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Dr Kathleen Dermody
Committee Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Via Online Submission

Dear Dr Dermody,

Inquiry into Automotive Transformation Scheme Amendment Bill 2014

Thank you for your invitation to contribute to the Senate Economics Legislation Committee Inquiry into the Automotive Transformation Scheme Amendment Bill 2014.

Approximately 260 Australian Automotive Aftermarket Association (AAAA) member companies manufacture product locally with around 170 of these companies actively exporting. Automotive aftermarket manufacturing represents 36% of all automotive manufacturing in Australia - that's \$5.2 billion per annum. And the aftermarket manufacturing sector alone employs 21,000 people directly and exports \$800 million per year of locally manufactured product. What is more, the aftermarket segment continues to show strong year-on-year growth.

Not only is the aftermarket segment significant in terms of its size, but it has totally different drivers compared to the Original Equipment (OE) segment. While some aftermarket manufacturers also supply OE components for fitment to Australian made or imported vehicles, 85% of product is sold to customers external to the car companies and their franchised dealer networks. Customers include wholesalers, retailers, resellers and end-users. Aftermarket products include replacement parts, accessories, 4WD parts, high performance and motorsport components and workshop tools and equipment. Many aftermarket manufacturers are expanding through high technology innovation with exports to Asia, Europe, Middle East and the USA.

The setting of policy for the automotive industry is one of the few areas of public policy which has had a consistent theme sustained by successive governments, over three decades. The intent of this industry policy and programs was that the Australian vehicle manufacturing industry would eventually evolve to a more sustainable level, with perhaps two car manufacturers, undertaking significant export programs with a sustainable supply chain for components. Hence, a central premise about the intended end-point for this 3 decade-long policy process is now moot. It is now time for current policy makers to re-define the intended transitional end game for the Australian OE supply chain.

We did cover (in some depth) in our submission to the recent Productivity Commission Inquiry, the narrow government view of the automotive industry. Click here to view the full AAAA submission: http://www.pc.gov.au/_data/assets/pdf_file/0015/130191/sub054-automotive.pdf

We argued that automotive aftermarket manufacturers also make automotive components (for a different customer), are highly trade exposed and have been equally subjected to the tariff phase down regime. And yet **every single scheme**, every program introduced to support Australia's automotive industry transition to a zero tariff environment, has ignored the one sustainable section of the industry – the Australian automotive aftermarket.

We have had this discussion with successive governments over many years and the argument (and the response) tends to get rather circular i.e. the aftermarket is growing without government support, therefore the aftermarket does not need government support and there is no need to re-design ACIS/ATS. The Productivity Commission also arrived at this conclusion. However, we must continue to state the case that the ATS should continue for the foreseeable future and should embrace the automotive aftermarket component sector, because government has created a situation where the OE supply chain is now receiving tax payer assistance to compete against the aftermarket.

This is not simply a case of '*we want what they have*'. It is, however, a statement that our manufacturers are fighting hard to work against the market forces that are creating a highly challenging competitive environment. Factors such as the value of the Australian dollar, our comparatively high labour rates and the inequity of the tariff regimes and government support programs adopted by our major trading partners. And now, to add "insult to injury", our OE colleagues are receiving government funding to diversify into our market. This is completely irresponsible public policy – the logic looks like this to us: the aftermarket has grown without government assistance, the aftermarket appears to be a profitable and sustainable part of this industry, let's incentivise the dying OE sector to compete against the aftermarket and somehow this means we can save some manufacturing expertise, maintain jobs and investment.

Whether the ATS continues or does not continue is not the point – from our perspective we are strongly opposed to subsidising one side of the industry and not the other. We are strongly opposed to the suggestion that OE can transition into our part of the industry with government incentives paid to specifically compete against the one section of the industry that is growing, hiring and exporting: the automotive aftermarket.

In our PC submission and our public hearing presentation, we made it very clear that the most obvious and likely sector to absorb OE supply chain capital and labour is the automotive aftermarket. There is however no market imperative for the aftermarket sector to work with OE. But if there is some political will and intent to retain the ATS and redesign it so that it can truly make a difference to a soft or a hard landing, then the only viable option is to provide incentives directly to the aftermarket to actively embrace the OE supply chain. Not the other way around.

If Government is interested in supporting the growth of the aftermarket as a transition strategy we have ample information on the critical commercial and infrastructure issues. A survey of our members (as cited in the Productivity Commission's final report) revealed that the aftermarket places a high priority on capital broadening and deepening investment, as well as technology and research and development, as part of the industry trend to move into the manufacture of higher value speciality products.

A further survey finding, which is relevant to interpreting the capacity of the aftermarket to invest to create the opportunities for the structural adjustment of the automotive sector, is the cost of capital as a key constraint on investment intentions. Some 46% of all survey respondents said that the cost of capital was a constraint on their investment plans. Hence, incentives to assist the aftermarket to make capital investments are a key to unlocking our potential to play a constructive role in the structural adjustment process. Widening access to ATS would be a positive initiative in this regard.

A summary of the arguments that we have previously advanced in favour of widening the ATS eligibility and program access are as follows:

- Even though the aftermarket segment has reasonable profitability, with a weighted average profitability at the EBIT level of 15.4%, the industry is still critically aware of the need to further improve productivity, to invest in capital deepening, plant and equipment and to continue to innovate and undertake research and development to push its production further up the value chain.
- The ATS is currently undersubscribed relative to its annual budget, as evidenced by the modulation rates for both the vehicle producer and supply-chain funding pools being set at unity. With continuing reductions in volumes in the future, there is scope to open up the program to other automotive component manufacturers, without disadvantaging the amount of funding available to existing program beneficiaries.
- The ATS seeks to improve competitiveness and levels of innovation through incentives in respect of investments in new plant and equipment and research and development activities. It is highly unlikely that the closure of three car manufacturing facilities will instil a level of investment confidence in the OE Industry. The aftermarket producers however, are not dependent upon local vehicle production, and investment confidence is not affected by the 2017 deadline.
- By limiting the accessibility of the ATS to manufacturers that are predominantly OE producers, government is not fostering greater efficiency and growth in the aftermarket segment, which is a sector that has very real prospects of absorbing some of the resources redeployed from the OE supply-chain. The current ATS policy settings are not used to generate absorptive capacity in the segment of the automotive supply chain that could play a positive and timely role in minimising displacement of resources from the declining OE supply chain. This is a wasted opportunity to make a long term difference.

A good discussion that should be had by the Senate Economics Legislation Committee is the reasonable proposition that the current ATS program should be broadened to include the automotive aftermarket sector. Incentives for capital investment and research and development can help boost investment and technology development in this sector. This will enhance the aftermarket sector's growth and its ability to play a role in transitioning the OE automotive supply chain.

I would be pleased to provide further information should the Committee believe it be of use in their deliberations.

Yours sincerely,

Stuart Charity
Executive Director
Australian Automotive Aftermarket Association

The Australian Automotive Aftermarket Association (AAAA) is the national industry association representing manufacturers, distributors, wholesalers, importers, exporters and retailers of automotive parts and accessories, tools and equipment in Australia. The Association has over 1700 member companies in all categories of the Australian automotive aftermarket and includes major national and multi-national corporations, as well as a large number of independent small and medium-sized businesses.