



Submission
to the
Department of Foreign Affairs and Trade on
Negotiations for a Free Trade Agreement
between
Australia and the United States of America
Issues and Implications for Australia's
Automotive Components Industry
January 2003

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Executive Summary

There is considerable uncertainty among Australian automotive component manufacturers as to whether an Australia United States Free Trade Agreement (AUSFTA) would result in a net benefit to their companies. Of those component companies willing to express a view, most think an AUSFTA would be positive. A 'best-guess' estimate based on a survey of FAPM members would be that the value of Australian production of automotive components would increase by around 2%.

A few Australian component producers expect to significantly increase their current value of direct imports of US-sourced automotive components as a result of an AUSFTA, although most expected no change. Indications are that such imports could increase in value by up to 20% but from a low base. By contrast, the prospective increase in automotive component exports to the US is less than 1%.

Most think the impact of an AUSFTA on their businesses would come about predominantly by changes in the derived demand for components resulting from an AUSFTA-driven increase in international trade in vehicles between the US and Australia rather than from direct trade in components.

Although opinions differ about the expected increase in vehicle trade resulting from an AUSFTA, a 'best-guess' by Australian component manufacturers is that both imports from the US and exports to the US would increase by around 20%, but again from a low base. On current Australia – US automotive trade figures, this would suggest that an AUSFTA would increase imports of vehicles from the US and increase exports of vehicles to the US by around 3,500 to 4,000 vehicles per year (around 1% of the Australian market). The increased exports are expected to be mostly utility type variants and would be on top of existing exports and known planned exports such as Holden's Monaro.

The expected increase in imports of vehicles from the US is expected to result mostly in trade diversion (probably lower import volumes from Japan) rather than in lower production levels in Australia. This is because the main US vehicle manufacturers also have manufacturing operations in Australia and it is expected that any increase in imports from the US will complement their local production range in Australia rather than substitute for it.

FAPM expects the local vehicle producers to maintain their existing commitment to Australian vehicle manufacturing and look to an AUSFTA to develop US markets for their utility variants through their parent companies. Such an outcome would clearly benefit Australian producers of automotive components.

For these reasons, FAPM sees little trade sensitivity for the Australian automotive industry in an AUSFTA.

However, this overall conclusion is reached with some important provisos. It is very much dependent on Australia securing duty free access on vehicles used for the transport of goods – the main segment of US vehicle production. The other concern of FAPM is the action of the UAW in the US. Holden's recent experience with export volume limitations being placed on the Monaro because of union "sensitivity" gives us little confidence that the US vehicle market will be 'free' for Australian exporters even with an AUSFTA. Our conclusion also presupposes a continuing and expanding commitment to Australian production of vehicles by the four local producers.

The AUSFTA **key issues** for the Australian automotive components industry are:

An Unaltered ACIS

ACIS is neutral with respect to automotive trade with any particular country. ACIS is WTO consistent and designed to provide transitional assistance for the Australian automotive industry as it adjusts to lower general levels of tariff assistance. It will be an important policy tool in the Australian industry adjusting also to duty free entry of US-sourced imports as part of an AUSFTA. The Australian Government has only recently re-affirmed ACIS until 2015 with a review in 2008. It is vital that ACIS remain unaltered within an AUSFTA.

The US Tariff on Commercial Vehicles

With both Holden and Ford gearing up for increased Australian production of utility type vehicles, the 25% US tariff on commercial vehicles should be the primary target for Australian negotiators with respect to automotive access into the US market.

Domestic Market Safeguard Provisions

Given the size of the US automotive industry, there is a risk for the Australian industry of a significant loss of domestic market share that will not be offset by increased exports to the US. Some 'trigger' system of market safeguard provisions would provide greater certainty for Australian producers particularly given the apparent and widespread uncertainty within the industry as to the net effect of an AUSFTA for local production.

Clear Rules of Origin

Clear rules of origin are vital if the Australian automotive industry is to have any confidence in the integrity of an AUSFTA. There must be no possibility that either components or vehicles manufactured or assembled in Mexico under NAFTA be allowed to enter free into Australia under an AUSFTA as US goods.

Exemption from the Provisions of US Government Procurement Rules

Australia should seek exemption from US Federal and State Government procurement preferences as if it were a signatory to the WTO Government Procurement Agreement 1996.

UAW

The demonstrable influence that the UAW has on limiting exports of automotive products to the US must be addressed in the AUSFTA negotiations. Whether this influence can be curbed through some form of mutual recognition of workplace issues or through some stronger means is a matter which needs further exploration – but a solution to this real problem must be found.

Other Issues

Anti-dumping: Consideration might be given in an AUSFTA to a provision which excludes anti-dumping action being taken by either member but instead which recognizes each member's competition policy law.

Mutual Recognition of Testing Standards: Work has been underway with APEC for some time on automotive standards issues. FAPM is not sure whether an AUSFTA which sets similar objectives is required or whether it would merely duplicate efforts being made elsewhere. Certainly mutual recognition of testing standards would be a useful advance in achieving product conformity.

Introduction

The Federation of Automotive Products Manufacturers (FAPM) represents the interests of Australia's major suppliers of automotive components. The proposed Free Trade Agreement (AUSFTA) between Australia and the United States (US) is a matter of particular interest to FAPM members and to the Australian automotive industry generally.

As a matter of principle, FAPM supports freer international trade and therefore welcomes discussions between the Australian and US Governments on an AUSFTA. But it must be recognized that bilateral free trade agreements can have distorting effects both on existing patterns of local production and on the sources of imports and destinations of exports. In coming to an overall assessment of the net effect of an AUSFTA, each Australian automotive producer must weigh up the commercial costs and benefits on their own business. These will vary with an AUSFTA depending upon a firm's existing commercial linkages into the US automotive industry and the potential to either establish such linkages or grow existing linkages. Much will also depend on board room strategic decisions about the preferred locations for product sourcing following implementation of an AUSFTA. Certainly the options for re-sourcing increase with lower trade barriers. But there are a host of other factors which will ultimately determine the extent to which an AUSFTA will affect automotive trade creation and diversion including customer preferences and loyalty; being located geographically close to the market; ability to profitably meet niche markets; continued capacity to meet product specifications at a competitive price and quality; availability of skills; educational and other social and economic infrastructure; and so on.

In considering the AUSFTA issues relevant to the automotive components industry, FAPM has assumed that the objective is for duty free trade in goods and services between Australia and the US and that negotiations will extend to a wide range of related matters such as industry policy; rules of origin; technical standards and regulations; trade remedies (such as anti-dumping and safeguards); customs procedures; government procurement; regional industry support measures and other non-tariff barriers.

The most obvious observation about the relative characteristics of the US and Australian automotive markets is the sheer size difference. It would take the US market less than a week to absorb a full year of Australia's total car production. By contrast, the annual production of cars at General Motors' Lansing plant in Michigan is more than the whole of Australia's annual production. This disparity suggests that US producers have a much greater capacity to make substantial inroads into the Australian market with free trade than Australian producers have to impact the US automotive market. But an AUSFTA also provides Australian-based manufacturers with the opportunity to gain duty free access to the world's largest single automotive market. Importantly it would provide Australian vehicle producers with an added advantage in being able to supply small run, niche market products into the US.

How the various automotive market forces would interplay given free trade between the US and Australia is complex. Clearly manufacturing size alone is not a sufficient condition for taking a dominant position the Australian automotive market. US-sourced vehicles have never sold at substantial volume in the Australian market despite the overwhelming scale differences between the two industries. Obviously the relatively high tariff protection afforded Australian automotive production in the past has had an influence but those tariff rates are now being phased down. Even at the current import tariff rate of 15%, automotive imports from the US are small relative to total Australian demand. This suggests that other factors may be more important than relative prices between Australian and US-sourced automotive products and between US-sourced imports and imports from other sources.

Further complicating the picture is a range of non-price issues. For example, the existence of left-hand drive vehicles in the US and right-hand drive vehicles in Australia may provide some degree of natural protection in the home market for vehicles, but not for components. There is also a range of non-tariff barriers that affect market access, particularly to the US market. For automotive components supply, geographic proximity to assemblers may be more important to gaining market access than free trade.

For Australian component producers, an AUSFTA potentially has a number of implications. It would directly increase domestic price pressures as US supplied components become significantly cheaper in what is already an extremely competitive Australian automotive components market. It would make Australian exports of automotive components to the US slightly cheaper. Of possibly more significance for Australian automotive component suppliers would be the impact of an AUSFTA on Australia's four vehicle manufacturers. With all four Australian manufacturers (and a number of major importers including BMW, Honda, Nissan and Subaru) having assembly plants in the US, imports of vehicles from the US would be expected to increase. Trade diversion from other sources such as Japan and Europe could be expected. With at least two Australian vehicle assemblers (Holden and Ford) gearing up to increase local production of utility type vehicles, any reduction in passenger vehicle assembly might be offset by an increase in exports of commercial vehicles to the US. In turn any increase in exports (and no reduction in local production) would create flow-on business for Australian component producers.

The purpose of this paper is to examine these issues and to assess the likely domestic implications of an AUSFTA in terms of imports, exports and Australian production of automotive products. To complement such an assessment, views on the likely commercial impact from an AUSFTA were sought from FAPM members.

