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Automotive Transformation Scheme Bill 2009

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Date introduced: 24 June 2009

House: House of Representatives

Portfolio: Innovation, Industry, Science and Research

Commencement: Sections 1 and 2: the day the Act receives Royal Assent.

Sections 3 to 29: 1 July 2010.[1]

Links: The relevant links to the Bill, Explanatory Memorandum and second reading speech can be accessed via BillsNet, which is at http://www.aph.gov.au/bills/. When Bills have been passed they can be found at ComLaw, which is at http://www.comlaw.gov.au/.

Purpose

The Bill implements the Government's policy arrangements for the automotive industry announced in *A New Car Plan for a Greener Future* and will establish the Automotive Transformation Scheme (ATS) to commence from 1 January 2011.

Background

The Bracks Review and A New Car Plan for a Greener Future

On 10 November 2008, the Government announced *A New Car Plan for a Greener Future* for the automotive industry. A key element of the car plan was the establishment of the ATS to replace the Automotive Competitiveness and Investment Scheme (ACIS).[2]

The ATS was one of the recommendations outlined in the Review of the Automotive Industry headed by the former Victorian Premier, the Hon Steve Bracks.[3] The review laid the blue print for the Government's policy arrangements for the Australian automotive industry and the ATS is the centre piece of that policy.

The review proposed that the design and delivery of ATS differ from that of ACIS.

1. However, sections 3 to 29 will not commence at all unless the companion Bill, the ACIS Administration Amendment Bill 2009, receives Royal Assent before 1 July 2010.
2. See ACIS Administration Amendment Bill 2009, Bills Digest, No. 9, 2009-10.
3. *Review of Australia's Automotive Industry*, Final Report, 22 July 2008. The ATS was termed the Global Automotive Transition Scheme by the review.

First, assistance should be in the form of grants rather than import credits which are used to offset customs duty payable on automotive imports. The import credits can be sold or transferred.[4]

The change in the way assistance was provided was advocated by the motor vehicle manufacturers. It was argued that the quantum of assistance was eroded by the rate of tariff or, in the case of imports with zero tariffs, as in the case of imports under a free trade agreement, no import duty offset was applicable. As the review explained:

> … ACIS credits earned can be used to discharge customs duty on eligible automotive imports or can be sold or transferred. According to the Federal Chamber of Automotive Industries, the automotive industry "favours retention of duty credits as the preferred mechanism for the delivery of investment support". On the other hand, GM Holden expressed concern about possible erosion of tariffs under future free trade agreements, and recommended that "the ACIS funding mechanism should be reviewed to provide an alternative to a duty credit which could be used to pay not only customs duties, but also tax liabilities.[5]

Second, the review recommended the maximum rate of assistance for eligible R&D should be increased from 45 per cent under ACIS to 50 per cent. The increase in the rate of subsidy by 5 cents in the dollar and streamlining of eligible R&D activities was intended to promote innovative R&D focussing more exports and productivity improvements:

> The funding mix under the assistance arrangements should be changed to offset the impact ACIS has had on retaining marginal firms in the industry, to more appropriately target R&D and to remove the anomaly in providing more assistance for the production of vehicles for the domestic market and New Zealand compared with assistance for production of vehicles for export to other markets…
>
> In addition, some of the eligible expenditure items for R&D that can be claimed by the supply chain under ACIS are generous. For example, firms can claim costs associated with recruitment and management. Streamlining the eligible expenditure items will help ensure that claims more accurately reflect R&D activities. It will also help raise the modulation rate.
>
> Removing the loadings and reducing the eligible expenditure items can be complemented by an increase in the rate for claims of eligible R&D. Currently, it is 45 percent. This could be raised to 50 percent. To further encourage R&D, the rate for plant and equipment claims can be reduced from its present 25 percent to 15 percent.[6]

A New Car Plan for a Greener Future made new commitments of $3.4 billion over and above the $3 billion earmarked for the remaining stages of ACIS. The package included

4. Ibid, p. 95.
5. Ibid, p. 32.
6. Ibid, pp. 96-97.

additional funding of $80 million to assist the transition from ACIS to the ATS. Other elements of the New Car Plan were:

- expanding and doubling the Green Car Innovation Fund from $500 million (from 2011 to 2016) to $1.3 billion (starting in 2009 and extending over ten years)
- $116.3 funding for the new Automotive Industry Structural Adjustment Program to assist component manufacturers with costs associated with labour market adjustments
- $20 million over the four years to 2012-13 to assist automotive suppliers improve their capabilities and integrate into national and global supply chains
- $10.5 million to expand the LPG vehicle scheme through doubling of payments for purchases of new vehicles using LPG technology from $1000 to $2000.

