation of Market Access:</u>

28. That the government advocates for mutually reciprocal trading conditions for Australia's automotive manufacturing industry and the role of these arrangements in attracting contract manufacturing models to Australia also be considered.

    While the Australian industry is the most open in the world, local manufacturers face significant trade and non-tariff barriers in seeking to enter export markets.

    These extend from particular duties and imposts through to less tangible barriers that create difficulties in selling Australian cars and components into various markets. It should be noted that these also apply to countries where Australia has existing FTAs, such as Thailand.

    These barriers significantly impact the ability of the Australian manufacturing industry to gain economies of scale and key volume increases through export. The impressive track record that the industry boasts (despite these factors) highlights what could be achieved in this regard.

29. That the government ensures that new policy and program settings for the automotive industry continue to include incentives for the encouragement of new investment initiatives at both the MVP and ACP levels.

Industry Facilitation of Market Access:

30. That the government addresses incentives for local MVPs to contribute to a soft landing for the supply chain, particularly through commitments to end-of-production timelines and providing linkages into global engineering and purchasing networks.

6 FAPM Industry Triage Role

A key policy element that will be required to ensure a smooth transition of the Australian automotive industry to a more sustainable future is for an appropriate body to play a co-ordination role in assisting supply chain players to consider and critically evaluate their prospects in the post-2017 industry environment.

In parallel with this activity, there will be a need for an appropriate organisation to guide and direct each relevant company to the most suitable support.

For example, some suppliers will have some prospect of transitioning their business into some sort of diversified outcome, be it based on engineering services, parts and accessories, OE or aftermarket products for export markets or some other form of advanced manufacturing. These companies will need support in being directed to industry-based opportunities and/or government-based support initiatives.

At the same time, there will be suppliers who will need support in planning for an orderly wind-down and closure of their business, while others will need assistance in reaching a decision on whether to continue. The FAPM also has an important role to play in these circumstances, in directing such companies to suitable advisory services and in avoiding an uncontrolled collapse of the industry.

It is also critical for Government to appreciate the potential toll on the FEGS program in the event that the likely failure of than 100 companies in the supply chain occurs.

The FAPM is the best placed body to undertake this role.

Accordingly, the FAPM calls on the government to provide it with some support to enable it to play this vital role in facilitating a smooth transition for the supply chain.

Recommendation:

31. That the government provides $1.5 million of funding to the FAPM over 3 years to play and industry "triage" role in assisting supply chain companies to consider their future options and in guiding these companies to the most suitable advice and support to ensure smooth transition of the industry, through to 2017 and beyond.

    This work is vital to maximise outcomes for 20,000 Australian workers in over 80 supply chain companies.

Long term actions 2017 - 2020

The FAPM has laid out a detailed 6 point plan that needs to be implemented as a matter of urgency to allow the maximum time and opportunity for:

- Displaced workers to re-skill and find alternative employment
- Some supply chain businesses to diversify and find new business opportunities
- Other supply chain business to plan for an orderly exit from the industry

- For the skillsets and technologies that have been built up in the automotive supply chain and MVPs to continue to generate economic wealth for the country from the global automotive supply chain and/or other industries.

Given the scale of the automotive industry and the significant downside risks associated with not managing this transition correctly, the FAPM recommends that a review of the automotive industry be undertaken in 18 months' time to provide the opportunity for further refinement of policy interventions as the transition process unfolds.

Recommendation:

32. That a review of the automotive industry be undertaken in 18 months' time.

Conclusion: Scope and scale of industry beyond 2017

The FAPM believes a strong and vibrant future for the Australian automotive industry still exists, albeit in a new form.

The contribution that the industry makes in its own right, in addition to the spill over benefits to the economy more broadly, and unique contribution to a range of areas including advanced manufacturing, skills and training, and lean principles and processes, highlights the breadth of these attributes.

One of only 13 countries globally with the capability to take a passenger vehicle from concept to the showroom floor, the FAPM believes the skillsets and capability of the Australian automotive industry are too important, too strategic and too valuable to let go following the departure of the local OEMs.

The FAPM believes there are two alternate visions for the future:

- Status quo
- Managed transition through FAPM's 6 Point Plan.

Status Quo

Maintaining the status quo will see no changes to the Automotive Transformation Scheme (ATS) and the continuation of the Automotive Diversification Programme (ADP) in its current form.

The FAPM is of the view that if there is no change to current policy settings, the Australian automotive supply chain is at risk of uncontrolled collapse, leading to the preventable loss of businesses and jobs. FAPM's reasoning for this position is outlined below.

Problems with ATS

ATS has a number of issues that impede the Scheme's effectiveness in delivering the required support to the automotive supply chain.

(i) 30,000 unit ATS eligibility threshold

The eligibility requirements for participation in the ATS, in particular the 30,000 unit production threshold, will pose a serious barrier for supply chain companies as production winds down. Parts manufacturers rely on the certainty of ATS to support their businesses through the disruption caused by the departure of the OEMs. This is also why the current levels and timeframe for ATS funding should be maintained as they are out to 2020.

(ii) Lack of ATS funding certainty
Any lack of certainty around continued availability of ATS assistance carries the risk of the premature closure of supply chain businesses.

(iii) Lack of support for development of new products and engineering services
Further, the potential to build a sustainable and diversified industry would be severely curtailed, with little incentive for the export of engineering services or the development of new automotive or non-automotive products. There would be no support for marketing of new diversified product or service offerings.

Problems with ADP
In its current form, the ADP presents a number of problems to automotive supply companies.

(i) Periodic funding rounds
Given the urgency of the need to diversify manufacturing operations, including identifying new markets, equipment and technology, administering the program via periodic rounds is leading to untimely decisions and delay in diversification activities.

(ii) Inadequate ADP funding
The competitive nature of the ADP funding rounds is also seeing good projects fail to secure government assistance. A better funded program would have a greater capacity to assist the diversification of more business that would save jobs and maintain a sustainable Australian manufacturing industry.

(iii) Narrow activity eligibility
The ADP's focus on plant and equipment fails to recognise the value for money presented by government support for R&D, commercialisation, marketing and other non-capital expenses incurred in diversifying manufacturing operations.

Under the current ADP settings, many businesses that could diversify and survive will simply go out of business at great cost to Australian jobs, economic activity and industry capability.

Managed Transition
If managed appropriately through the FAPM's suggested 6 point plan, the coming realignment of the automotive industry presents an opportunity to retain key aspects of the supply chain in Australia.

The priority objectives of a properly managed transition include:

- The orderly transition to new employment for displaced workers
- The orderly exit of suppliers who have determined they will not continue trading beyond 2017
- Enough time for suppliers to diversify
- Capacity to build the services export industry

The FAPM is of the view that if the 6 point plan is implemented that some 20,000 jobs that would otherwise be lost could be transitioned into new areas within manufacturing, compared to existing policy settings.

It is our belief that this plan would assist around 80 businesses to transition to the post-2017 environment.