

19 July 2006

The Secretary of the Committee
House Standing Committee on Economics, Finance and Public Administration
Submission via email
efpa.reps@aph.gov.au

Dear Sir/Madam

Subject: INQUIRY INTO THE STATE OF AUSTRALIA'S MANUFACTURING SECTOR

We write in response to a recent invitation for comment on issues relating to the state of and future directions for Australia's manufacturing sector. We have also contributed to a separate submission by the Federal Chamber of Automotive Industries. We will limit our contribution to background material, and provide input specifically relating to the automotive manufacturing industry.

BACKGROUND

Ford Australia is a leading automotive company with extensive design, engineering and manufacturing facilities located in Broadmeadows and Geelong, Victoria. Its core products are the Ford Falcon and Ford Territory which are sold in Australia as well as exported to markets such as New Zealand, South Africa and Thailand. These vehicle lines are complemented by a broad portfolio of imported products from Europe, Africa and Asia including the Ford Fiesta, Ford Focus and Ford Courier. In 2005, Ford Australia sold 129,140 locally manufactured and imported vehicles. Ford Australia is ultimately owned by the Ford Motor Company in Dearborn, Michigan.

Ford Australia presently employs more than 6,000 people in areas such as Manufacturing, Product Development, Purchasing, IT, Sales & Marketing and Finance. There are also more than 220 independently owned Ford dealerships nationwide which provide steady employment to thousands of Australians. Ford Australia also has a major impact on activity and employment in the local automotive components sector from which it sources components such as drive shafts, suspensions, transmissions, instrument panels, seat kits, tyres, instrument panels and electrical components. Ford Australia presently sources components locally at a higher rate per vehicle than any other manufacturer in Australia.

Ford has more than 80 years of automotive manufacturing history in Australia with the first Ford vehicle manufactured in Geelong in 1925. The Ford Falcon has been in continuous production since its introduction in 1960, and has become one of Australia's leading cars. The engine and platform of the Ford Falcon are wholly designed, engineered and manufactured in Australia.



In 2001 Ford Australia recognised a shift in consumer preferences towards the emergence of a new category of vehicles termed "crossovers" and responded to these market signals by designing, engineering and producing the new Ford Territory. The Ford Territory, which represented a \$500 million investment, has been a resounding success since its introduction in 2004, winning Wheels Magazine's 2005 Car of the Year Award and quickly becoming Australia's top-selling SUV.

A STRATEGY FOR THE FUTURE

Earlier this year, Ford Australia announced a new, innovation-focused, strategic direction for the company, including significant investment in new projects and accompanying facilities, totalling more than \$1.8 billion over the next decade. Central to the new strategy is the expansion of the product development capability, and its enhanced role as an engineering and design "centre of excellence" for the Asia Pacific and Africa region, effectively moving Ford Australia up the global supply chain. Ford Motor Company recently awarded this significantly expanded team the lead role for the design and engineering of a new global light commercial vehicle to be sold in more than 80 markets worldwide. This project represents one of the most significant automotive R&D projects ever undertaken in Australia.

The new project, and those that will follow, will enable the broadening of the knowledge base, skills and competitiveness of Ford Australia's already significant R&D capability. It will also smooth the peaks and troughs of the traditional development cycle associated with motor vehicle model cycles. This new, globally-focused strategic direction will provide incremental employment opportunities and stimulating career paths for Australian automotive industry employees.

Accompanying the public announcement of the establishment of the new "centre of excellence" was a statement of further substantial investment in the development of new derivatives of the Ford Falcon and Ford Territory for the Australian market and potential export opportunities.

Investment in these new and emerging products and technologies will ensure that Ford remains at the leading edge of automotive development and manufacture in Australia – remaining relevant to Australian consumers, whilst potentially reaching out to new consumers in worldwide markets – and continues to invest in and develop Australian industry capability. This strategy is in the national interest of maintaining and further developing dynamic, vibrant and healthy automotive and component manufacturing sectors.

COMPETITIVE ENVIRONMENT

In recent times, the automotive manufacturing industry has operated under a stable and comprehensive policy framework which has afforded local automotive manufacturers a degree of certainty when planning longer term strategies. Automotive policy elements, such as the ACIS scheme, have facilitated investments in R&D capability and enabled operational production planning based on a predictable and long term policy platform. In addition to the formal domestic automotive policy arrangements, the Federal Government has demonstrated a willingness to consult on issues that arise through the various industry forums.



Whilst the automotive industry experienced a record year for vehicle sales in 2005, the domestic manufacturing industry is facing some significant challenges. These challenges, many global in nature, have combined to create a difficult environment for Australian motor vehicle manufacturers. While these factors have previously confronted the automotive industry, it is the convergence and coincidence of several of these factors that has presented a significant challenge to the sector.

