

Senate Economics Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Supplementary Budget Estimates

2014 - 2015

Department/Agency: Productivity Commission

Question: SBT47-55

Topic: Automotive Industry

Reference: written - 31 October 2014

Senator: Xenophon, Nick

Question:

47. In the Final PC Report on Australia's Automotive Manufacturing Industry released in August, you suggest that changing to a single pool of funding would ultimately result in a redistribution of ATS payments from component producers to motor vehicle producers. Given this analysis, when combined with the proposed cuts to the ATS fund by the Government, do you not believe that this will bring forward the closure of supply chain firms and in turn the industry?
48. In Finding 3.1 of the Report, it states that:

Australia's industry assistance policy, regulatory settings and trade negotiation outcomes are best determined according to the interests of the Australian community as a whole.

Yet your report considers quantitative comparisons of assistance levels across countries, and the multiplier effect as being ineffectual. On what basis did you reach that conclusion? Can you please detail in that case what measures you used in determining the future of further assistance to the automotive industry?
49. In Finding 4.1 of the Report it details the Australian automotive manufacturing industry as one of the most heavily assisted industries in the country. Yet in Finding 3.1 you detail that this sort of quantitative comparison across countries does not yield robust results. Would you not agree that this is in fact contradictory, and in that case Finding 4.1 is not robust?
50. Whilst the report concluded that claims based on 'multiplier effects' failed to consider the cost of the assistance to tax-payers and alternative uses of resources, the report did not provide a measure of the multiplier effect. Can you explain why this was absent?
51. Do you agree that there is a multiplier effect involved with direct job losses in the automotive industry, and if so what would you set this number as being?
52. I refer to Recommendation 5.1, where you recommend the Government repeal the current ATS Act after Ford, Holden and Toyota cease manufacturing motor vehicles in Australia. In this recommendation, you make no mention of the automotive components sector. Would you agree that this recommendation underestimates the reliance of this sector currently on ATS funding?

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53. In the report, you go on to make a number of recommendations to Federal and State Governments, to pull all their current funded programs in the automotive sector. Have you assessed the economic impact of overall job losses, and on the broader economy?
54. In Finding 6.1 of the Report, there is an admission that the magnitude of job losses will very much depend on the extent to which component manufacturers are able to diversify into export or other markets. Would you agree that there is a direct link between job losses and available funding through the ATS?
55. In Recommendation 7.1 you confirm that governments should ensure appropriate resourcing of welfare, training and employment services in the regions where the automotive sector job losses will be hardest felt. Do you believe that current programs are appropriate and sufficient to deal with this issue?

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Answer:

47. Decisions about the closure of automotive supply chain firms will depend on a number of factors, including the extent to which component manufacturers choose to, and are able to, diversify into other markets. Factors that have led to a reduction in Australian-sourced componentry include relatively high domestic manufacturing costs and global trends, including the move by vehicle producers to global platforms and rationalisation of larger tier 1 component suppliers that have a global presence.

Decades of government assistance have been unsuccessful in overcoming the market conditions and competitive pressures that face the industry. Nonetheless, under the MYEFO funding schedule, component producers would still be expected to receive more than 80 per cent of the payments that they would otherwise have received under the legislated funding schedule between 2014 and 2017.

48. Policy decisions should seek to maximise the value of our scarce resources with a view to improving the wellbeing of the Australian community as a whole. Industry assistance generally favours the assisted industry (including capital owners) at the expense of domestic consumers (by raising prices) and/or taxpayers (where budgetary assistance is provided) and other domestic industries (through higher costs), not firms and residents in other countries. Thus, while interventions by foreign governments might distort trade, that they do so is not an argument for matching policies in Australia. (It is an argument for advocating freer trade policies globally.) (The Commission did consider other countries' assistance arrangements in its assessment of the global conditions facing the automotive manufacturing industry in Australia (chapter 2). A detailed survey of these arrangements is set out in appendix B.)

All activity in the economy is interlinked, but linkages per se are not a basis for providing assistance to one industry over another. A number of matters are relevant:

- multiplier effects are not unique to the automotive industry — expansion or contraction of any industry will have flow on effects on input suppliers, labour and capital as well as user industries.
- claims for assistance based on multiplier effects typically are one-sided as they fail to consider the cost of assistance to taxpayers and consumers and the forgone alternative uses of resources in other industries in the economy. Higher taxes and prices and higher costs in other industries will similarly trigger (negative) multiplier effects, offsetting expansionary effects in the assisted industry. It is the net impact which is relevant for policy.
- Often multiplier analysis overstates output and employment effects because the analysis assumes that prices do not adjust in response to output changes in markets. Generally speaking, markets adjust through a combination of quantity and price changes (see Gretton (2013)).