The Australian automotive industry

The Australian automotive industry has three motor vehicle manufacturers (Toyota, Holden and Ford)[7] who are supplied by approximately 200 component, tooling and design, and engineering firms located predominantly in Victoria and South Australia.

According to the *Australian Automotive Intelligence Yearbook 2009*, the industry:

- in 2007, employed a total of 67 384 persons – of which 26 135 persons were employed in motor vehicle manufacturing
- had a gross turnover in 2007 of $24.7 billion
- spent $635 million on R&D in 2007
- in 2007, the motor vehicle manufacturers reported net losses totalling $27 million on total sales of $18.75 billion.

In 2008, 332,000 passenger motor vehicles and light commercial vehicles were produced and 159,876 vehicles were exported. Exports of motor vehicles and components were worth $5.8 billion in 2008 while imports were worth $22.7 billion.

Fully built passenger motor vehicles (the Toyota Camry, Holden Commodore, Ford Territory and until 2008, the Mitsubishi Diamante) are exported to the Middle East, South Africa, New Zealand and Oceania. Components including engines and brake parts are exported to most major global automotive markets – China, Korea, the EU and the United States.[8]

There has been a strong increase in automotive trade associated with trade liberalisation and the restructuring of the industry over the past two decades. Between 1988 and 2008, motor vehicle exports have risen from 1,921 units in 1988 to 159,876 units in 2008.

7. In early 2008, Mitsubishi announced it would close its plant in Adelaide and become solely an importer.
8. See *Australian Automotive Intelligence Yearbook 2009*, pp. 66-69.

Domestic production is now geared to the export market which accounts for 48 per cent of total production compared with 0.5 per cent in 1988. The value of imports has risen correspondingly and the more than 600 per cent growth over the same period was valued at $25.7 billion. The resulting automotive trade amounted to $24 billion in 2008.[9]

The global automotive industry

In 2008, more than 70 million motor vehicles, including passenger motor vehicles and commercial vehicles were produced worldwide.[10]

Global production is dominated by the four major producer countries (Japan, China, the United States and Germany) which accounted for 50 per cent of global production in 2008. Australia's production of motor vehicles accounts for 0.5 per cent of global production.

Five large firms (Toyota, General Motors, Volkswagen, Ford and Honda) with multi-national operations account for 42 per cent of the global market. Market outsiders such as Tata Motors, the Indian commercial vehicle producer and FAW Group, China's first automotive producer are increasing their share of exports and global production.

In 2009, with the global economic downturn and recession in the United States, the global automotive industry is experiencing a combination of pricing pressures from rising oil prices, fall in demand and changes in consumer buying habits. It is estimated that half of the light vehicle plants in the United States will permanently close within the coming years.[11] As a result of the plant closures in the United States, in 2009, China became the second largest automobile maker, surpassing the United States, after Japan and the largest automobile market in the world.[12]

The Automotive Transformation Scheme (ATS)

The New Car Plan described the replacement of ACIS Stage 3 with the ATS. ACIS Stage 3 was planned to run from 1 January 2010 to 31 December 2015. The ATS incorporates the additional tranche of assistance as recommended by the Bracks Review (from 2015 to 2020) and will replace ACIS Stage 3 which will expire effective from 31 December 2010. Underlining the new ATS program is the reduction in tariffs from 10 per cent to 5 per as scheduled on 1 January 2010.

The industry generally will be compensated by an even greater than expected level of transitional and ongoing assistance than under ACIS. The ATS will include:

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9. Ibid, p. 67.
10. See World Motor Vehicle Production by Country: 2008, Organisation Internationale des Constructeurs d'Automobiles.
11. J Rubin, *Wrong Turn*, CIBC World Markets, 2 March 2009.
12. See "China poised to be the world's largest auto market", msnbc, 4 February 2009.

- total capped assistance of $1.5 billion from 2011 to 2015
- total capped assistance of $1 billion from 2016 to 2020 and
- total uncapped assistance of approximately $850 million from 2011 to 2020.

Capped assistance will continue to be split 55 per cent (to motor vehicle manufacturers) and 45 per cent (component manufacturers and suppliers) as recommended by the Bracks Review.

