



Australia's textile, clothing and footwear industries

What future after 2005?

Australian Industry Group submission to the Productivity Commission review of post-2005 arrangements for the textile, clothing and footwear sector

February 2003

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SUMMARY AND RECOMMENDATIONS

Australia's textile, clothing and footwear (TCF) industries are going through a process of great change. After decades of government support through tariff protection and industry assistance, the sector is increasingly facing the realities of a global, open and competitive market environment.

The Commission has been asked by the Government to evaluate current assistance arrangements for the textile, clothing and footwear sector, to provide policy options for post 2005 assistance and to report on a range of related matters that will affect the sector's long term viability.

Ai Group's submission reports the view of TCF companies on these matters. In summary, based on Ai Group's survey of 123 companies in the TCF sector, with sales of over \$1.2 billion (10% of all sales), the industry appears uncertain in its views on the future of government assistance after 2005. While the majority of surveyed companies are prepared to accept lower tariffs after 2005, support comes with expectations of a pause in tariffs till 2010 and continuation of industry assistance under the Strategic Investment Program (SIP). Despite this, many are opposed to any further lowering of tariffs, particularly if not supported by reciprocal action from competing countries.

Industry Adjustment Process

Faced with lower tariffs from 2005, firms have adopted measures involving a mix of downsizing domestic operations (including staff cuts, moving production offshore and other rationalisation), and an increasing focus on pursuing growth strategies (including product development, new capital equipment, exports and more R&D).

Firms receiving SIP funding were much more likely than firms not participating in SIP to have:

- Introduced new capital equipment;
- Engaged in product development;
- Undertaken more R&D activity;
- Started to export or expand exports;
- Improved supply chain control; and
- Improved labour flexibility.

Similar to trends emerging in the lead up to tariff reductions in 2005, survey results show that most of the focus on future growth strategies and technological improvement is accounted for by firms receiving SIP funding. Looking forward, these firms placed a significantly higher level of importance on measures aimed at boosting R&D activity than they had in the past. Given its relationship to product development, it is not surprising that SIP funded firms looked to product development for future growth. As well, capital investment remained at high priority.

The Strategic Investment Program (SIP)

The Textile, Clothing and Footwear Strategic Investment Program (SIP) is designed to foster the development of sustainable, competitive TCF industries in Australia during the transition to a more competitive trading environment post-2005. A total of \$677.7 million over five years is provided under SIP.

A close examination of the distribution of SIP funding would suggest that the program is inherently geared towards the textile and carpet sub-sectors. Relative to the distribution of establishment and sales, clothing and footwear firms are significantly under-represented in the program, making up 77% of establishments (and 44% of sales) but receiving only 36% of funds. This is in contrast to textile (including technical textiles) firms which constitute 18% of firms and 37% of sales, yet get 44% of funding.

Feedback from the survey indicates that SIP has had a positive impact on company behaviour and performance. Over 93% of firms benefited from new investment, 78% from new R & D, and 72% from related efficiency/productivity gains.

Despite the success of SIP, both among SIP fundees and non-SIP firms there remains support for improved flexibility in the program. SIP recipients overwhelmingly favoured allowing funding for efficiency improvements and a more flexible definition of innovative design and process. As well, they supported quarterly SIP payments.

The review of SIP above has highlighted the need to provide for enhanced flexibility in the program. More firms should be given access, the rules should be applied less rigidly, process efficiency improvements should be supported, and some degree of modulation encouraged. As well, funding should better reflect the distribution of activities and firms within the TCF sector.

These changes rather than weaken the effectiveness of the program would strengthen its focus on investment and research and development by supporting more initiatives across a broader number of firms. As our analysis has shown, SIP funding has facilitated greater effort by funded companies.

Consequently, Ai Group recommends:

- Rec 1 *The continuation of the Strategic Investment Program (SIP) beyond 2005.***
- Rec 2 *That SIP funding arrangements be changed to provide for a greater degree of flexibility in funding investment, R & D, and process improvement activities.***
- Rec 3 *That degree of modulation of funding be allowed to facilitate greater company access to the program.***

Market Access

The import tariff on clothing and finished textiles currently stands at 25%. For cotton sheeting, fabric, carpet and footwear the import tariff is 15%, and for sleeping bags, table linen and footwear a tariff of 10% applies on imported goods. In 2005, the tariff will fall to 17.5%, 10% and 7.5% respectively.

Responses from firms in the TCF sector indicates that a further lowering of tariffs after 2005 would have a significant negative impact on the domestic operations of firms.

The Ai Group survey indicated that significant falls would be likely for:

- Local production (with 85% of firms citing a probable decline);
- Employment (74%);
- New investment (60%); and
- Selling prices (57%).

At the same time, 78% of firms indicated that imports would rise, and 66% cited a probable increase in offshore production.

The industry has mixed views about the future direction of import tariffs after 2005. Overall, 43% of firms would not support a decline in tariffs after 2005, with an additional 11% unsure. However, such support was contingent on a pause in tariffs until 2010 and continued government support for domestic TCF firms. Firms receiving SIP funding were more likely to support a reduction in tariffs (subject to continued support for the industry) than firms not participating in the SIP.

It is clear that further reductions to tariffs after 2005 will force more closures and transfer of operations offshore, particularly for those firms who are not

supported through the SIP program. This is a heavy cost to pay if our trading partners are slow or resistant to lower both their tariff and non-tariff barriers.

Ai Group holds strongly to the view that there should be a pause in tariff reductions after 2005. It therefore recommends:

Rec 4 No reduction of import tariffs after 2005 be contemplated until tariff and non-tariff barriers in overseas countries are reduced proportionately to levels that exist in Australia.

As well, the Federal Government operates an Expanded Overseas Assembly Provisions Scheme (EOAP), which enables Australian firms to import duty free finished products using Australian pieces. This program is supported by companies who make use of the EOAP scheme (although many TCF firms who don't have mixed views) and enables Australian TCF firms to combine their expertise in product design and global marketing with the benefit of low cost of production from offshore sites to remain competitive on the domestic markets with imports. Ai Group therefore recommends:

Rec 5 That the Expanded Overseas Assembly Provisions Scheme be continued beyond 2005.

Consideration of domestic assistance arrangements for firms participating in the TCF sector, must be viewed in the context of a fully global TCF market. Accordingly, Ai Group believes it is vital to consider assistance regimes in other economies.

Tariff and non-tariff barriers imposed by other countries are significant constraints to developing exports of Australian TCF products.

The removal (or indeed significant reduction) of import tariffs would have an immediate impact on Australian exports of TCF products. Tariffs remain a significant barrier for the TCF industry, particularly in the developing world. Non-tariff barriers are certainly harder to identify, substantiate and possibly eradicate. It is vital that they are not overlooked however, as their practice can be equally restrictive. The benefits of multilateral tariff reduction could well be negated if NTMs are permitted in their place. Accordingly, Ai Group recommends:

Rec 6 The Australian government pursues trade liberalisation via the World Trade Organisation.