United States and Australian Automotive Profile

3.1 Relative Sizes of the Automotive Industry in the US and Australia

More vehicles are produced and sold in the US than in any other single national market. In 2001, sales of light vehicles (passenger cars, station wagons, vans, sport utilities, and pick-up trucks) were 17.1 million units¹ of which 11.2 million were produced in the US (Table 3.1).

Nine multi-national manufacturers dominate US production - BMW, DaimlerChrysler, Ford, General Motors, Honda, Mitsubishi, Nissan, Subaru and Toyota.

The US automotive parts industry comprises some 3,800 firms, with a majority supplying both original equipment to vehicle assemblers and replacement parts (often referred to as the aftermarket).

Of the top 50 global automotive components suppliers, 21 are headquartered in the US.

Table 3.1: US Production of Vehicles (Units)

	1997	1998	1999	2000	2001
Cars	5,933,921	5,554,373	5,637,949	5,542,745	4,881,717
Light Trucks	5,831,438	6,046,216	6,954,350	6,838,411	6,288,900
Total Light Vehicles	11,765,359	11,600,589	12,592,299	12,380,628	11,170,617
Medium/Heavy Trucks	337,716	374,342	431,868	390,804	256,136
Total Vehicles*	12,130,575	12,002,663	13,024,978	12,773,714	11,426,753

*Total Vehicles includes some additional "other trucks".

Source: Ward's Automotive

Intra-NAFTA trade dominates US foreign trade in automotive products. US exports of road vehicles in 2001 were around 1.6 million units. Nearly 75% of those exports went to Canada or Mexico. Around 51% of road vehicle imports into the US come from Canada or Mexico.

By contrast, the Australian automotive market is small by global standards and is dwarfed by the North American market. In 2001, Australian sales of motor vehicles accounted for 1.4% (around 800,000 units) of the world market compared with North America's 36%. Annual Australian production of vehicles (around 360,000 units) accounts for only around 0.5% of global production compared with the US's 20.7%. Australian production of vehicles is centred on the local subsidiaries of four of the world's leading automotive manufacturers (Ford, General Motors, Mitsubishi and Toyota) and is concentrated in the upper/medium segment of the market. There are around 200 firms producing automotive components in Australia. Of these, approximately 20 firms produce 75% of the total value of Australian component production.

¹ Source: <http://www.apecsec.org.sg/committee/auto/usa.html>

3.2 Australia-US Automotive Business Linkages

There are strong linkages between Australian-based manufacturers of automotive products and US automotive companies. Two top three companies in the Fortune Global 500 list by revenues - General Motors and Ford - both have substantial investments in the manufacture of vehicles in Australia. The other top three Fortune Global 500 company, DaimlerChrysler, owns 37% of Mitsubishi Motors Corporation of Japan which wholly owns Mitsubishi Motors Australia Limited.

There are also several local manufacturers of automotive components with US affiliations including Bridgestone Australia Ltd (part of the Tennessee-based Bridgestone Corporation); Delphi Automotive Systems Australia (part of the Michigan-based Delphi Automotive Systems); Johnson Controls (part of the Milwaukee-based Johnson Controls, Inc;) and Monroe Australia and Walker Australia (part of the Illinois-based Tenneco Automotive). Other component suppliers have US affiliations that provide for sharing and access to advanced automotive technologies often through various forms of royalty-type arrangements. For example, FMP Group (Australia) has an affiliation with Honeywell Friction Material.

As well, some Australian component suppliers have made direct investments in the US. For example, Air International has an engineering office in Detroit employing 60 people and PBR International manufactures brake calipers in plants in South Carolina and Tennessee (with engineering and customer support provided from an office in Michigan). PBR's original equipment customers in the Americas include Chevrolet, Pontiac, Ford, Oldsmobile, Buick and GMC.

It will be the decisions of these companies with substantial existing US-Australia linkages that will largely determine the commercial impact of an AUSFTA on the Australian automotive industry. How those decisions will play out and whether such existing linkages will impact advantageously or adversely on the size and structure of Australian automotive components manufacturing essentially depends on whether the advantages of local sourcing continue even with cheaper US-sourced automotive products. Given the predominantly derived demand nature of the components market, both Holden's and Ford's response in particular will be critical. FAPM expects that both companies will maintain their existing commitment to Australian vehicle manufacturing and look to an AUSFTA to develop US markets for their utility variants through their parent companies. In this sense, the existing commercial linkages will be more a potential source of growth rather than contraction for the Australian automotive industry.

3.3 Automotive Trade Between Australia and the US

In 2001, Australia ran a \$1.2 billion automotive trade deficit with the US - with Australian exports worth around one-half of US imports. Around 84% of that trade deficit was contributed by automotive components.

Exports of automotive products to the US accounted for around 22% of total Australian exports of automotive products, while imports of US automotive products accounted for around 13% of total Australian imports of such products.

Table 3.2: Australian Automotive Trade With the US (A\$'000 by calendar year)

	1997	1998	1999	2000	2001
Exports of Vehicles	435,727	199,085	263,315	375,874	604,661
Exports of Components	267,634	373,638	462,624	491,587	486,345
Total Exports	703,362	572,723	725,939	867,461	1,091,006
Imports of Vehicles	647,397	682,185	570,412	734,690	787,917
Imports of Components	1,138,873	1,344,021	1,272,299	1,510,653	1,477,211
Total Imports	1,786,270	2,026,206	1,842,711	2,245,343	2,265,128
Trade Balance	-1,082,908	-1,453,483	-1,116,772	-1,377,882	-1,174,122

Source: <http://www.apecsec.org.sg/committee/auto/australia.html>

More than one-half of the \$788 million of US-sourced vehicles are either non-passenger type vehicles (off-road dumpers, road tractors for semi-trailers, golf carts, etc) or motor-cycles. There would be little, if any, trade sensitivity for these sorts of vehicles.

Australia's trade in automotive products with the top 20 export destinations and import sources are at Attachment A. In 2001, the US ranked as Australia's number 2 destination for vehicle exports; number 1 for automotive components exports; number 3 (behind Japan and Germany) as a source of vehicle imports; and number 2 as a source of automotive components imports.

Australia's volume of vehicle imports is shown in Table 3. Imports of vehicles into the US from Australia in terms of vehicle numbers more than doubled over the three years 1999 to 2001.

Table 3.3: US Road Vehicle Trade with Australia (Units)

	1999	2000	2001
US Road Motor Vehicle Exports to Australia	17,800	18,826	16,092
Road Motor Vehicle Imports into US from Australia	7,160	13,209	15,404

Source: US Trade data

In 2001, the most significant Australian automotive exports to the US were passenger vehicles (worth \$585 million) and mounted brake linings (\$144 million). The most significant imports were off-road vehicles (\$191 million) and gearboxes (\$180 million).

Mitsubishi has been the most successful Australian vehicle exporter to the US. Around 62,000 units of the Diamante sedan have been exported since 1996. However, from September 2003, Holden expects to annually export to the US around 18,000 Monaro coupes which will be introduced into that market in 2004 as the Pontiac GTO.

Australian component manufacturers who have developed markets in the US include:

The Air International Group – one of Australia's largest systems providers and one of the few companies in the world experienced in fully integrated automotive heating, ventilation and air conditioning.

Robert Bosch (Australia) – an extensive export business in body electronics, diodes, steering wheel angle sensors and throttle bodies for fuel injection.

Clyde-Apac Automotive Products – manufacturer of OEM jack assemblies.

Empire Rubber – manufacturer of vehicle sealing systems, anti-vibration components, moulded products and metal components.

Gibbens Industries – manufacturer of various types of automotive springs, hose clamps and multisided applications.

Mackay Consolidated Industries – manufacturer of hoses, moulded and metal-to-rubber bonded products and metal-engineered components.

Monroe Springs (Australia) – manufacturer of coil and leaf springs.

PBR International – designers and manufacturers of complete brake and clutch systems.

Schefenacker International Australia – designer and manufacturer of interior and external rear view mirrors, electric actuators, memory and power fold systems.

Tristar Steering and Suspension Australia – manufacturer of power steering gears and suspension components.

FMP Group (Australia) – Australia's largest manufacturer of automotive friction material.

Castalloy – manufacturer of cast-aluminium automotive components.

Delphi Automotive Systems Australia – manufacturer of catalytic converters, exhaust catalysts, fuel pumps and filters, fuel tanks, rack and pinion gears.

Forgecast Australia – manufacturer of non-ferrous forgings.

Intercast and Forge – manufacturer of a range of brake components for PBR's plants in the US.

Monroe Australia – manufacturer of ride control products including shock absorbers, strut assemblies and cartridges, gas springs.

Mullins Wheels – manufacturer of alloy wheels.

ROH Wheels Australia – Australia's largest manufacturer of steel and alloy wheels.

Trico Products – manufacturer of windscreen wiper arms and blades.

Issues Relating to Automotive Access into the US Market

Although the US is generally an open economy, it does have a number of specific financial and regulatory measures which directly impact on the automotive industry. Many of these are non-discriminatory as between US-produced goods and imports and include such measures as differential vehicle and fuel taxes, safety and emission standards, fuel efficiency standards for cars and light trucks; and duty drawback. In this paper, only those measures which in some way discriminate against imports in favour of US-produced goods are identified and discussed.