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Industry-specific budgetary assistance, such as that provided to the automotive manufacturing industry, provides benefits mainly to particular firms and their owners (and, indirectly, their employees), but imposes costs on taxpayers and means that potentially higher-value uses for public funds are forgone. In undertaking this inquiry the Commission considered the benefits and costs of automotive industry assistance to the Australian community overall (that is, it took an economy wide perspective). In order to assess whether automotive industry assistance achieves an outcome that is in the best interests of the Australian community the Commission considered whether:

- there is an in-principle role for government based on a ‘market failure’ (such as an externality)
- the market failure (if there were one) is substantial and amenable to government action
- the benefits to the community from government intervention outweigh the costs.

The Commission evaluated a number of policy rationales for industry-specific assistance against these principles and concluded that the rationales are weak, and that the economywide costs of such assistance outweigh the benefits.

49. Finding 4.1 is based on the Commission’s assessment of the effective rates of assistance (ERA) to individual industries within Australia. (The ERA is the tariff and budgetary assistance expressed as a proportion of the industry’s (unassisted) value added.) This finding (and the underlying analysis) is robust as the Commission is able to derive ERAs for Australian industries on a consistent basis. Further detail on the Commission’s methodology can be found in the Commission’s Trade and Assistance Review series.

Finding 3.1 reflects that there are a number of significant constraints to conducting a detailed quantitative analysis of assistance across countries, including:

- the number of assumptions that are required to add and compare diverse forms of assistance across countries
- the lack of quality data on all assistance measures in the public domain
- the range of policy measures with varied objectives and purposes which potentially affect automotive manufacturing activities.

The caveats that would apply to the results of any such analyses would be of such significance as to render the exercise worthless, rather than be a useful input into the policy-setting process for industry assistance.

50. The Commission modelled the effects of the closure of passenger motor vehicle manufacturing plants in Australia. The modelling illustrates the initial negative effects on component and other suppliers but also the positive impacts on taxpayers and consumers. Employment impacts improve over time as other industries expand in response to lower costs (through a real depreciation of the Australian dollar). Thus, unlike simplistic multiplier

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analysis, the modelling takes into account a much broader range of linkages throughout the economy and allows market prices to adjust.

51. There is a flow-on effect from job losses in the short- to medium-term, as reflected in our finding that while 6 600 employees would be directly affected, there could be up to 40 000 job losses. It is not feasible to make a precise upper bound estimate of job losses due to uncertainty about the extent of job losses among supply chain firms, the time period over which plant closures occur, producer and consumer behaviour and the rate at which job opportunities are created in other industries and regions. However, the Commission has attempted to err on the side of more pessimistic assumptions to arrive at an approximate upper bound estimate for job losses. Higher estimates of job losses by others reflected a combination of an assumption of little or no price adjustment (a simplistic multiplier analysis) and inappropriate inclusion of jobs in the manufacture of components for the aftermarket and in other parts of the industry (such as bus and truck manufacturing) that are unlikely to be significantly affected by the closure of motor vehicle manufacturing plants in Australia.

52. The Department of Industry considers it is unlikely that there will be any eligible claimants on ATS funding after the closure of the Ford, Holden and Toyota motor vehicle manufacturing plants in Australia. The Department considers that the majority of component producers would not meet the condition of registration under the ATS Regulations after the motor vehicle producers cease manufacturing.

53. A quantitative analysis of the economywide and regional impacts of the impending passenger motor vehicle manufacturing plant closures in Australia is provided in the supplement to the inquiry report (Economywide Modelling of Automotive Industry Changes). The analysis sheds light on the broad order of magnitude of the adjustment task.

54. As noted in the response to Q. 47, decisions about the closure of automotive supply chain firms (and associated job losses) will depend on a number of factors.

As also noted in the response to Q. 47, decades of government assistance have been unsuccessful in overcoming challenging market conditions and competitive pressures that faced the industry. Nonetheless, under the MYEFO funding schedule component producers would still be expected to receive more than 80 per cent of the payments that they would have received under the legislated funding schedule between 2014 and 2017.

55. The Productivity Commission did not evaluate the adequacy or efficacy of existing welfare, training and employment services in the affected regions.