Rec 7 Simultaneously continue to seek favourable bilateral trade and sub-regional trade and economic conditions with key overseas markets.

Industrial Relations

The TCF sector has had its fair share of difficult industrial relations issues. In the more recent past the disputes at Feltex Australia and Godfrey Hirst Australia over enterprise agreements are just two examples. The emotional issue of protection of employee entitlements involved significant and very disruptive stoppages.

Results from the Ai Group survey of firms in the TCF sector show that only 16% of firms viewed the industrial relations climate as good or very good. In comparison, 54% described the climate as average, and 30% poor or very poor.

The issue of broader cooperation between the union and employers in the industry is one that requires serious consideration, especially given the findings of the Ai Group survey, which found that only 4% of firms believed

union activity helped in the development of the TCF sector. In total, 68% of firms indicated union activity hindered the development of the sector (27% were unsure).

In order to facilitate the continued development of a sustainable and competitive TCF sector to the end of the decade Ai Group recommends:

- Rec 8 Suitable training programs dealing with effective grievance resolution and employee relations be developed and overseen by a genuinely independent body.***
- Rec 9 Additional powers be available to the AIRC to suspend or terminate a bargaining period. The additional powers would relate to situations where protected action is:***
- Causing significant damage to an enterprise***
 - Significantly endangering the welfare of employees in an enterprise***
- Rec 10 Protected action be outlawed for the purposes of pattern bargaining.***
- Rec 11 The AIRC be given the power to establish a cooling off period in appropriate circumstances.***
- Rec 12 Secret ballots be mandatory before protected action can be taken.***
- Rec 13 The Workplace Relations Act be amended to clarify that protected action cannot be taken prior to the expiry date of a certified agreement.***

Rec 14 *An industry representative body including representation from the Ai Group and the ACTU and TCFUA be set up to explore various industry-level matters of mutual interest and endeavour to develop worthwhile initiatives of benefit to the industry.*

THE KEY ISSUES

Australia's textile, clothing and footwear (TCF) industries are going through a process of great change. After decades of government support through tariff protection and industry assistance, the sector is increasingly facing the realities of a global, open and competitive market environment.

Where once the sector was a key foundation of the Australian economy – providing jobs, investment and growth particularly in regional economies – and was particularly important in the settlement process for Australia's post-war immigrants, the sector is now searching for a new future.

Over the last few years, the sector has undergone an intense round of self-inspection and review, with mountains of documents being produced setting out action agendas, strategy plans, vision statements, blueprints for the future, and strategic reviews. While these studies are a positive approach by the sector to determine its own future, they also highlight the uncertainty the industry feels about its place in the global marketplace.

This is not to deny that the sector had, and continues to have, many successes. Our fashion houses are among the best in the world. Exports have grown strongly over the last decade, investment and research and development are stronger, and the sector still employs over 88,000 people. Each year the sector purchases over \$7 billion of inputs from other Australian industries.

The TCF sector is also important for certain metropolitan and regional economies, where the industry is concentrated in inner Melbourne, West Sydney, Wollongong, Newcastle, Geelong, Warrnambool, Wangaratta and Wodonga.

Productivity Commission review

Given the considerable efforts the industry has taken to set its own future, is there a need for another review?

At a simple level, the answer is yes because the Federal Government committed itself to a formal review when it announced in late 1997 its package of assistance to take the industry to 2005. Given the investment that the Federal Government has put into the sector, totalling \$216 million in 2001/2, a review is appropriate.

However, at a more complex level, any review needs to complement and support the considerable work the industry has already put into its future. The ATCFL Forum Strategic Plan, **TCFL 2012**, sets out a blueprint for the industry to grow in a globally competitive environment. It should provide the starting point for the Productivity Commission's review.

The Commission has been asked by the Government to evaluate current assistance arrangements for the textile, clothing and footwear sector, to provide policy options for post 2005 assistance and to report on a range of related matters that will affect the sector's long term viability.

The Government has specifically asked the Commission to:

- evaluate the effectiveness, efficiency and appropriateness of current assistance programs in meeting the Government's goal of achieving structural change and a more internationally competitive TCF sector by 2005;
- identify and analyse major impediments to the long term viability of the TCF sector;
- identify major opportunities for the sector and its strengths and weaknesses for securing these opportunities;
- identify and analyse post 2005 policy options, including tariff options, consistent with the Government's international obligations, which

would encourage the sector to adjust to a more viable and sustainable competitive position, with particular attention to the impact of those policy options on regions where TCF accounts for a high level of regional industry concentration;

- examine relevant workplace issues; and
- report on the likely impact on the TCF industries of international trade developments.

Ai Group's submission reports the view of TCF companies on these matters. In summary, based on Ai Group's survey of 123 companies in the TCF sector, with sales of over \$1.2 billion (10% of all sales), the industry appears uncertain in its views on the future of government assistance after 2005. While the majority of surveyed companies are prepared to accept lower tariffs after 2005, support comes with expectations of a pause in tariffs till 2010 and continuation of industry assistance under the Strategic Investment Program (SIP). Despite this, many are opposed to any further lowering of tariffs, particularly if not supported by reciprocal action from competing countries.

Further, many in the industry believe changes need to be made to SIP arrangements to enhance flexibility. A range of key issues have been identified which form the basis of Ai Group's submission.

Key issues

Consistent with the Terms of Reference, Ai Group has identified a number of key issues for consideration and comment in its submission.

Issue 1 Nature of industry adjustment

The TCF sector has now had five years to adjust to the prospects of lower tariffs in 2005. What action companies have taken is important in understanding the process of change taking place within the sector. It also

provides a basis of comparing what further action is available to the industry to continue to adjust to change.

Issue 2 The Strategic Investment Program

Current arrangements for the TCF sector came into effect in 2000/01. Under the Strategic Investment Program Scheme (SIP), the industry can apply for grants in respect of new investment, research and development, value adding, the purchase of second hand plant and equipment, and restructuring initiatives.

The critical issue is what will be the nature of the assistance, if any, to be provided after 2005. While SIP has been in operation for only two years, there may well be a case for further fine-tuning of the program.

Issue 3 The future of tariffs after 2005

The import tariff on clothing and finished textiles currently stands at 25%. For cotton sheeting, fabric, carpet and footwear the import tariff is 15%, and for sleeping bags, table linen and footwear a tariff of 10% applies on imported goods. In 2005, the tariff will fall to 17.5%, 10% and 7.5% respectively.

The Federal Government operates an Expanded Overseas Assembly Provisions Scheme (EOAP), which enables Australian firms to import duty free finished products using Australian pieces.

The critical issue facing the industry is whether tariffs will continue to fall after 2005. Related to this is the level of tariff and non-tariff barriers that will apply to our major trading partners.

Issue 4 Workplace relations

The Terms of Reference for the review require the Commission to consider workplace issues. The pace of change and adjustment to lower tariffs

depends on the industry and its workers working together to become more competitive and efficient.

The TCF has historically been a sector that has experienced high levels of industrial disputation. The critical issue facing the industry is whether this environment of conflict is the best interest of the industry, employers and employees.