4.1 Import Tariffs

The US imposes a 2.5% tariff on imports of passenger cars and automotive components but has a 25% tariff on imports of commercial vehicles used for the transport of goods, including utility-type vehicles with an open bed. Commercial vehicles make up around 60% of the US new vehicle market.

Table 4.1: US Tariff Rates

Passenger Vehicles* (87.03)	2.5%
Trucks (87.04)	25%
Buses (87.02)	2%
Complete Engines (84.07, 87.08)	2.5%
Body Stampings (87.0829)	2.5%
Transaxles/Transmissions (87.0850)	2.5%
Remainder of 8708	2.5%

* For the purposes of assessing tariffs, passenger vehicles are defined as vehicles which are primarily intended for the transport of passengers. This category includes the light trucks commonly referred to as Minivans and Sport Utility Vehicles (SUVs), but not light-duty pick-up trucks.

There is no difference between the US WTO bound tariff rates and the applied tariff rates.

Removal of the 2.5% tariff on passenger vehicles and components would make Australian manufacturers marginally more competitive in the US market. Potential Australian exports of utilities or vehicles like Holden's new AWD will benefit substantially by removal of the US's 25% tariff on commercial vehicles imported from Australia. In turn, the Australian production of components for such vehicles would be a major beneficiary from growth in Australian exports of commercial vehicles.

4.2 NAFTA

The 1995 North American Free Trade Agreement (NAFTA) is a wide-ranging regional trade agreement covering trade between Canada, Mexico and the US. Under the agreement trade barriers are being gradually phased out. NAFTA lifts restrictions in the world's largest regional automotive market over a 10-year period except for used auto imports into Mexico, which are quota controlled through to 2019. The trade restrictions being phased out include tariffs on

imports between the three countries, Mexico's local content rules and Mexico's trade balancing requirements.

With respect to automotive, the existence of NAFTA is probably the most persuasive case to support an AUSFTA. As intended, NAFTA has increased trade between Canada, Mexico and the US and has encouraged foreign direct investment, particularly in Mexico. Such increased trade and investment has been at the expense of potential exports from companies in third party countries facing relatively higher tariffs and, in the case of trucks into the US, a much higher absolute tariff rate.

The commercial desirability of breaking into the US automotive market and the necessity to be competitive with automotive firms located within NAFTA has encouraged some Australian automotive firms to establish manufacturing facilities within the the bloc (thereby contributing to trade diversion rather than actually boosting trade flows).² But direct investment in NAFTA countries may not be an economically efficient option for Australian automotive components companies if domestic competitive strengths (such as skilled labour, technology or access to raw materials) are not easily transferable offshore. FAPM expects existing investments by Australian firms within NAFTA countries to be unchanged as a result of an AUSFTA.

4.3 Government Procurement

Discrimination against foreign products in procurement procedures can exist in a number of forms, such as:

- (a) expressly prohibiting foreign companies from tendering for government procurement contracts;
- (b) giving preferential treatment to companies agreeing to use a substantial or minimum percentage of domestically produced goods in meeting government contracts; or
- (c) imposing conditions and requirements on bidders for the purpose of precluding foreign companies in favour of domestic companies.

The US is a signatory to the WTO Government Procurement Agreement 1996 which to some extent ameliorates the extent to which it preferences national suppliers of goods and services to Government. In theory, companies from countries which have acceded to the WTO Government Procurement Agreement 1996 receive the same national treatment as if they were a US company (under the *US Trade Agreements Act 1979*) provided appropriate reciprocal procurement opportunities are given for US products and US suppliers. Australia however is not a signatory to that Agreement and as such is not eligible to receive any reciprocal exemptions from the provisions of US government procurement preferences.

Procurement laws that discriminate in favour of domestic producers create economic costs by distorting free international trade. For those procuring goods, such policies prevent buying the best possible goods and services at the lowest possible price, and achieving maximum utility from a given budget expenditure. For suppliers, restrictions on the opportunities for foreign companies to enter the market mean that domestic industries are given higher protection, reducing their motivation to make improvements in their ways of doing business or to develop new products. Thus domestic preferences ultimately favour neither buyer nor seller.

² An example of Australian automotive investment in Mexico is Howe Leather which manufactures leather car seats and supplies its product to the North American automotive industry from a factory in Juarez in Northern Mexico.

Buy American Act 1933

The *Buy American Act 1933* allows the US Government to discriminate against foreign products in government purchasing. The Act directs federal agencies to purchase, for public use, only:

"unmanufactured articles, materials and supplies ... produced in the United States," and "manufactured articles, materials and supplies ... manufactured in the United States substantially from ... materials ... produced or manufactured ... in the United States" (41 U.S.C. 10(a)-(d)).

Under the Act, products or materials are "produced" or "manufactured" in the United States if at least 50 percent of their content is of domestic origin. "Domestic" means the place of manufacture or production irrespective of the nationality or ownership of the supplier. Thus, products manufactured in the United States by foreign affiliates of overseas firms also qualify for favoured treatment.

The Act provides for the purchase of foreign products but only under restricted circumstances. For example, foreign products may be purchased by government agencies only if the purchase of a US product is "not in the public interest". The statute also permits foreign products to be purchased when the price of a US product is at least 6 percent higher than that of a comparable foreign product. The purchase of foreign products is also allowed if the required product is not produced in the US.

The *Buy American Act 1933* only affects sourcing of products for use by the US Federal Government. Its impact on the Australian automotive industry in the context of the total US market would not be significant. Nevertheless it is a policy aimed at hindering international trade to the detriment of US imports. As a non-signatory to the WTO Government Procurement Agreement 1996, imported goods from Australia are particularly affected in the absence of any other arrangement. A provision of any AUSFTA might be that Australia be accorded the status of a signatory to the WTO Government Procurement Agreement 1996 for the purposes of the *Buy American Act 1933*.

Procurement by US State Governments

State governments account for around 50 percent of all government purchases in the United States. Thus their impact on international trade is at least as important as that of the federal government.

There are procurement laws at the state and local level in the US with provisions similar to those imposed under the *Buy American Act 1933*. In recent years, some state-legislatures, such as California's, have amended their laws to prevent preferential treatment. Nonetheless, many local and state governments continue to maintain laws that provide preferential treatment.

At present, the US has only offered to include 37 States in the WTO Government Procurement Agreement 1996. Procurement by the other 13 states is not covered by the 1996 Agreement. As with the *Buy American Act 1933*, discrimination against Australian goods could be lifted by according Australia signatory status of the WTO Government Procurement Agreement 1996 for the purposes of State procurement for at least the 37 declared States.

4.4 Rules of Origin Labelling

The *American Automobile Labeling Act 1992* (AALA) was enacted to provide potential purchasers of new passenger motor vehicles with information about the country of origin of vehicles and their parts. The AALA provides that new passenger cars, pickup trucks, vans and sport utility vehicles manufactured on or after October 1, 1994 have labels specifying the percentage value of the US / Canadian parts content of each vehicle, the country where the vehicle was assembled, and the countries of origin of its engine and transmission.

While the AALA labeling is consistent with the WTO Rules of Origin Agreement, the clear intent of the AALA is to provide consumers of new passenger vehicles in the US with information which enables them, if they so wish, to discriminate in favour of US / Canadian produced vehicles. In this respect, it is a form of country source labelling that goes beyond the minimum accepted international requirements.

The actual practical impact of the AALA in discriminating against imported vehicles into the US is however problematic. In January 2001, a review of AALA published by the US National Highway Traffic Safety Administration (NHTSA) found, among other things, that "Most consumers are unaware of the existence of the AALA labels" and that "Even those consumers that care deeply about US / Canadian parts content and assembly do not rely extensively on the AALA labels to pinpoint the make-models with high US / Canadian content. Instead, they simply buy Big 3 vehicles."³

By encouraging a "buy local" consumer attitude, the AALA discriminates against imported passenger vehicles. In this sense, it is a non-tariff barrier although its actual effect on Australian exports of vehicles is likely to be insignificant.

4.5 UAW Trade Policy

The International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW) is one of the largest and most diverse unions in North America, with members in virtually every sector of the economy. The UAW has approximately 710,000 active members and has contracts with some 3,200 employers in the US, Canada and Puerto Rico.

It is not the existence of the UAW that is of concern to FAPM's members. Rather it is UAW's policy towards freer trade and automotive imports which can in practice be a significant disincentive to US companies to buy from Australia. For example, the UAW's 2002 trade policy states that:

We will continue to oppose the flawed fast track legislation that passed the House this year. The UAW will join with the coalition that has worked so hard to change U.S. trade policy to defeat the House's corporate-driven approach in the Senate.

In addition, there will be a great deal of monitoring of trade data and trade negotiations to do. This will be especially important if the economic slowdown continues. It has been our experience that economic difficulties abroad lead foreign producers to use the U.S. market as a dumping ground to keep their factories running. We will be watching for increased job-displacing imports in all major UAW-related industries and preparing to take actions under U.S. trade laws to defend the jobs of our members.