The maximum rate of assistance for approved R&D will be increased from 45 per cent to 50 per cent and the list of eligible R&D activities will be reduced. However, there will be no funding for recruitment and management expenditure associated with R&D activities as recommended by the Bracks Review.

Modulation of payments will occur to ensure that assistance is available over the entire program period.[13] Under ACIS, quarterly assistance was determined on a pro rata basis, using a motor vehicle producer modulation rate or a component producer modulation rate.

Participants in the ATS will be required to demonstrate compliance with the conditions provided for by the ATS. As stated in the Explanatory Memorandum to the Bill:

> The Bill also includes a strong monitoring regime, including provision for authorised officers to obtain a monitoring warrant to check compliance with the Scheme. These provisions are necessary, given that the Scheme is a self-assessment scheme, to facilitate effective monitoring and to ensure the integrity of the Scheme.[14]

The cost of the ATS, in terms of capped funding, will be $2.5 billion which will be guaranteed through a standing appropriation. Uncapped assistance (approximately $850 million) will be provided through an annual appropriation. This support to the industry is far above the assistance provided to any other single industry.

Assistance will be in the form of grants (cash) rather than import duty credits and it is expected that provision for the first budgetary outlays for capped and uncapped assistance will be made in the 2010-2011 Budget.

The proposed ATS will consolidate and strengthen the operations of the three motor vehicle manufacturers with a supply of funds during the ten-year lifetime of the program. More critically, the ATS will help reposition the industry into an expected new growth segment of the market in Australia and globally.[15]

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13. That is, grants will be modulated (or reduced) to provide a 55 per cent allocation to the available modulated capped funding to motor vehicle manufacturers and 45 per cent to component producers.
14. Automotive Transformation Scheme Bill 2009, Explanatory Memorandum, p. 3.
15. See "Governments partner with Ford on new green engines", Media release, Minister for Innovation, Industry, Science and Research, 24 July 2009.

However, the proposed ATS raises four key issues.

- The first is the question whether the details of funding allocations and compliance with the ATS should left out of the Bill and consigned to the regulations. The Bill establishes the framework of the ATS with the administrative arrangements to be included in the regulations.
- Secondly, will there be adequate monitoring and independent evaluation of a self-assessment scheme that delivers substantial cash payments to the ATS participants? A major criticism of ACIS was the lack of publicly available data on ACIS funded production and R&D.[16]
- The third question is how sustainable is the ongoing assistance likely to be given the need for further improvements to productivity and the industry's dependence on export growth? The assistance provided under the previous Export Facilitation Scheme and ACIS has not produced the benefits in terms of sustainable growth in the industry. While restructuring has resulted in a reduction in the number of motor vehicle manufacturers from five to three, the industry produces fewer motor vehicles than it did in the mid 1980's when the Button Car Plan was announced.
- The fourth issue is the WTO consistency of the ATS which is a form of production subsidy.[17]

Main provisions

Object of the Act

Proposed section 3 of **Part 1** of the Bill sets out the object of the Act, which is to encourage competitive investment and innovation in the Australian automotive industry through the provision of assistance to ATS participants. The object is to be achieved in a way that improves environmental outcomes and promotes the development of workforce skills.

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16. Australian National Audit Office, *Administration of the Automotive Competitiveness and Investment Scheme*, Audit Report no. 19, 2007-08. The ANAO Report, which focussed on ACIS Stage 2, found that only limited information had been reported publicly and performance outcomes were difficult to measure.
17. The WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement) defines a *subsidy* when there is a financial contribution by a Government or any public body and when there is a benefit conferred. A subsidy is deemed to exist when both these conditions are met. The SCM Agreement also defines a *prohibited subsidy*, which includes subsidies contingent on export performance. Typically export subsidies can range from ad valorem payments to firms based on the size of export sales, to export credits, loans, insurance programs and price supports.

The Automotive Transformation Scheme

Proposed paragraphs 5(1)(a) to (h) of **Division 1** prescribe the matters that must be included in the regulations.

Proposed subsection 5(2) of **Division 1** establishes the ATS as a self-assessment scheme.