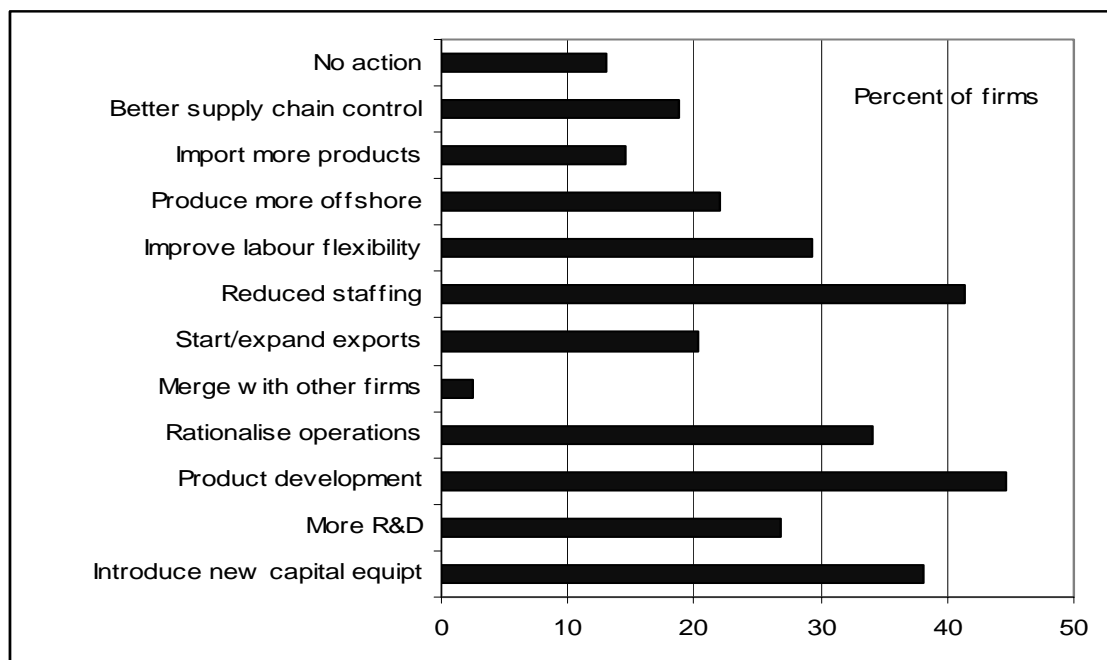
INDUSTRY ADJUSTMENT PROCESS

Ai Group survey

In January 2003, Ai Group undertook a survey of members in order to ascertain company views on post-2005 assistance arrangements for the TCF sector. The survey covered the responses of 123 TCF firms employing 7,500 persons, with combined sales of almost \$1.2 billion in 2001-02 (around 10% of Australia's TCF sector).

The survey provides an indication of the measures firms have implemented over the last five years in preparation for a further reduction in TCF tariffs in January 2005. Ai Group also collected information on the likely response of firms to a further reduction in tariffs sometime after 2005.

Chart 1 Adjustment strategies in preparation for reduced tariffs



Confronted by lower tariffs from January 2005, the most common strategic (chart 1) response measures implemented by firms in the TCF sector have involved product development (45% of firms) and reduced staffing (42%).

Other key measures implemented (identified by more than 20% of firms) include:

- Introduction of new capital equipment (38%);
- Rationalisation of operations (34%);
- Improved labour flexibility (29%);
- More research and development (27%);
- Start/expand exports (20%); and
- Producing more offshore (22%).

Overall, the results suggest that faced with lower tariffs from 2005, firms have adopted measures involving a mix of downsizing domestic operations (including staff cuts, moving production offshore and other rationalisation), and an increasing focus on pursuing growth strategies (including product development, new capital equipment, exports and more R&D).

The wide range of strategies adopted by firms would appear to reflect the increasing level of global competition in the TCF sector, and the associated pressures on firms to cut costs and maintain product quality.

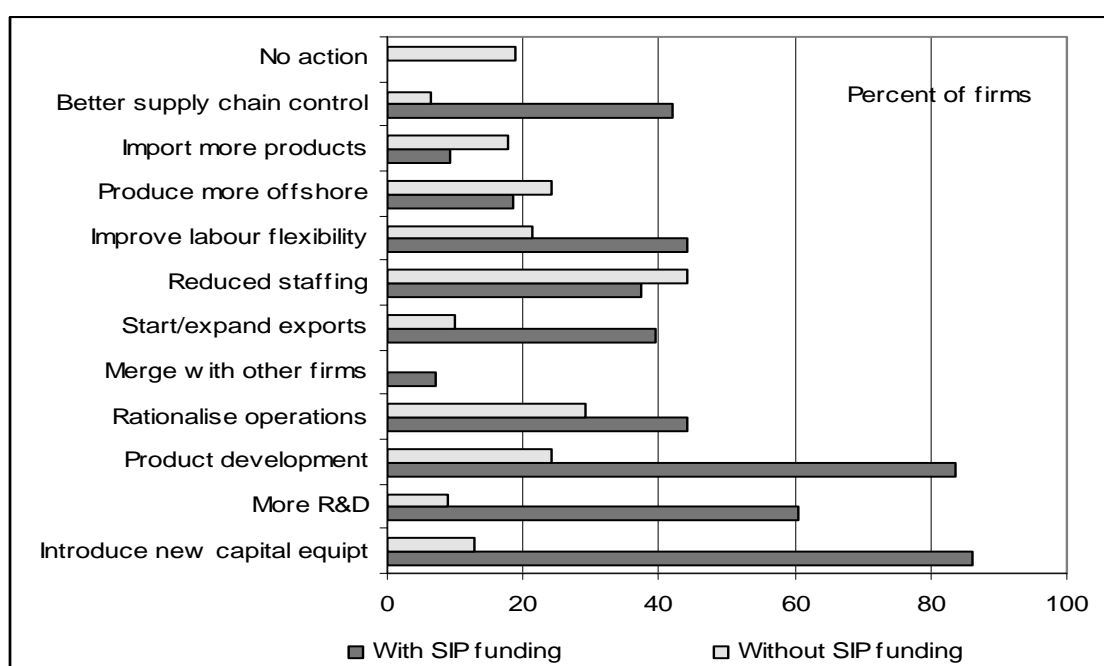
A further examination of results indicate that companies receiving funding under SIP have been more inclined to undertake measures aimed at growing markets and improving products than those not receiving funding (chart 2).

Firms receiving SIP funding were much more likely than firms not participating in SIP to have:

- Introduced new capital equipment;
- Engaged in product development;

- Undertaken more R&D activity;
- Started to export or expand exports;
- Improved supply chain control; and
- Improved labour flexibility.