³ NHTSA Report Number DOT HS 809 208 at <http://www.nhtsa.dot.gov/cars/rules/regrev/evaluate/809208.html>

We must also keep track of China's compliance with its commitments to fundamental changes in the way it organizes its economy. The WTO accession agreement requires the elimination of discrimination against imports, special subsidies for domestic producers and exports, as well as other unfair trade practices. Those provisions must be enforced.

The UAW will also keep trade negotiations under close scrutiny. The FTAA, with its potential to expand NAFTA throughout the hemisphere must be the target of continuing pressure. Working with our allies, in the U.S. and throughout the Americas, we will continue to educate our members and the broad public about the economic and social dangers of allowing the corporate-driven model of regional integration to advance. We will insist that the negotiators take up the issues we have identified as crucial to improving the lives of working people and their families – worker rights, sustainable and equitable development and debt relief. Equally important, we will oppose the adoption of new rights for corporations and investors that tie the hands of governments in regulating their economies to promote employment and protect public health and critical services.

U.S. negotiations to establish free trade agreements with individual countries must also be watched. Already, negotiations with Singapore and Chile are underway; others could be added. Though the economic impact of any one of these potential deals would be limited, if they further extend the flawed trade policies of the Bush Administration, they will make the necessary changes in those policies more difficult to achieve.

Source: <http://www.uaw.org/cap/02/issue/issue18-10.html>

At the recent Productivity Commission *Review of Automotive Assistance*, Air International referred to the difficulties both it, and an Australian vehicle producer, had experienced in the US due to union related constraints on imports to that market:

In the United States, the Australian industry is routinely either excluded or constrained from supply deals for which it is the most competitive supplier. This has happened to us with major component supply projects where a major buyer has pulled out despite our being the best source of supply.

The most common obstacle to such deals is union resistance...It is common knowledge that a few years ago, union resistance was a major factor in the failure of an Australian subsidiary of an American vehicle manufacturer to land a major order to supply around 50,000 large family sedans and station wagons per year to the United States.

Source: *sub. 56, pp.22-23*

General Motors Vice-Chairman Bob Lutz, speaking at the launch of Holden's Monaro (Pontiac GTO) in Los Angeles, said Australian imports were limited to 18,000 a year after the UAW showed "sensitivity" to the deal. "They have trouble understanding why a traditional US-sized car with an American V8 wouldn't be built in the States," he said. "That also precludes us looking at other Holden products like the Statesman or the Ute. We would very definitely like to do that but we just can't."

The demonstrable influence that the UAW has on limiting exports of automotive products to the US must be addressed in the AUSFTA negotiations. Whether this influence can be curbed through some form of mutual recognition of workplace issues or through some stronger means is a matter which needs further exploration – but a solution to this real problem must be found.

4.6 US State Incentives

The US's federal system results in state governments being the primary sources of investment incentives which can include access to land, provision of transport infrastructure, cheaper than market rates for finance, training incentives and tax concessions.

In recent years, a number of major investments in automotive manufacturing in the US have been supported by substantial state government incentives. These included incentives for Honda which negotiated a US\$159 million investment package with the Alabama Government; for Hyundai which received an investment package of US\$123 million also from the Alabama State Government; and for Volvo which received US\$148 from the Virginia Investment Partnership program.

While such incentives may not directly adversely affect the Australian automotive industry, they may affect the industry indirectly. This could occur through the increased competition for highly mobile automotive investment that may be attracted away from Australia and through US policies directed more at import replacement than at increased international trade. Counter-balancing this impact might be an increased opportunity for US-linked Australian component suppliers to supply favoured US-based manufacturing operations under an AUSFTA rather than say European based manufacturing operations.

Issues Relating to Automotive Access into the Australian Market

Like the US market, the Australian automotive market is open to international competition with around 70% of new vehicles sold being imported.

Australia has no import bans or quotas on automotive products but special arrangements apply to imports of second-hand vehicles. As in the US, duty drawback provisions apply to duty paid imported components which are subsequently embodied in more elaborately transformed exports. Australia also imposes strict vehicle safety standards and has mandated environment protection measures with respect to vehicles but such polices are non-discriminatory between imported and domestically produced vehicles. Vehicle component approval is not required for the Australian market.

5.1 Import Tariffs

Australian applied imports tariff rates on most passenger motor vehicles (PMV) and related components were phased down to 15% on 1 January 2000. These rates will remain at 15% until 1 January 2005 when they will fall to 10%. There will be a further fall to 5% on 1 January 2010. Tariffs on light commercial and AWD vehicles and components for these vehicles are 5% with no change currently scheduled. Second-hand vehicles are subject to the relevant vehicle tariff plus a specific tariff of A\$12,000 per vehicle (except low volume imports under the Specialist & Enthusiast Vehicle Scheme which are subject to the \$12,000 specific tariff).

Table 5.1: Applied and Bound Tariff Rates

Category (HS Tariff Classification)	MFN Applied Tariff			WTO Tariff Binding		
	Low	High	Average	Low	High	Average
PMV (87.03)	5%	15%	9.70%	15%	40%	27.70%
Trucks (87.04)	5%	5%	5%	5%	20%	14.30%
Buses (87.02)	5%	5%	5%	10%	15%	12.50%
Engines (84.07/ 84.08)	0%	15%	4.20%	1%	50%	21.40%
Body Stampings (87.08.29)	0%	15%	6.70%	5%	15%	6.25%
Transaxles/ Transmissions (87.08.50)	0%	15%	8.75%	1%	25%	14%

5.2 Industry Development Arrangements (ACIS)

The Automotive Competitiveness and Investment Scheme (ACIS) commenced on 1 January 2001 and runs for 15 years. ACIS is designed to encourage firms to make long term investments in Australia's automotive industry, based on production, investment, and R&D activity. Benefits are provided to individual companies in the form of transferable import duty credits, up to a maximum of 5% of sales. Consistent with WTO rules, ACIS does not discriminate against

automotive imports nor favour automotive exports. ACIS is also neutral in terms of affecting trade with any particular country.

An AUSFTA would reduce the import duty liability on automotive products sourced from the US. Assuming an average import duty rate of 10% across all automotive imports from the US, this 'saving' would be around \$225 million per annum on current import values.

Precisely how ACIS and an AUSFTA would interact is problematic. Most vehicle imports from the US into the Australian market are intra-company transactions between globally related entities (namely Holden and Ford) or between companies with significant manufacturing operations in the US but not in Australia. Predominantly the vehicle imports have been described in the import statistics as "assembled off-road vehicles...". Most automotive components imports are gearboxes (predominantly imported also by the vehicle assemblers) and replacement parts mostly destined for the after-market.

Without a duty liability on automotive imports from the US, some ACIS import duty credits currently being earned would be 'freed'. This would increase the supply of available credits. If the 'freed' credits were sold, it is likely to reduce the market price of credits transferred. However, because the total duty liability on all automotive products would still far exceed available credits even with an AUSFTA, the effect on the market price of credits transferred could well be insignificant.

Most likely the 'freed' credits would be diverted to offset import duties on automotive products from non-US sources. Nevertheless, there would remain a liability on such imports that must be met. The import credits used have a cash value so there would be a real relative cost involved with diversion. The operation of ACIS would therefore not be expected to affect the relative import advantage that US automotive products would have with an AUSFTA. In other words, any trade diversion resulting from an AUSFTA would occur because of the change in relative landed duty-paid prices. It would not be caused by the operation of ACIS.

5.3 Government Procurement

Under the Federal Government's Executive Vehicle Scheme (EVS), vehicles can be provided to members of the Senior Executive Service as part of a remuneration package. While the Guidelines require that Australian-made vehicles be leased where these are available, they do provide scope to lease certain imported vehicles where the engine capacity of those vehicles is below that of the smallest Australian-made vehicle.

Under the Guidelines imported vehicles are to have an engine capacity of 2000cc or less and be selected from the range of vehicles sold by manufacturers with a local operation in vehicle assembly or component production.

While not as restrictive as the *Buy American Act 1933*, the EVS does provide favoured treatment for Australian-produced vehicles and the existence of the scheme may well be raised by the US as a barrier to further imports of US-sourced vehicles into the Australian market. The EVS has no direct impact on automotive components imports but has an indirect derived demand effect for Australian-produced components incorporated into a proportion of the Australian-made vehicles supplied under the EVS. That proportion depends on the extent to which imported vehicles would be substituted for Australian-produced vehicles without the engine capacity limitation under the EVS guidelines.

5.4 Direct Government Assistance

Both the Federal and State Governments have provided direct assistance to particular firms. Under the Strategic Investment Coordination program, Holden received \$12.5 million from the Federal Government and unspecified support from the Victorian Government to establish a new V6 engine plant in Victoria. In 2002, Mitsubishi received \$35 million in cash assistance from the Federal and South Australian Governments to expand the capacity of its vehicle production in Adelaide. The Victorian Government reportedly provided funding to Ford in the form of infrastructure, training and R&D assistance in relation to its planned \$500 million investment to produce a new AWD vehicle.