Recent "External" Factors Impacting the Competitiveness of the Automotive Manufacturing Industry:

- 1 **Strength of Australian Currency:** A significant appreciation of the Australian dollar has led to a reduction in the relative cost of imported vehicles. This has resulted in a situation whereby imported vehicles now comprise nearly 75% of total sales in 2005, versus 68% in 2001. Since late 2002, there has been a sustained appreciation of the Australian dollar in the order of more than 30%. This has contributed to a deterioration in the relative cost competitiveness of a locally manufactured vehicle of approximately \$5,000 versus an imported vehicle.
- 2 **Commodity Price Escalation:** Additionally, local manufacturers are also incurring increased costs for purchases of their raw materials such as steel, aluminium and petro-chemical based products as a result of the resources boom, driven in large part by high levels of demand from emerging economies such as China and India.
- 3 **Rising Oil Prices:** The sustained increase in the price of oil over the past 18 months has affected consumer confidence and is potentially contributing to a shift in consumer preference away from the larger sized vehicles produced by Australia's four automotive manufacturers. It is difficult to precisely quantify the likely longer term impact of this.
- 4 **Market Fragmentation:** The Australian vehicle market is one of the most highly competitive vehicle markets in the world, with more than 50 brands offering over 350 models in a relatively small market by global standards. This has resulted in lower average volumes per brand, with the market share of locally manufactured vehicles steadily declining over the past decade. This fragmentation can be expected to continue as new brands and models, including some from China, enter the market in coming years.

These factors identified above have combined to produce a shift in the competitive position of locally manufactured vehicles relative to imported models. The relative price attractiveness of imported vehicles, facilitated by movements in tariffs, new trade agreements and currency movements, combined with consumer sensitivity to petrol price rises has contributed to a shift away from locally manufactured vehicles. In summary, the convergence of an increase in manufacturers' input costs, a reduction in tariffs, a shift in consumer preferences and sustained currency appreciation have all served to create a most challenging competitive environment for Australian automotive manufacturers, at a time when a number of global parent companies themselves are under increasing pressure.

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In addition to these "external" factors impacting the industry, local automotive manufacturers and automotive component suppliers are under increasing pressure to develop their technological capabilities as new product technologies are introduced into the Australian market via imported models. This subsequently leads to cost, delivery and quality pressures being placed on local component suppliers and vehicle manufacturers in order to compete with the increasingly sophisticated and technologically advanced imported products from markets that are developing and investing in their automotive component manufacturing capability.

TRADE OUTLOOK

As mentioned above, the Australian vehicle market is characterised by a proliferation of brands and models, both locally manufactured and imported, all competing in a relatively mature and small (by global standards) market of approximately one million units annually. Ford Australia's strategy for the future aims to consolidate and grow its domestic market share whilst seeking out appropriate export opportunities to drive further growth with innovative and targeted products.

Ford Australia has been broadly supportive of the government's trade liberalisation policies. It believes the free trade agreement (FTA) strategy of recent years has provided a useful opportunity to energise the pursuit of broader multi-lateral trade liberalisation objectives via the World Trade Organisation. A particular characteristic of global automotive trade, however, is the pervasive existence of a wide variety of non-tariff barriers (NTBs) including import quotas, variable customs valuation methodologies, local content requirements, financing restrictions, targeted taxation arrangements and unique distribution channel requirements.

A number of these above-mentioned NTBs are presently in place in regional economies where Australia is seeking to negotiate new FTAs, as well as in countries where FTAs are already in existence. Ford Australia strongly believes a fundamental imperative in the successful negotiation of any of these free trade agreements – Malaysia, ASEAN and China – must incorporate a comprehensive identification of the prevailing NTBs and a clear, agreed and binding process/timetable for their early elimination. In a market as open to competition as Australia, it is crucial that local automotive manufacturers be provided the opportunity to compete in global markets on fair and competitive terms.

CONCLUSION

Looking forward, there are several key elements to a robust and viable automotive manufacturing industry in Australia. The first of these elements is the ability of local automotive manufacturers (and local automotive component manufacturers) to offer a "full service" capability; that is, the ability to design, develop, manufacture and supply their customers with a complete solution that meets the needs of their customers. In other words, the ability of manufacturers to create value and become intrinsically embedded into the supplied product so as to become inextricable, should customers be tempted to move elsewhere.

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The second element, which is somewhat linked to the first element, involves local manufacturers becoming more integrated with the global operations of their parent companies. As well as moving further up the supply value chain and thus becoming more valuable, integration into global operations creates opportunities for flow-on technological capability as well as placing local companies to take advantage more fully of global sourcing decisions made by parent companies.

Finally, the last element is the establishment of a sustainable volume base for domestic production which enables scale economies and efficiencies to be achieved.

A domestic automotive manufacturing industry is strategically important to the Australian economy. A dynamic, viable and competitive automotive manufacturing sector is a source of both employment and investment in R&D innovation, and directly and indirectly affects the health of other sectors of the economy such as automotive component manufacturing, the broader manufacturing industry and the resources sector.

The recent announcement of Ford Australia's innovation-focused strategies for future growth and development through investment in R&D and product development capability strongly positions the company to take advantage of emerging opportunities in both domestic and global markets. We remain committed to working with government at all levels to create a policy environment that is focused on the long term, but remains flexible and responsive to the changing global environment and circumstances.

Ford Australia would be happy to elaborate on the issues raised in this letter. The writer can be contacted on (03) 9359 8068, or at email ehaug@ford.com.

Yours sincerely

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Government Liaison Manager



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