Chart 2 Adjustment strategies, SIP compared to non-SIP participants



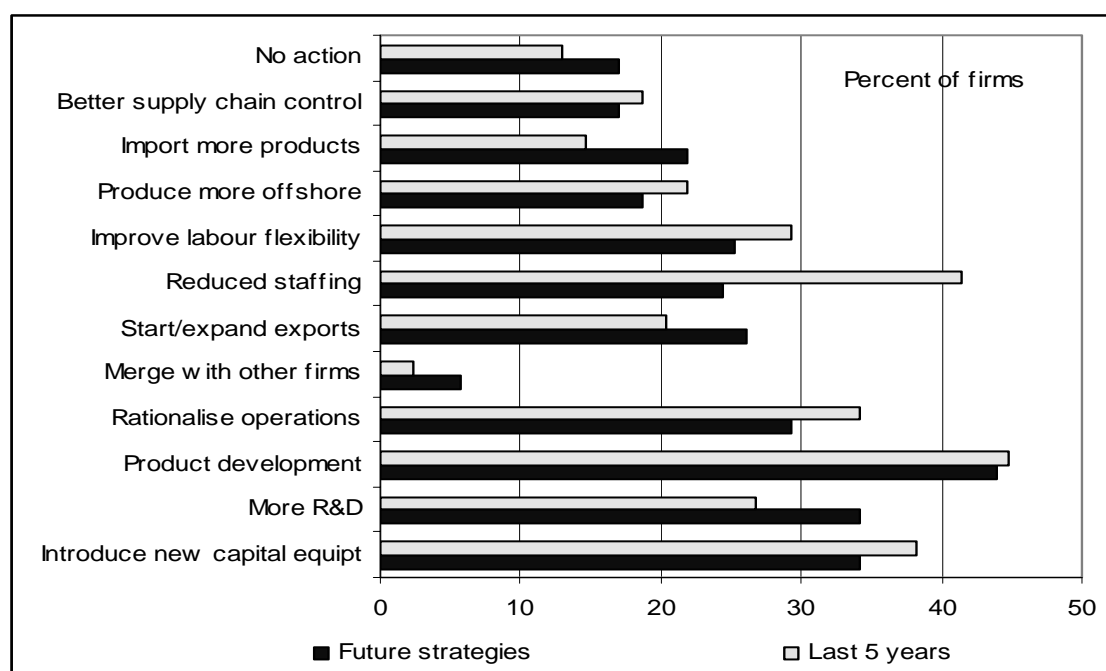
These firms were also more likely to have rationalised operations. In part this probably reflects the finding that firms receiving funding under SIP were more likely to have taken *some kind of action* in response to lower tariffs from 2005, as opposed to firms not receiving SIP funding (the survey revealed that all firms indicating no action had been taken in preparation for lower tariffs in 2005 were not participants in SIP).

Firms participating in SIP were also less likely to have imported more products, moved production offshore and reduced staffing as part of response measures to lower tariffs from January 2005 (perhaps not surprising given the investment focus of the program).

Companies were also asked to identify likely measures they would undertake should tariffs fall further in 2010, after a pause from 2005. The survey results suggest that looking forward, strategies aimed at growing markets and new technology, including product development and new capital equipment, will remain important (chart 3).

However, there appears to be more of a focus among firms on R&D activity and expanding imports and exports, indicating that there is significant upside potential for a greater focus on innovation and technological development within the TCF sector. Also notable is the lower emphasis placed on reducing staff levels, probably reflecting the significant amount of job shedding in the sector over the last decade. This would indicate that it is becoming more difficult for firms in the TCF sector to reduce staffing as a means to confront future challenges.

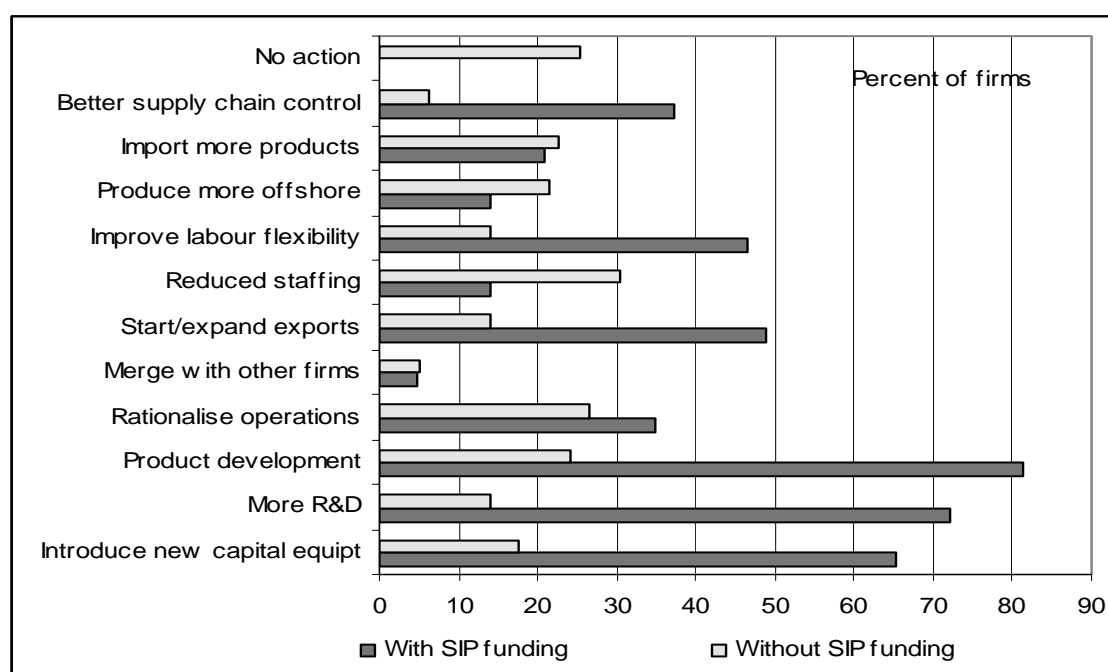
Chart 3 Likely future adjustment strategies



Similar to trends emerging in the lead up to tariff reductions in 2005, survey results show that most of the focus on future growth strategies and technological improvement is accounted for by firms receiving SIP funding (chart 4). Looking forward, these firms placed a significantly higher level of importance on measures aimed at boosting R&D activity than they had in the past. Given its relationship to product development, it is not surprising that SIP funded firms looked to product development for future growth. As well, capital investment remained at high priority.

For all three strategies – R & D, product development and investment – the behaviour of SIP funded companies was in contrast to non-SIP participants, where these remained a low priority.

Chart 4 Likely future adjustment strategies, SIP compared to non-SIP participants



One in four (25%) firms not receiving SIP funding indicated they are likely to take no action in the face of a reduction in tariffs from 2010 (an increase on

the 19% of these firms who indicated they had not taken action in the lead up to lower tariffs in 2005). These firms also indicate that should tariffs be reduced further from 2010, future measures would continue to focus on staff reduction and rationalisation of operations, and to a lesser extent, product development, higher imports and moving more production offshore.