Like the US, Australian Governments provide direct assistance to the automotive industry. The objective of that assistance is to support existing investment and jobs in the industry and to encourage new investment. There is no doubt that such support favours domestic production of vehicles over imports, including imports from the US. But it is not cut and dried in respect of components. The supported existence of US-based domestic vehicle assemblers such as Ford and Holden means that imported components from the US may well be higher than they might otherwise be without that investment.

6 Likely Impact of an AUSFTA on the Australian Automotive Industry

This chapter discusses the likely trade diversion and trade creation effects of an AUSFTA on vehicle and component producers separately (although the focus is on component producers). Trade diversion is driven by AUSFTA-induced changes in relative prices for automotive products. Trade creation is driven by the overall expansion in the Australian market for automotive products attributable to the general economic stimulus associated with an AUSFTA.

There are two distinct sub-markets for automotive components:

- for direct incorporation as original equipment (OE) in vehicle production (or indirectly as part of assemblies/sub-assemblies which are, in turn, incorporated as original equipment) — often referred to collectively as the 'original equipment' market; and
- for replacement parts — often referred to as the 'aftermarket'.

It is common for automotive components destined for both sub-markets to come off the same production line. Price tends to dominate in determining aftermarket sales, whereas non-price considerations (such as quality and the security and predictability of the timing of supply) are important in supplying the OE market.

Imperatives dictated by the need to operate production lines at high levels of capacity utilisation mean that component suppliers often look to domestic sales to cover their fixed costs. They are more prepared to marginally cost exports if such a strategy means that lines can be operated more profitably (e.g. at design capacity). However, the relatively stronger bargaining position of vehicle producers can mean that OE suppliers are under constant pressure to cut margins to the bone in order to secure long-term contracts to achieve critical base load demand.

The combined effect of these various considerations can mean that automotive component producers often feel that they are constantly caught “between a rock and a hard place.” But it is not in the interests of vehicle producers to push too hard, because of the advantages to them of encouraging the emergence and continuation of a viable domestic automotive component sector offering some flexibility in potential sources of supply. Typically, supply considerations commonly leads vehicle producers to source very high levels of needed components domestically (either made in-house or sourced from local components suppliers).

Impact on Price Relativities

The US imposes a 2.5% tariff on imports of passenger cars and automotive components but has a 25% tariff on imports of commercial vehicles used for the transport of goods, including utility-type vehicles with an open bed. Australia imposes a 15% tariff on imports of passenger cars and automotive components, scheduled to fall to 10% in 2005 and 5% in 2010. Tariffs on light commercial and AWD vehicles and components for these vehicles are 5%.

The price reductions arising from these tariff rate changes are shown below.

Table 6.1: AUSFTA Price Advantages for Australian Exporters of Automotive Products to the US

Product	Price Change (%)
PMVs(a)	-2.4
CVs(b)	-20.0
Components	-2.4

Notes:

- (a) Passenger motor vehicles, including Minivans and Sport Utility Vehicles (SUVs) but not light-duty, pick-up trucks.
- (b) Commercial vehicles used for the transport of goods, including utility-type vehicles with an open bed.

Table 6.2: AUSFTA Price Advantages for US Exporters of Automotive Products to Australia

Product	Price Change (%)	Price Change (%)
	Pre 2005	Post 2005
PMVs(a)	-13.0	-9.1
CVs(b)	-4.8	-4.8
Components	-13.0	-9.1

It is these changes in price relativities which will largely drive the trade diversion and trade creation effects which will, in turn, largely determine the overall impact of an AUSFTA on the Australian automotive industry. Also important is how these price changes will impact upon the sourcing decisions of firm's purchasing components. This matter is further examined in Attachment C.

6.1 Automotive Trade Diversion

Japan is the number one source country for imports of both automotive components and of vehicles into Australia. It might be expected therefore that any AUSFTA-generated trade diversion in terms of Australia's automotive imports would be away from Japan (mainly) in favour of the US. In terms of the destination of Australia's automotive exports, any AUSFTA-generated trade diversion is likely to be more dispersed - away from the rest of the world in favour of the US.

Australian Vehicle Producers

Australian exporters of passenger vehicles will gain only a slight price advantage (2.4%) as a result of an AUSFTA. Because GM and Ford are affiliates of US-based vehicle producers and because Australian vehicle producers are able to efficiently produce relatively small runs of vehicles by world standards, both companies may well be able to cost-effectively complement model offerings in the US market. A promising example of such a niche offering is GMH's Monaro. The 2.4% price reduction will also help Mitsubishi's export efforts in the US market.

More promising - because of the much larger prospective price advantage (20%) - will be Australian exports of commercial vehicles particularly given that such vehicles currently account for around 60% of the new vehicle market in the US. Such a price incentive may well induce new production of qualifying vehicles in Australia, particularly if parent companies decided that such 'niche' vehicles represented a profitable way of broadening product offerings in this important market segment.

Australian Component Producers

Component producers making parts for such vehicles would then benefit from the derived demand of increased US sales induced by the 20% price advantage, as well as any increase in passenger motor vehicles.

Increased direct sales of components into the US market seem more problematic given the more modest AUSFTA-induced price advantage of 2.4% — although this may still be a sufficient price wedge to induce some source switching by US vehicle producers towards Australia and away from Japan and other Asian and European suppliers.

As against such prospects, there would be serious repercussions for component producers were an AUSFTA to precipitate an exit from Australia of one of the remaining four passenger motor vehicle (PMV) producers. Such a prospect could not be entirely discounted given the price advantage (of 13% until 2005) that would be associated with the introduction of an AUSFTA. The major argument against such a development would be the experience of past exits — where companies choosing to supply the Australian PMV market entirely from foreign sources saw their market shares dramatically reduced (compared to the situation where they maintained a domestic presence in vehicle production).

Then there is the prospect of increased Australian imports of US components spurred by a 13% price advantage associated with an AUSFTA. The major argument against a flood of such imports would be uncertainties associated with such a long and complex supply chain — with the history of the industry favouring local sourcing for the vast majority of components.

Nevertheless, with the relatively greater AUSFTA-induced price advantage favouring component imports from the US compared with the inducement to export Australian components to the US, some net inroads into the Australia market for components attributable to increased US imports has to be expected.

US Vehicle Producers

Based on estimated price effects in Table 6.2, US passenger vehicle producers will gain a significant (13%) price advantage on vehicle exports to Australia compared to the *status quo*. This may well encourage some re-evaluation of maintaining vehicle production facilities in Australia. As discussed previously, however, considerations bearing on such a decision would go beyond pure price considerations, including the fact that such switches in the past in Australia have seen vehicle producers' market shares fall dramatically (e.g. most recently Nissan).

US Component Producers

US component producers would also gain a significant (13%) price advantage on exports to Australia compared to the *status quo*. To the extent that US exports displaced corresponding Australian production, local component producers would suffer (and Australian gross domestic product would decline).

Such an advantage would not only be expected to mean more US component imports but also a re-sourcing of automotive components currently imported from south-east Asia and Europe in favour of the US as the preferred source. To the extent that this involved just a change in country of origin (representing merely trade diversion), Australian component producers (and Australian gross domestic product) would be unaffected.

6.2 Automotive Trade Creation

Trade creation effects flow from increased economic activity attributable to an AUSFTA. There have been a number of bullish assessments of the advantages to Australia of entering into a Free Trade agreement with the US, including the potential for trade creation associated with the boost that would be given to economic growth — both in Australia and (to a lesser extent) the US. Two examples are the recent report for the Department of Foreign Affairs and Trade (DFAT) by the Australian APEC Study Centre (APEC 2001) and a report (also to DFAT) by the Centre for International Economics titled *Economic impacts of an Australia-United States Free Trade Area*.⁴

In terms of pure trade creation effects attributable to an AUSFTA, Australian automotive industry production could expand to the tune of around 0.33% if exports were assumed to expand in line with expanding economy-wide output (see Section 6.4).

6.3 Results of FAPM Member Survey

To inform this submission, FAPM sought the views of its membership on the likely impacts of an AUSFTA on the vehicle and component sectors of the Australian automotive industry. Twenty-two companies responded. These respondents account for over \$2.2 billion in annual production of automotive components, for some \$227 million in component exports to the US, and for some \$61 million in component imports from the US.⁵

AUSFTA-Induced Changes in Automotive Component Exports to the US

Most component producers who responded to the survey were either unsure about how an AUSFTA would affect their current values of exports to the US or thought it would have no impact. A small number of companies thought their own-company exports to the US would increase. None thought their own-company exports would decline as a result of an AUSFTA. Across all respondents, the expected increase in automotive components was a modest +0.55%.

Table 6.3: Respondents' Estimates of an AUSFTA-Induced Change in Component Exports to the US

Number of Responses	
No change	12
Increase:	
5%	1
35%	1
100%	1
Not sure	7

Expected change weighted by current own-company export values +0.55%

⁴ Both reports are available from DFAT's website (www.dfat.gov.au).

⁵ Although the respondents cover a significant proportion of the Australian manufacture of automotive components, the small number of respondents means the results of the survey must be treated with some caution.

AUSFTA-Induced Changes in Automotive Component Imports from the US

Most component producers who responded to the survey were either unsure about how an AUSFTA would affect their current values of imports from the US or thought it would have no impact. Only two companies thought their own-company imports from the US would increase. None thought their own-company imports would decline as a result of an AUSFTA. Across all respondents, the expected increase in imports of automotive components was 19%, but from a low base.