Proposed section 7 of **Division 2** provides that ATS has two types of assistance: capped assistance and uncapped assistance. **Proposed section 8** states that capped assistance under the ATS must not exceed the stage caps. For Stage 1, commencing 1 January 2011 and ending 31 December 2015, the cap must not exceed $1.5 billion. For Stage 2, commencing 1 January 2016 to 31 December 2020, the cap must not exceed $1 billion. Moreover, capped assistance cannot exceed $300 million per year, although if less than $300 million is paid in particular year, the 'underspend' can be carried forward and paid in any later year of the relevant stage. Thus it is possible that funding will exceed $300 million in some years.

Proposed section 9 ensures that payments made to ATS participants may only be made if certain conditions are satisfied. These include that money may be offset or recovered in the circumstances specified in the regulations.

Proposed section 10 provides that amounts of capped assistance will be appropriated from the Consolidated Revenue Fund.

Proposed sections 11 to 26 deal with monitoring compliance with the ATS. Overall, the powers are fairly standard for a Commonwealth scheme of this nature. Amongst other things, an authorised officer may enter premises without consent[18] under a ***monitoring warrant*** issued by a magistrate.[19] They may operate electronic equipment at the premises in order to exercise monitoring powers and require a person to answer questions and produce documents requested by the authorised officer who enters the premises under a monitoring warrant. A person that is required by the authorised officer to answer questions, produce documents etc, but refuses to do so or otherwise fails to comply, commits an offence carrying a maximum penalty of six months imprisonment: **proposed section 24.** However, no offence is committed if the person has a reasonable excuse – this includes the situation that the answering of a question etc would tend to incriminate them.

It is worth noting that in Commonwealth legislation dealing with regulatory schemes, self-incrimination is often not an excuse for failing to comply with a requirement of an authorised officer acting under a warrant. However, in such situations the person does

18. If entering under warrant, the officer must announce they are authorised to enter the premises and must allow any person on the premises the opportunity to allow entry into them.
19. A 'magistrate' refers to a State or Territory magistrate (subsection16C(3) of the *Acts Interpretation Act 1901* (Cth)).

have some protection in that generally the information obtained is inadmissible as evidence in a criminal proceeding, other than a proceeding for giving false or misleading information or documents under sections 137.1 and 137.2 of the *Criminal Code Act 1995*. Whether in this case the retention of self-incrimination as a reasonable excuse for not complying with the requirement of an authorised officer acting under a warrant is consistent with the Government assertion that under the Bill the ATS will have a 'strong monitoring regime' is something that Parliament may wish to consider.

Proposed section 26 provides that the power conferred on a magistrate in respect of the issuing of monitoring warrants, is conferred on a magistrate in a personal capacity, and not as a court or member of a court.

Concluding comments

The release of the New Car Plan follows a number of reviews of the industry in recent years and more specifically the Bracks Review. The review made 42 recommendations, the majority of which have been incorporated into the New Car Plan. The review also recommended that the existing scheduled tariff reductions proceed as planned.

While the quantum of assistance under the ATS is capped by the Bill at $2.5 billion, details of the administration of the ATS are lacking. The Explanatory Memorandum states that the administrative details will be included in the regulations to reduce the complexity of the legislation and provide flexibility in dealing with changing circumstances in the automotive industry. The regulations will need to ensure there is adequate monitoring and evaluation of grant payments and that funding is not used to "prop up" firms and the timing of payments reflects the objectives behind the ATS.[20] The industry will also need to ensure that it understands the ATS to ensure that R&D projects and capital investments are consistent with the ATS.

A specific concern is the WTO consistency of the ATS under the SCM Agreement. The New Car Plan makes clear that the ATS is central to the Government's objective to establish Australia as one of only a small number of countries capable of designing and building environmentally cleaner cars. The New Car Plan also makes clear that Australia will continue to pursue markets for its automotive exports through the assistance provided under the ATS. As a form of subsidy, the ATS will provide production incentives to the industry directed to the supply of the export market. It is to be noted that in the 1990s, encouraged by the Export Facilitation Scheme, exports displayed their strongest growth until the scheme was replaced by the more WTO acceptable ACIS.[21]

20. In its Audit Report no.19, 2007-08, *Administration of the Automotive Competitiveness and Investment Scheme*, the ANAO identified $141 million in inappropriate claims made under ACIS since 2001.
21. The WTO consistency of the Export Facilitation Scheme was examined by a WTO Panel in the Howe Leather case in 1999. The Panel found that while a low-interest government loan

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to Howe was not inconsistent with the SCM Agreement, the grant payments to Howe were because these were tied to exports.