In addition to collecting information on firm adjustment measures to lower tariffs, the survey also collected other data covering:

- The potential impact of any reductions in TCF tariffs on production, investment and employment;
- Utilisation of the Strategic Investment Program (SIP) within the TCF sector;
- Potential improvements to the SIP;
- The major impediments to the long term viability of the TCF sector, and
- Exports and barriers to trade.

These will be discussed in more detail in relevant sections of this submission.

THE STRATEGIC INVESTMENT PROGRAM (SIP)

The Scheme

The Textile, Clothing and Footwear Strategic Investment Program (SIP) is designed to foster the development of sustainable, competitive TCF industries in Australia during the transition to a more competitive trading environment post-2005. A total of \$677.7 million over five years is provided under SIP.

The Scheme provides incentives in the form of grants to promote investment, innovation and value adding in the Australian TCF industries.

The Scheme is open to entities undertaking TCF manufacturing and/or design for manufacturing activities in Australia. Five types of grants are available, all paid annually and in arrears:

- Type 1 grants for new plant & equipment/buildings;
- Type 2 grants for research & development (including innovative product development);
- Type 3 matching value added grants;
- Type 4 special grants for second hand plant and equipment for restructuring initiatives in TCF dependent communities, and;
- Type 5 special miscellaneous grants for ancillary activities relating to restructuring initiatives in TCF dependent communities.

Types 1-3 grants are the mainstream grants, and are assessed by AusIndustry, while Types 4 and 5 grants are project specific and involve Ministerial approval.

Types 1-3 grants are calculated as follows:

- up to 20% of eligible new plant & equipment/building investment expenditure;

- up to 45% of eligible expenditure on research & development type activities;
- up to 5% of the TCF value added by the entity in Australia in the year of the claim, limited to the total value of benefits earned under grant Types 1 and 2 in that year.

For Types 4 & 5 grants, benefits will be up to 20% of eligible expenditure.

A participant must incur \$200,000 worth of eligible expenditure before a grant can be made. The \$200,000 of eligible expenditure can be accumulated to enable participants to build up their investment credits over the five years of the program.

Each participant's total benefits under SIP in any one year will be limited to 5% of their total eligible revenue in the twelve months preceding the claim year.

The issues

The ***Textile, Clothing and Footwear Strategic Investment Program Act 1999*** sets out the provisions for the operation of the program.

Unlike the ACIS automotive assistance program which sets out an overall purpose for the program¹, the legislation for SIP sets no clear program objective other than to make grants and /or loans in connection to the five type of grants.

However, the Explanatory Memorandum to the Bill does state that “the Scheme is aimed at providing an investment incentive to leverage a cultural change towards international competitiveness and global integration of the

¹ Namely to “provide transitional assistance to encourage competitive investment and innovation in the Australian automotive industry in order to achieve sustainable growth, both in the Australian market and internationally, in the context of trade liberalisation”

Australian TCF industries". The Minister in the Second Reading Speech of the Bill highlighted the two key objectives of the Scheme being to encourage Australian TCF firms to increase their investment in new plant and equipment and undertake increased levels of research and development and product development.

Therefore in terms of evaluating the SIP program, the key issues that need to be addressed are:

- Whether the program is meeting its objectives;
- Is there a need for further fine-tuning, such as providing for greater modulation; and
- Should SIP continue beyond 2005.

While SIP has been in operation for only two years, it is clear that some fine tuning may be necessary. This view is in contrast to the review undertaken by the Department of Industry, Tourism and Resources, which essentially concluded of its own program that it is working well and requires little change.

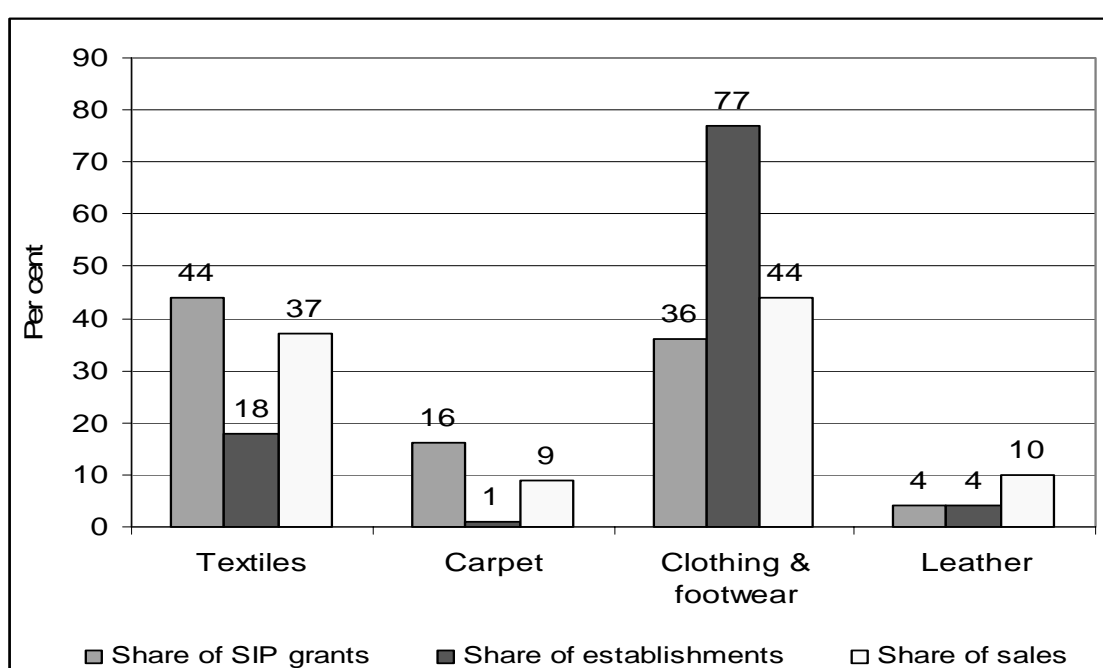
As the previous section highlighted, those companies that have received assistance under SIP have experienced significantly different behaviour from those who have not. The rate of investment, R & D and more broadly defined efficiency improvements for funded companies has been significantly higher than non-funded companies.

However, whether it has impacted on the overall level of investment and R & D in the industry is indeterminate given that the program is relevant for only one in twenty companies. For most TCF companies, the process of adjustment to lower tariffs has been determined solely by market forces and imports.

Unlike the Department who argue that the sectorial distribution of grants to the 5% of TCF firms who get funding is fair and balanced, a closer examination of the distribution would suggest that the program is inherently geared towards

the textile and carpet sub-sectors. Chart 5 below shows relative to the distribution of establishment and sales, clothing and footwear firms are significantly under-represented in the program, making up 77% of establishments (and 44% of sales) but receiving only 36% of funds. This is in contrast to textile (including technical textiles) firms which constitute 18% of firms and 37% of sales, yet get 44% of funding.

Chart 5 Distribution of SIP grants relative to industry measures



As well, the Department review dismissed a number of concerns raised by TCF companies. It noted however that a clearer articulation of the aims and specific objectives of SIP may be required, for which Ai Group is in agreement.