Neither of the two companies expecting an increase in own-company imports thought Australian production would be adversely affected by such an increase. One of the two companies expected that imports from other sources would decline.

Table 6.4: Respondents' Estimates of an AUSFTA-Induced Change in Component Imports from the US

Number of Responses	
No change	13
Increase:	
20%	1
100%	1
Not sure	7

Expected change weighted by current own-company import values +19%

AUSFTA-Induced Changes in Vehicle Trade with the US

Taken together, the industry is therefore expecting a deterioration in the bilateral balance of trade in automotive components with the US — with exports to the US anticipated to increase by less than 1% while imports from the US are expected to increase by around 19%.

There was considerably less uncertainty among respondents as to an AUSFTA-induced impact on trade in vehicles. There was a fairly strong view that an AUSFTA would increase trade in vehicles between the US and Australia.

Table 6.5: Respondents' Estimates of an AUSFTA-Induced Change in Vehicle Exports to the US

Number of Responses	
No change	5
Increase:	
Unspecified	3
5%	1
9%	1
15%	1
20%	5
100%	1
Not sure	5

Table 6.6: Respondents' Estimates of an AUSFTA-Induced Change in Vehicle Imports from the US

Number of Responses	
No change	5
Increase:	
Unspecified	3
10%	3
15%	1
20%	2
25%	2
Not sure	6

Opinions clearly differ about the expected increase in vehicle trade resulting from an AUSFTA. A 'best-guess' is that both imports from the US and exports to the US would increase by around 20%. On current Australia – US automotive trade figures, this would suggest that an AUSFTA would increase imports of vehicles from the US and increase exports of vehicles to the US by around 3,500 to 4,000 vehicles per year on top of existing exports and known planned exports such as Holden's Monaro.

The expected increase in exports of vehicles from Australia would in turn benefit the Australian components industry through an increase in production, although the increase is expected to be relatively small – a maximum of 4,000 additional vehicles in a current annual Australian production of around 360,000 to 400,000 units (around 1%).

The expected increase in imports of vehicles from the US is expected to result mostly in trade diversion rather than in lower production levels in Australia. This is because the main US vehicle manufacturers also have manufacturing operations in Australia and it is expected that any increase in imports from the US will complement their local production range in Australia rather than substitute for it.

Expected Net Effect on Australian Automotive Component Producers

More than half the respondents were unsure about the net impact of an AUSFTA on their company. Some simply thought the impact would be negative or would be positive but did not specify the impact in percentage terms. Making the assumption that the negative and positive responses cancel one another out and assigning a 'no change' to 'not sure' responses, the survey results indicate a projected industry-wide increase of 2% in the value of Australian production of automotive components as a result of an AUSFTA.

6.4 Overall Economic Impact on the Australian Automotive Industry

The only readily available quantification of the likely economic impact on the Australian automotive industry of an AUSFTA is a Centre for International Economics report titled *Economic Impacts of an Australia-United States Free Trade Area*. In that report (Table 4.5), Australian exports of Motor vehicles and parts⁶ to the US are projected to increase by 10.33%, total import volumes to increase by a modest 1.85% and domestic production to contract by and even more modest 0.79%.

These figures can be compared with FAPM member views of a 0.55% increase in Australian exports of automotive components to the US (compared to the 10.33% modeling estimate for the sector as a whole), a 19% increase in component imports from the US (compared to the 1.85% modeling estimate for the sector as a whole) and a 2% increase in Australian production of automotive components (compared to the 0.79% contraction estimate for the sector as a whole from the modeling exercise).

The CIE comments on its results for the Australian automotive industry in the following terms:

... the majority of additional exports from the US to Australia as a result of AUSFTA are manufactured goods. Accordingly, it is exports of these products from other regions that the US exports displace. For example, US exports of motor vehicles and parts to Australia increase by US\$525 million following Australia's elimination of bilateral motor vehicle and parts tariffs. As US automotive products are now cheaper relative to automotive products sourced from other regions, Australian consumers substitute to the cheaper US products. As such, automotive exports to Australia from the European Union and Japan fall by US\$103 million and US\$181 million respectively. Overall, however, trade creation for Australia, the United States and the world as a whole outweighs the trade diversion.

Further comment on the CIE report and modeling in general is at Attachment B.

⁶ This is an aggregate industry which lumps all industry segments together (e.g. vehicle assembly and automotive component production, as well as goods such as heavy commercial vehicles which would be largely unaffected by an AUSFTA).

7 The AUSFTA Key Issues for the Australian Automotive Industry

7.1 An Unaltered ACIS

ACIS is neutral with respect to automotive trade with any particular country. ACIS is WTO consistent and designed to provide transitional assistance for the Australian automotive industry as it adjusts to lower general levels of tariff assistance. It will be an important policy tool in the Australian industry adjusting also to duty free entry of US-sourced imports as part of an AUSFTA. The Australian Government has only recently re-affirmed ACIS until 2015 with a review in 2008. It is vital that ACIS remain unaltered within an AUSFTA.

7.2 The US Tariff on Commercial Vehicles

With both Holden and Ford gearing up for increased Australian production of AWD vehicles, the 25% US tariff on commercial vehicles should be the primary target for Australian negotiators with respect to automotive access into the US market.

7.3 Domestic Market Safeguard Provisions

Given the size of the US automotive industry, there is a risk for the Australian industry of a significant loss of domestic market share that will not be offset by increased exports to the US. Some 'trigger' system of market safeguard provisions would provide greater certainty for Australian producers particularly given the apparent and widespread uncertainty within the industry as to the net effect of an AUSFTA for local production.

7.4 Clear Rules of Origin

Clear rules of origin are vital if the Australian automotive industry is to have any confidence in the integrity of an AUSFTA. There must be no possibility that either components or vehicles manufactured or assembled in Mexico under NAFTA be allowed to enter free into Australia under an AUSFTA as US goods.

7.5 Exemption from the Provisions of US Government Procurement Rules

Australia should seek exemption from US Federal and State Government procurement preferences as if it were a signatory to the WTO Government Procurement Agreement 1996.

7.6 UAW

The demonstrable influence that the UAW has on limiting exports of automotive products to the US must be addressed in the AUSFTA negotiations. Whether this influence can be curbed through some form of mutual recognition of workplace issues or through some stronger means is a matter which needs further exploration – but a solution to this real problem must be found.

7.7 Other Issues

Anti-dumping: Consideration might be given in an AUSFTA to a provision which excludes anti-dumping action being taken by either member but instead which recognizes each member's competition policy law.

Mutual Recognition of Testing Standards: Work has been underway with APEC for some time on automotive standards issues. FAPM is not sure whether an AUSFTA which sets similar objectives is required or whether it would merely duplicate efforts been made elsewhere. Certainly mutual recognition of testing standards would be a useful advance in achieving product conformity.

Attachment A

Automotive Trade Between Australian and the US

Table A1: Australia's Top 20 Import Sources for Automotive Vehicles

		CY 1996	CY 1997	CY 1998	CY 1999	CY 2000	CY 2001
		A\$'000	A\$'000	A\$'000	A\$'000	A\$'000	A\$'000
1	JAPAN	3,348,651	4,223,805	5,465,270	5,777,015	6,476,622	6,336,771
2	GERMANY	588,499	750,658	1,004,849	1,031,911	1,048,211	1,489,145
3	USA	760,710	647,397	682,185	570,412	734,690	787,917
4	KOREA REPUBLIC OF	764,761	856,645	817,298	670,173	810,471	666,107
5	THAILAND	22,175	83,379	138,694	564,139	751,756	564,075
6	UNITED KINGDOM	331,672	373,353	383,329	339,651	322,415	453,751
7	SOUTH AFRICA	12,013	59,192	94,609	134,446	219,004	320,439
8	SWEDEN	111,040	128,103	138,899	152,862	118,722	150,967
9	FRANCE	22,465	36,517	65,703	47,355	41,278	147,197
10	SPAIN	105,438	72,392	129,049	87,403	78,820	141,271
11	ITALY	29,933	32,960	64,509	78,300	94,195	120,382
12	BELGIUM-LUXEMBOURG	124,633	125,575	107,814	57,135	74,459	98,192
13	AUSTRIA	131,641	83,647	84,075	146,529	159,465	85,533
14	FINLAND	12,809	34,455	33,812	49,465	30,597	55,744
15	MEXICO	24	254	29,494	7,805	47,825	43,217
16	BRAZIL	40	0	51	32	112	37,193
17	NETHERLANDS	1,016	15,030	13,344	25,581	24,781	27,584
18	CANADA	42,954	31,551	75,199	116,450	71,854	20,962
19	MALAYSIA	2,297	36,954	22,113	19,960	30,389	17,528
20	ARGENTINA	0	82	6	0	53	10,060
TOTAL ALL COUNTRIES		6,432,732	7,607,425	9,383,160	9,916,308	11,165,391	11,607,787

Source: <http://www.apecsec.org.sg/committee/auto/australia.html>

Table A2: Australia's Top 20 Export Destinations for Automotive Vehicles

		CY 1996	CY 1997	CY 1998	CY 1999	CY 2000	CY 2001
		A\$'000	A\$'000	A\$'000	A\$'000	A\$'000	A\$'000
1	SAUDI ARABIA	26,818	15,964	252,021	499,126	896,759	1,379,116
2	USA	209,840	435,727	199,085	263,315	375,874	604,661
3	NEW ZEALAND	412,287	241,717	333,290	391,696	358,959	434,906
4	UNITED ARAB EMIRATES	63,023	232,817	147,396	97,812	176,107	218,353
5	KUWAIT	1,239	2,861	54,870	132,421	140,277	185,645
6	INDONESIA	15,054	16,822	7,845	55,428	108,292	97,946
7	OMAN	18,098	43,019	46,575	32,585	49,286	71,176
8	QATAR	505	0	14,555	21,860	34,308	42,483
9	SOUTH AFRICA	64,337	33,382	18,176	20,981	7,983	36,420
10	BAHRAIN	11,438	45,531	49,273	20,024	24,739	28,497
11	THAILAND	31,580	14,553	1,564	28,669	33,027	26,185
12	JAPAN	41,052	45,363	33,256	52,940	49,871	18,719
13	MALAYSIA	39,432	22,130	4,090	23,276	20,423	17,080
14	SINGAPORE	25,958	15,026	3,899	9,408	19,835	12,875
15	UNITED KINGDOM	4,515	3,095	8,366	10,088	13,528	10,203
16	PAPUA NEW GUINEA	24,591	58,816	9,749	5,184	10,691	10,171
17	HONG KONG	1,845	894	2,337	3,114	1,853	9,009
18	PAKISTAN	81	0	0	1	70	7,812
19	NETHERLANDS	513	425	7,369	2,892	1,764	3,919
20	KENYA	1,594	463	3	5,375	3,307	3,826
TOTAL ALL COUNTRIES		1,020,182	1,269,004	1,296,094	1,758,543	2,424,794	3,262,186

Source: <http://www.apecsec.org.sg/committee/auto/australia.html>

Table A3: Australia's Top 20 Import Sources for Automotive Components

		CY 1996	CY 1997	CY 1998	CY 1999	CY 2000	CY 2001
		A\$'000	A\$'000	A\$'000	A\$'000	A\$'000	A\$'000
1	JAPAN	1,443,043	1,483,277	1,573,507	1,640,722	1,973,026	1,928,523
2	USA	1,102,541	1,138,873	1,344,021	1,272,299	1,510,653	1,477,211
3	GERMANY	340,986	331,149	451,286	457,560	427,405	408,517
4	KOREA REPUBLIC OF	145,113	177,961	189,050	169,218	186,728	211,010
5	CANADA	32,560	35,573	43,686	42,041	49,524	195,772
6	CHINA	56,413	72,986	106,339	131,289	172,220	195,655
7	UNITED KINGDOM	217,233	242,581	240,253	173,648	156,456	148,712
8	TAIWAN	104,436	109,063	114,085	119,853	131,893	140,517
9	MALAYSIA	74,129	78,597	93,264	81,511	112,278	126,727
10	THAILAND	19,546	23,214	44,428	69,708	103,415	115,825
11	SWEDEN	108,827	111,271	94,622	95,614	112,629	111,187
12	NEW ZEALAND	78,665	85,413	120,421	104,008	101,470	109,142
13	ITALY	87,775	84,682	99,476	105,169	92,859	100,417
14	SAMOA	59,090	53,564	53,850	56,806	65,355	89,511
15	INDONESIA	31,142	50,213	65,388	70,529	82,383	88,592
16	FRANCE	65,063	70,838	94,332	83,783	84,316	87,403
17	PHILIPPINES	59,808	52,438	62,481	66,115	90,562	82,154
18	SPAIN	61,457	52,696	84,496	79,868	69,944	62,798
19	BRAZIL	30,485	30,787	34,422	28,562	32,015	36,355
20	BELGIUM-LUXEMBOURG	17,301	22,448	27,486	25,942	32,717	36,256
TOTAL ALL COUNTRIES		4,246,270	4,433,591	5,096,891	5,053,680	5,790,910	6,014,610

Source: <http://www.apecsec.org.sg/committee/auto/australia.html>

Table A4: Australia's Top 20 Export Destinations for Automotive Components

		CY 1996	CY 1997	CY 1998	CY 1999	CY 2000	CY 2001
		A\$'000	A\$'000	A\$'000	A\$'000	A\$'000	A\$'000
1	USA	181,203	268,396	373,951	462,678	491,587	486,345
2	KOREA, REPUBLIC OF	239,382	372,809	181,523	255,555	460,317	334,293
3	NEW ZEALAND	153,836	148,326	133,067	136,316	144,933	167,028
4	JAPAN	162,845	175,805	170,787	168,431	215,084	141,828
5	PAPUA NEW GUINEA	40,308	39,910	34,839	33,319	43,966	62,063
6	UNITED KINGDOM	62,786	55,653	80,035	91,153	58,538	54,910
7	INDONESIA	42,944	34,518	15,738	32,438	59,082	51,878
8	SINGAPORE	34,379	31,111	20,518	24,494	28,327	41,395
9	GERMANY	76,674	68,452	35,660	52,690	43,213	24,950
10	SAUDI ARABIA	1,377	1,875	2,637	1,877	19,061	24,880
11	VIETNAM	365	2,813	10,032	7,856	14,256	22,299
12	MALAYSIA	24,702	27,248	7,747	10,116	13,656	21,160
13	BELGIUM-LUXEMBOURG	7,056	12,011	6,919	40,290	16,884	19,939
14	SOUTH AFRICA	28,409	29,796	25,964	18,610	18,896	16,815
15	UNITED ARAB EMIRATES	5,216	5,058	6,010	5,182	7,287	15,213
16	THAILAND	9,619	11,367	9,467	10,191	10,793	14,859
17	CHILE	253	1,092	2,561	1,586	3,192	13,476
18	CHINA	2,574	5,210	6,256	8,562	4,257	12,514
19	CANADA	8,717	10,990	10,710	14,467	13,160	11,975
20	MEXICO	1,054	2,912	1,812	1,852	8,496	11,290
TOTAL ALL COUNTRIES		1,243,345	1,448,079	1,278,232	1,493,610	1,799,221	1,675,421

Source: <http://www.apecsec.org.sg/committee/auto/australia.html>

Attachment B

Quantifying the Likely Effects on the Australian Automotive Industry

Only the CIE report attempts to quantify the likely gains to Australia (and to the US) from an AUSFTA. It summarises its results as follows:

Both Australia and the United States gain from the formation of a bilateral free trade agreement modelled here.

- Welfare (as measured by real household consumption) and production (as measured by GDP) rise for both countries over time, with the removal of barriers to trade assumed to be over a five year period.
- Using the APG-Cubed model, by 2006, when full implementation of the FTA is assumed, Australian welfare could be nearly 0.3 per cent above what it might otherwise be. This continues to rise to 0.4 per cent by 2010 and 0.5 per cent by 2020. For the United States, welfare peaks in 2006 at 0.016 per cent above what it otherwise might have been.
- Australian GDP could be 0.33 per cent higher by 2006. This gap would then continue to widen, levelling off by 2010 at 0.4 per cent of GDP — an annual increase in that year of nearly US\$2 billion.
- US GDP, even though rising only by 0.02 per cent above what it might otherwise be, still amounts to an annual increase of US\$2.1 billion in 2006.

Expressing the stream of net benefits over the next 20 years in net present value terms, the gain in welfare to Australia could be US\$9.9 billion and for the United States US\$10.3 billion (chart 1).

- For GDP, the net present value of benefits is US\$15.5 billion for Australia and US\$16.9 billion for the United States.
- In terms of the share of GDP, the gains to Australia are bigger. This reflects the greater relative importance of the bilateral trade to Australia than the United States, the fact that a couple of key sectors, such as sugar and dairy stand to expand with the removal of the United States' tariffs, and a slightly higher average barrier removed in Australia.
- For both economies the rise in exports is greater than imports and Australia's current account (expressed as a percentage of GDP) improves by 0.9 per cent, while there is a negligible change for the United States.
- Overall, world exports rise showing that trade creation is greater than trade diversion as a result of forming the free trade area. (New Zealand is one of the main third party beneficiaries since its trade with Australia is relatively important and so it benefits from Australia's expansion. In addition, New Zealand picks up some of the trade diversion in dairy products as Australia shifts product from Asian markets to the United States).

The GTAP (Global Trade Analysis Project) model captures all trade and resource use interactions in an economy-wide setting and allows detailed commodity effects to be reported. Using this model, the important points are as follows.

For Australia the largest gains are in sugar and dairy. The price of sugar in Australia could rise by 13 per cent and the output of raw sugar could rise by 7.8 per cent. Exports of sugar to the United States could rise by 2 550 per cent, but that is off a very low base of just 85 000 tonnes. This represents an initial increase of US\$442 million per annum. Even though Australian exports to the United States rise considerably, this still represents a small share of the United States market and has a small impact on US prices and output. Over time, the impact would be larger.