Industry concerns about the operation of SIP are understandable given the contrast to ACIS, the government assistance program for the automotive industry. In broad terms, the contrast between the two highlight the dilemma:

- ACIS is available to all car companies and nearly all (tier one) component manufacturers, SIP is available to only a few (5% of the industry)
- ACIS has a low sales threshold for entry, SIP has a high \$200,000 R & D and/or capital expenditure threshold.
- ACIS adopts a broad approach to eligible expenditure for R & D, SIP appears to have a narrow definition.
- ACIS funds product development and process efficiency improvements, SIP offers limited support.
- ACIS pays companies quarterly, SIP pays annually.
- ACIS modulated available funds, SIP has not up to now.

While the number of TCF companies far exceeds those in the automotive sector, necessitating the need for tighter guidelines, it could be argued that these are designed more to exclude rather than include participation. This is particularly so given the resistance to modulation.

While Ai Group would not advocate throwing the scheme wide open, as it **must** maintain its focus on strategic investment and R & D, some fine tuning to enable greater flexibility should be considered. Modulation of funds would facilitate this happening.

The views of companies

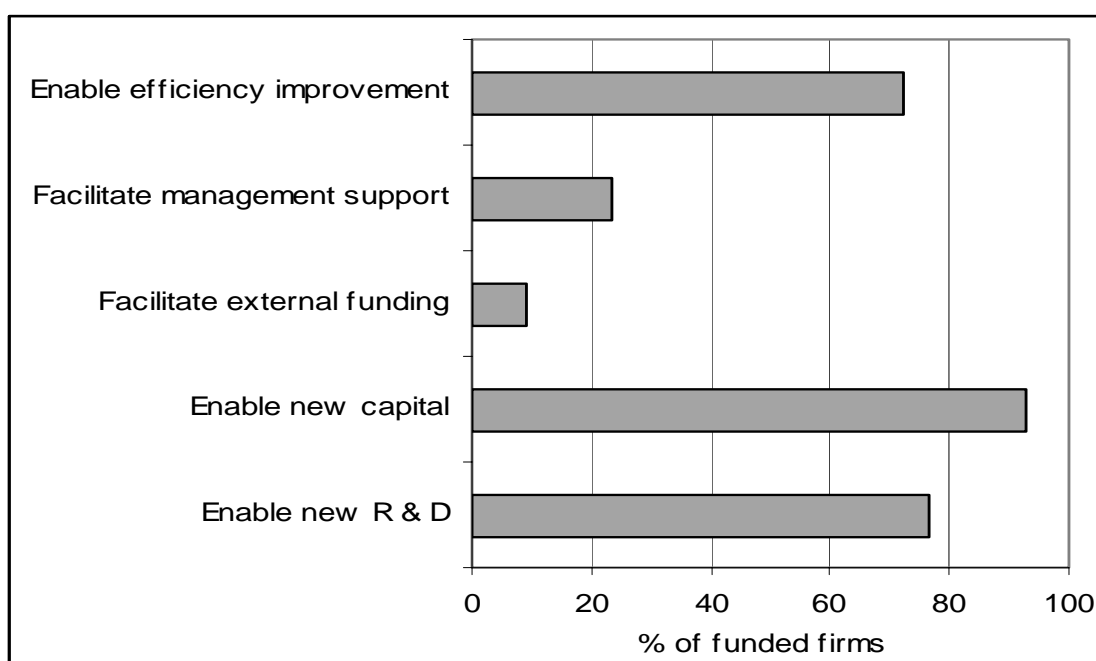
Feedback from the survey indicates that SIP has had a positive impact on company behaviour and performance. As highlighted previously, firms receiving SIP funding were much more likely than firms not participating in SIP to have:

- Introduced new capital equipment;
- Engaged in product development;
- Undertaken more R&D activity;
- Started to export or expanded exports;

- Improved supply chain control; and
- Improved labour flexibility.

More specifically, companies funded under SIP reported significantly high levels of outcomes in terms of R & D, investment and related efficiency improvements. As shown in Chart 6, over 93% of firms benefited from new investment, 78% from new R & D, and 72% from related efficiency/productivity gains. SIP however played a limited role in leveraging external funds for investment and R & D, or facilitating management consideration/approval for funded projects. This is not surprising given that SIP funding is paid retrospectively.

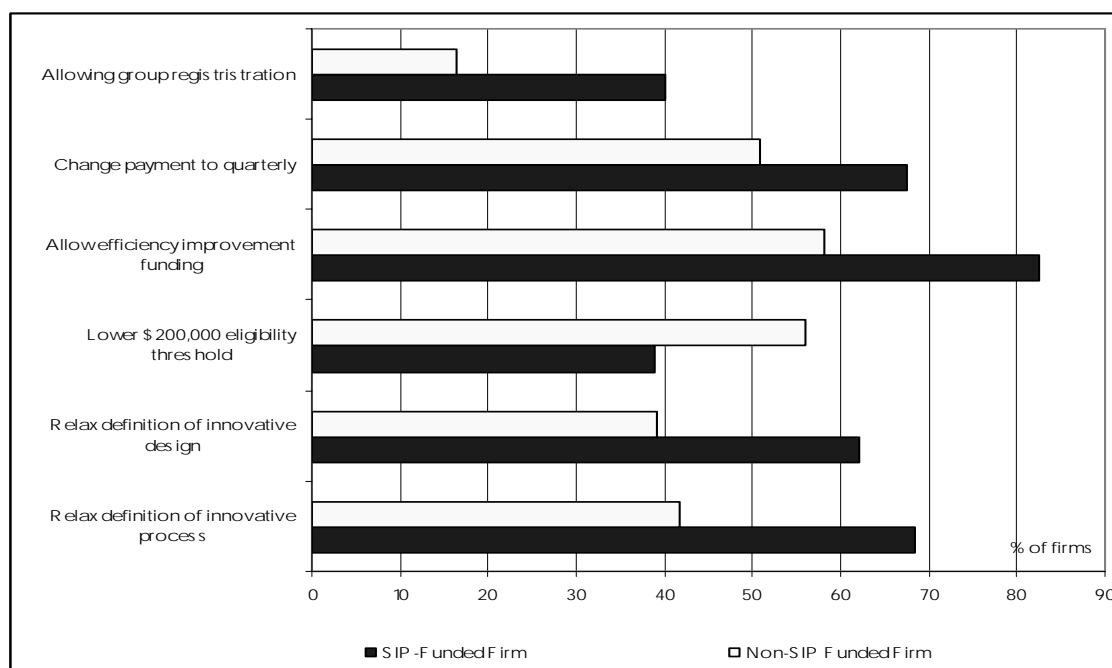
Chart 6 Benefits of SIP funding to companies



Despite the success of SIP, both among SIP fundees and non-SIP firms there remains support for improved flexibility in the program. SIP recipients (chart 7) overwhelmingly favoured allowing funding for efficiency improvements and

a more flexible definition of innovative design and process. As well, they supported quarterly SIP payments.