For the United States the main gain is in the manufacturing sector. Exports of motor vehicles and parts to Australia could rise by 46.6 per cent and exports of metal products could rise by 25.2 per cent.

Although the kinds of modeling deployed above assume that trade in products produced by individual industries are imperfect substitutes for one another (so that, for example, neither Australian nor US automotive producers capture all the market when an AUSFTA-induced change in relative prices favour a particularly country), the values assigned to the parameters⁷ determining the extent of substitution that will actually occur are merely 'guesstimates.' Another aspect of what could happen in the case of the Australian automotive industry as a result of an AUSFTA (the exit of a vehicle manufacturer) is not easily handled in a modeling framework because such an event would represent a discrete (and large) change, whereas the models deployed assume change will be incremental rather than discrete/discontinuous. This means that industry insiders may well be better informed of the likely effects of an AUSFTA on the Australian automotive industry than the kinds of models deployed by the CIE.

⁷ Known as import substitution elasticities.

Attachment C

Influences on Firms' Sourcing Decisions

Vehicle producers tend:

- to outsource activities that are perceived to be non-critical to their operations (the history of the automotive industry world wide has been one of increasing outsourcing of components);
- to establish close relationships with suppliers (e.g. to the point where they can achieve just-in-time delivery of components for incorporation into the assembly line);⁸ and
- to reduce the supplier base over time (e.g. by demanding that component suppliers increasingly deliver complete sub-assemblies/assemblies for incorporation into vehicles — even to the extent that such suppliers assume design and quality control responsibilities).⁹

As alluded to above, many considerations can come into play when vehicle producers decide on which components they will make in-house and which they will buy in — including price, fitness for purpose, reliability, availability, flexibility of sourcing, and security and predictability of the supply chain generally. The emergence of 'just-in-time' inventory strategies also means that the cost (and risk) of holding inventories of components is increasingly shared between component and vehicle producers.

Various researchers have studied the choice of in-house versus outsourced supply, and of local versus international sourcing. A popular way of thinking about such decisions is depicted below — where the alternatives of in-house production, exporting or foreign direct investment (FDI) in the target country are considered within what has been called the OLI framework (see over).

A necessary condition for a firm to invest abroad is that its net ownership advantages in serving particular markets must exceed the advantages of other firms. These ownership advantages derive largely from the possession of intangible assets that are exclusive or specific to the firm at least for a period of time. Examples of such intangible assets include advanced technology, superior production techniques, patents, trademarks, management skills and exclusive access to markets or raw materials.

As highlighted in the diagram below, an alternative to exporting automotive components from Australia to the US is to set up operations over there (via FDI). Hymer (1976)¹⁰ considered that FDI (of which there are already examples — see main report) is motivated by a firm seeking to increase its profits by exploiting its inherent advantages in another country.¹¹ He argued that firms indigenous to a particular country possess home country advantages, such as better knowledge of the host country's language,¹² laws and politics. To be successful in an alien environment, the investing firm's 'ownership advantages' would therefore need to more than offset the home country advantages possessed by competing home country firms.

⁸ This, of course, generally rules out foreign suppliers unless they are still in relatively close proximity (e.g. US producers sourcing from component producers in Mexico).

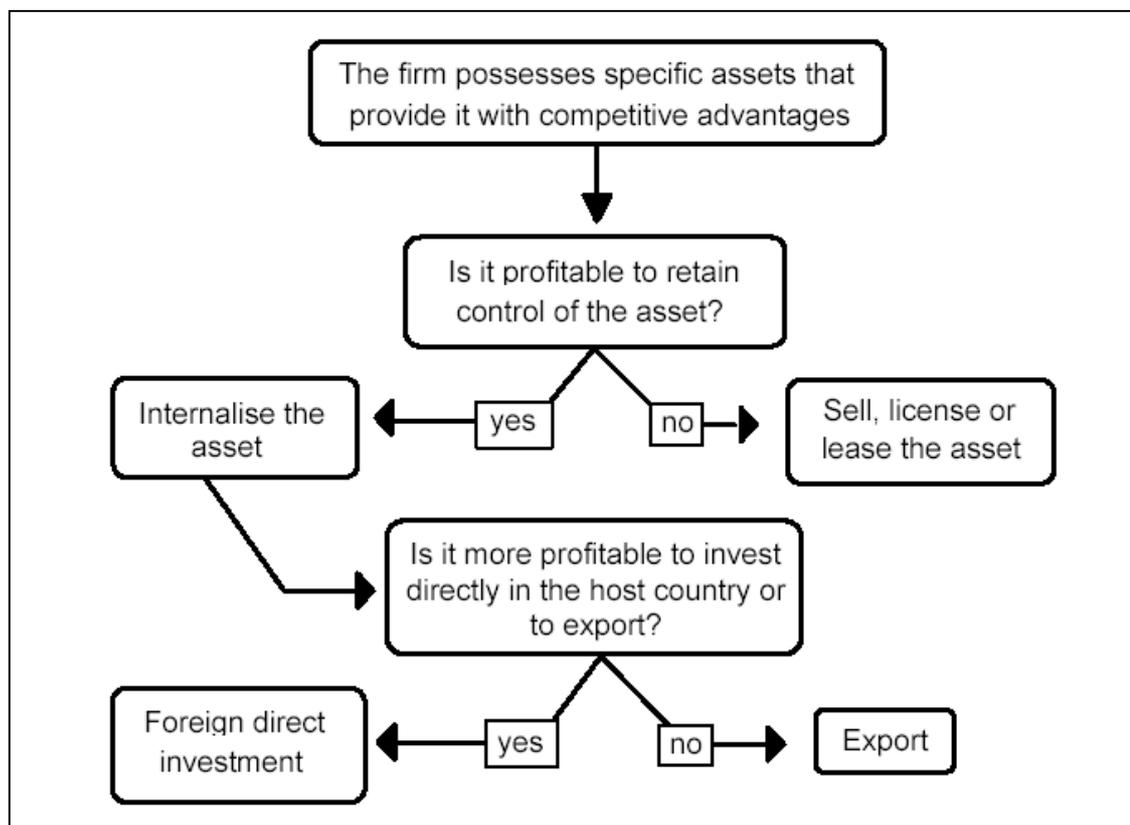
⁹ This trend leads to the increasing dominance of relatively large firms in the component supply sector.

¹⁰ Hymer S. H. (1976), 'The theory of international operations,' reproduced in Gomes-Casseres B. and D.B. Yoffie (eds) (1993), *The international political economy of direct foreign investment*, Volume I, Edward Elgar, Brookfield, Vermont.

¹¹ Such advantages might include access to patented technology, specific management or marketing skills and ownership of brand names.

¹² An obvious advantage of an AUSFTA would be that English is a common language.

OLI Framework



Source: Adapted from Dunning (1993)¹³ and BIE (1993, 1995).¹⁴

Other considerations outside the influence of the firm also impinge on sourcing decisions.

Thus, overlaying the microeconomic decisions of firms are changing relative rates of return between the investing firms' host country and alternative foreign locations for their activities. Changing relative rates of return reflect, in part, different macroeconomic policies and their impacts on, for example, exchange rates and the relative costs of capital between the firms' domestic economy and overseas markets. For example, a fall in the relative price of the host country's currency will make foreign assets cheaper, therefore providing an impetus to FDI.

Similarly, changes in taxation and a decline in the domestic share market can make foreign investment more attractive. Moreover, to the extent that a host country's economic growth reflects its macroeconomic and microeconomic policy choices, there could be indirect or 'second round effects' on the relative attractiveness of investment at home or abroad. Clearly, similar factors also influence the relative attractiveness of investing in different countries. In the longer term, the major macroeconomic factor influencing firms' foreign investment decisions is the countries' comparative advantages. Underlying a country's comparative advantage is its factor endowments: its abundance of capital, labour and land (including minerals) relative to other countries. A country's advantage changes as it develops (e.g. its endowments of physical and human capital grow, and its real wages and living standards rise).

¹³ Dunning J. H. (1993), *The globalisation of business*, Routledge, London

¹⁴ Bureau of Industry Economics (BIE 1993), *Multinationals and governments: Issues and implications for Australia*, Research Report 49, AGPS, Canberra and BIE 1995, *Investment abroad by Australian companies: Issues and implications*, 95/19, AGPS, Canberra.

Finally, sourcing decisions may be made by parent companies (head office) — possibly overruling the preferences of subsidiaries or affiliates of multinational enterprises (MNEs). This can occur, for example when MNEs pursue global supply chain management strategies, or assign exclusive responsibility for particular markets to individual subsidiaries in the interests of simplicity or workability (as often happens in the global automotive industry). Studies suggest, for example, that local subsidiary management is more likely to advocate local sourcing — perhaps partly because they are more sensitive to the attitudes of host country governments (which are always keen to maximise local value added).

Indeed, firms' business strategies can change over time — often progressing through four distinct stages:

- an initial stage of domestic focus;
- a second stage of initial entry to a foreign market;
- a third stage of overseas 'beachhead' expansion; and
- a final stage of global rationalisation.

Additionally (and unsurprisingly), advances in transportation and communications have reinforced the world-wide trend towards the increasingly global dispersion of production in the case of both vehicles and components.