Chart 7 Suggested improvement to SIP program



Amongst non-SIP firms, similar views were held about changing the program, although the smaller percentages were due to a large proportion of firms (between 37% and 63%) being unsure as they had limited experience with SIP. However, most telling, the majority favoured lowering the threshold, which was presumably excluding them from registering for funding.

Going forward

The above analysis has highlighted the dilemmas the Federal Government faces in finding the right balance for industry assistance.

There is a place for SIP going forward focusing on strategic investment and R & D, but for most firms the process of adjustment to lower tariffs after 2005 will be left to the marketplace. With around 7,000 establishments (and only about 400 receiving SIP funding) this reality is unlikely to change greatly.

Nevertheless, the review of SIP above has highlighted the need to provide for enhanced flexibility in the program. More firms should be given access, the rules should be applied less rigidly, process efficiency improvements should be supported, and some degree of modulation encouraged. As well, funding should better reflect the distribution of activities and firms within the TCF sector.

These changes rather than weaken the effectiveness of the program would strengthen its focus on investment and research and development by supporting more initiatives across a broader number of firms. As our analysis has shown, SIP funding has facilitated greater effort by funded companies.

Consequently, Ai Group recommends:

- Rec 1 The continuation of the Strategic Investment Program (SIP) beyond 2005.***
- Rec 2 That SIP funding arrangements be changed to provide for a greater degree of flexibility in funding investment, R & D, and process improvement activities.***
- Rec 3 That degree of modulation of funding be allowed to facilitate greater company access to the program.***

MARKET ACCESS

Current arrangements

The import tariff on clothing and finished textiles currently stands at 25%. For cotton sheeting, fabric, carpet and footwear the import tariff is 15%, and for sleeping bags, table linen and footwear a tariff of 10% applies on imported goods. In 2005, the tariff will fall to 17.5%, 10% and 7.5% respectively.

The critical issue facing the industry is whether TCF tariffs should remain at the legislated levels for 2005 or move downwards.

Decisions about the level of tariffs to apply post 2005 must be viewed in the context of high levels of support (including tariff and non-tariff measures) among other regional economies. This is particularly relevant within the Asia region, which accounts for a large share of imports of TCF products into Australia.

Overseas regimes

International trade facilitated by the World Trade Organisation (WTO), otherwise known as the multilateral trading system, is set upon a course of global trade liberalisation, which aims to produce a global business environment which is both stable and predictable. This ideal has clearly not been achieved as yet, as the environment is far from a “level playing field”.

High tariff barriers are symptomatic in the developing world, and there is a proliferation of non-tariff measures (NTMs) globally, as countries seek to protect industries facing competition in the face of trade liberalisation.

Tariff barriers

A comparison of tariff rates applied by various countries is complicated by the fact that different tariff definitions are employed. Countries may cite their “basic indicator” tariff, which is in fact a “simple average” of their tariff rate, or a “trade-weighted average” which takes into account the trade volume history. In either case, the quoted rate may not reflect the actual tariff applied.

Furthermore, it is routine for countries which are opening markets for increased trade to apply Bound Rates, “binding” their commitments to a minimum and maximum tariff rate. High bound rates give the legal flexibility to increase tariffs if the level of imports increases, and thereby protect domestic industry. This scope for applying rates for a single classification is further complicated by the practice of applying tariffs which may even sit outside the bound range, as often happens in developing countries.

A summary of identified tariff barriers for TCF trade, both on the basis of anecdotal evidence and as a result of a comparison of the “basic indicators” published by the United Nations Conference on Trade and Development are as follows:

- High tariffs are applied in Indonesia (up to 20%), Malaysia (up to 30%), India (up to 40%), China (up to 30%), South Africa (up to 40%) and Mexico (up to 35%).
- Whilst both India and China could be seen as potential growth markets for Australian exports, given their burgeoning middle-classes, high tariffs on a large range of products have circumvented this.
- Most developing nations (including South Africa) not only apply prohibitive tariffs, but are eligible for preferential trade arrangements whilst simultaneously being exempt from WTO agreements to eradicate industry subsidisation schemes.
- Tariffs are also a significant barrier when treatment by certain favoured countries puts Australia at a competitive disadvantage. For example, the

favourable treatment Mexico enjoys with the US under the North American Free Trade Agreement (NAFTA) relatively disadvantages Australia. Mexico has duty free access into the US for garments produced from US components. Garments made from non-US fibres are subject to 18-30% duties carried forward on entering the US.

- Discretion within a country's Bound Rate range of duties may also relatively favour some products (and as a result, countries) over others. For example, in the US, men's knitted cardigans made from wool attract a 16.3% duty, whilst an equivalent garment made from cashmere attracts only a 5% duty. In this way, Australian wool cardigans are relatively less attractive than cashmere cardigans, generally made in Italy.

Non-tariff measures (NTMs)

There is an enormous raft of NTMs applied by countries, (and particularly developing countries,) to protect their domestic TCF industries in the face of global liberalisation. Whilst many are difficult or impossible to substantiate, their identification and subsequent eradication is vital if true liberalisation of trade is to be achieved. Some of the key NTMs faced by the TCF industry offshore are:

- *Quantity Control Measures, or Import Quotas*
Quotas are being phased out over a 10-year schedule from 1995, under agreements reached at the WTO Uruguay Round. As the Productivity Commission Inquiry, for which this submission is being prepared, is examining the post-2005 TCF Assistance Arrangements, it is not relevant to discuss quotas, as in theory they should not apply at that time. (There is some concern however, that the US may succumb to domestic political pressure to resist its agreed obligations.)

- *Monopolistic Measures*

Monopolistic measures refers to vertical monopolisation and inaccessible distribution systems. For example, anecdotal evidence has shown that it is extremely difficult for Australian companies to find a market for their textiles and apparel in Indonesia, where distribution is tightly controlled by a number of family companies, or the so-called “off-shore Chinese networks”.

- *Technical Measures*

Countries are increasingly imposing more onerous technical measures which may not only increase the cost of exporting, but may hamper or even prevent certain imports. These technical measures are typically additional product assurances such as environmental and chemical characteristic requirements and definitions. For example, US Customs now require documentation showing “stitch count” accompany knitted imports: this is not possible for 3-dimensional flatbed knitwear such as those made by Coogi.

- *Inequitable Principles.*

This refer to corruption, at all levels including government and corporate, and is prevalent in many developing countries. Practices which are included here are arbitrary tariff evaluations, application of excessive inspection and quality standards, arbitrary awarding of contracts and subsidies, unofficial “tax” holidays, excessive delays in customs clearances and misuse of tariff bindings. Many Australian companies simply avoid markets where these principles apply.

- *Intellectual Property Rights (IPR)*

Once again, Australian companies tend to avoid markets where they hold the belief that their IPR will be insufficiently protected or enforced. China is probably the foremost example cited, followed by India, Indonesia, Malaysia, South Korea and Vietnam.

- *Subsidies*

Subsidies is one of the most common NTMs employed by developing countries. Raw materials, finance and capital equipment may be

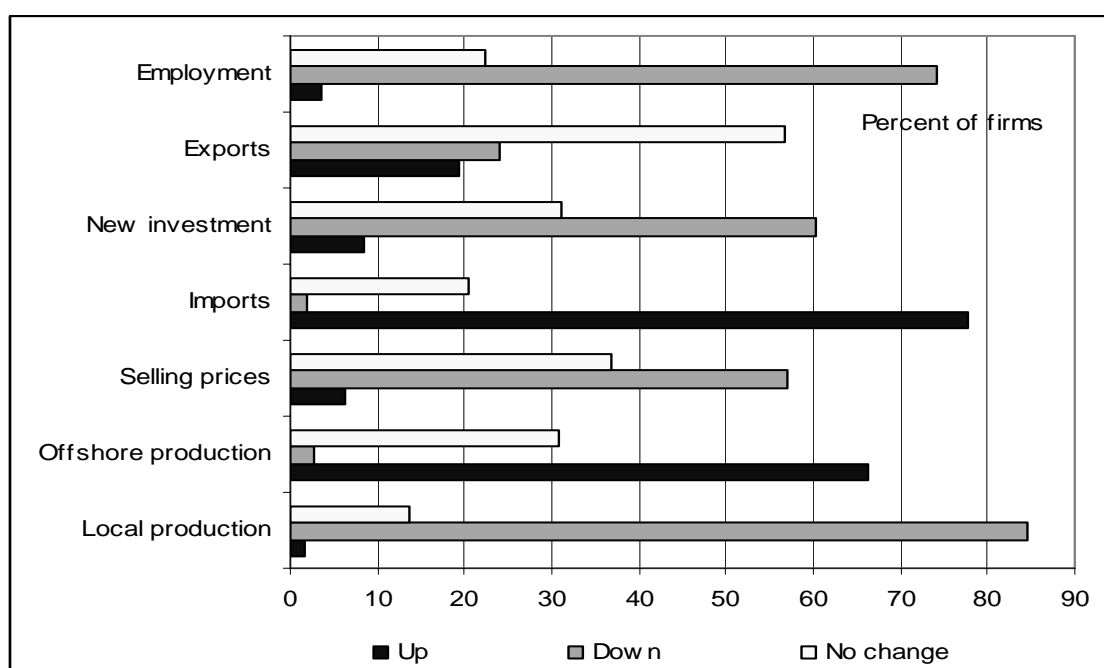
subsidies by government, thereby giving an unfair advantage to recipients. According to the Agreement on Subsidies and Countervailing Measure negotiated under the Uruguay Round of the WTO, developing countries may legitimately provide subsidies:

- 1) least-developed and developing countries with a per capita GNP of less than US\$1000 are exempted from disciplines on prohibited export subsidies, and a time-bound exemption from other prohibited subsidies; and
- 2) for other developing countries the export subsidy prohibition is under a time-bound exemption.

The views of companies

Responses from firms in the TCF sector indicates that a further lowering of tariffs after 2005 would have a significant negative impact on the domestic operations of firms (chart 8).

Chart 8 Impact of further tariff reductions after 2005



The Ai Group survey indicated that significant falls would be likely for:

- Local production (with 85% of firms citing a probable decline);
- Employment (74%);
- New investment (60%); and
- Selling prices (57%).

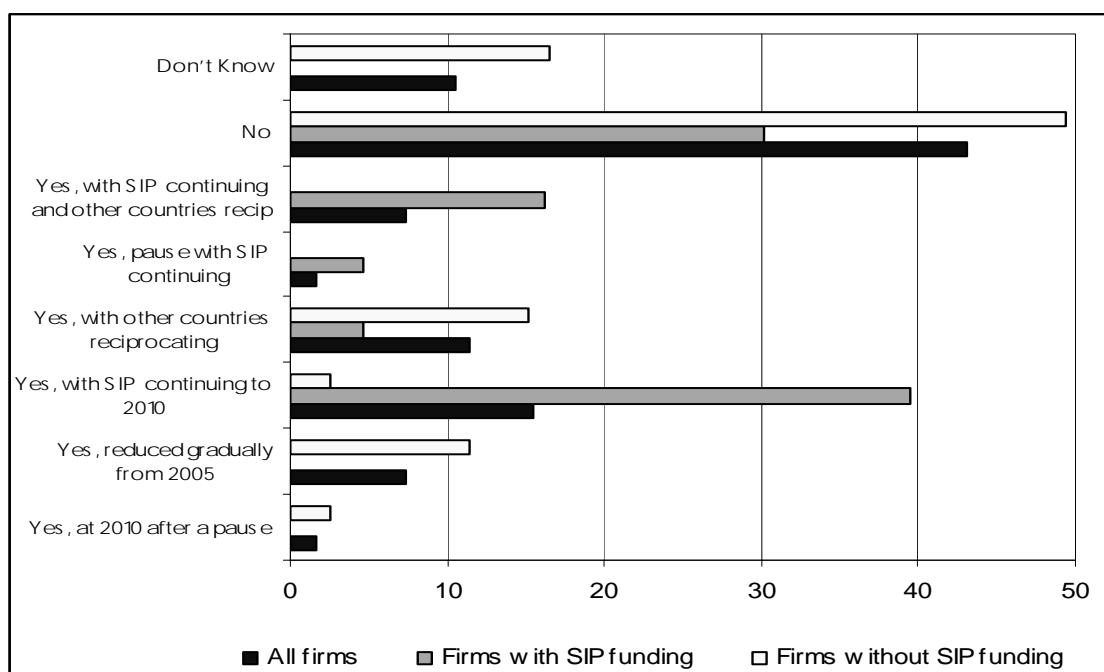
At the same time, 78% of firms indicated that imports would rise, and 66% cited a probable increase in offshore production.

The industry has mixed views about the future direction of import tariffs after 2005. Overall, 43% of firms would not support a decline in tariffs after 2005, with an additional 11% unsure. However, such support was contingent on a pause in tariffs until 2010 and continued government support for domestic TCF firms.

In addition, 71% of firms indicated that if lowering tariffs in and after 2005 are going to lead to job losses, additional funding should be available in 2005 to assist the adjustment process.

Those supporting lower tariffs after 2005 did so with the following provisions (chart 9):

- Tariffs decline in 2010 after a pause (2% of all firms);
- Tariffs be reduced gradually from 2005 (7%);
- With SIP continuing to 2010 (16%);
- With other countries reciprocating lower tariffs (11%);
- At 2010 after a pause with SIP continuing (2%); and
- With SIP continuing and other countries lowering tariffs (7%).

Chart 9 Support for further reduction in tariffs post 2005

Firms receiving SIP funding were more likely to support a reduction in tariffs (subject to continued support for the industry) than firms not participating in the SIP. In total, almost two thirds (65%) of firms receiving SIP would support lower tariffs, subject to:

- A continuation of SIP to 2010 (40% of all firms receiving funding under SIP);
- With SIP continuing and other countries reciprocating with lower tariffs (16%);
- With other countries reciprocating lower tariffs (11%); and
- At 2010 after a pause with SIP continuing (2%).

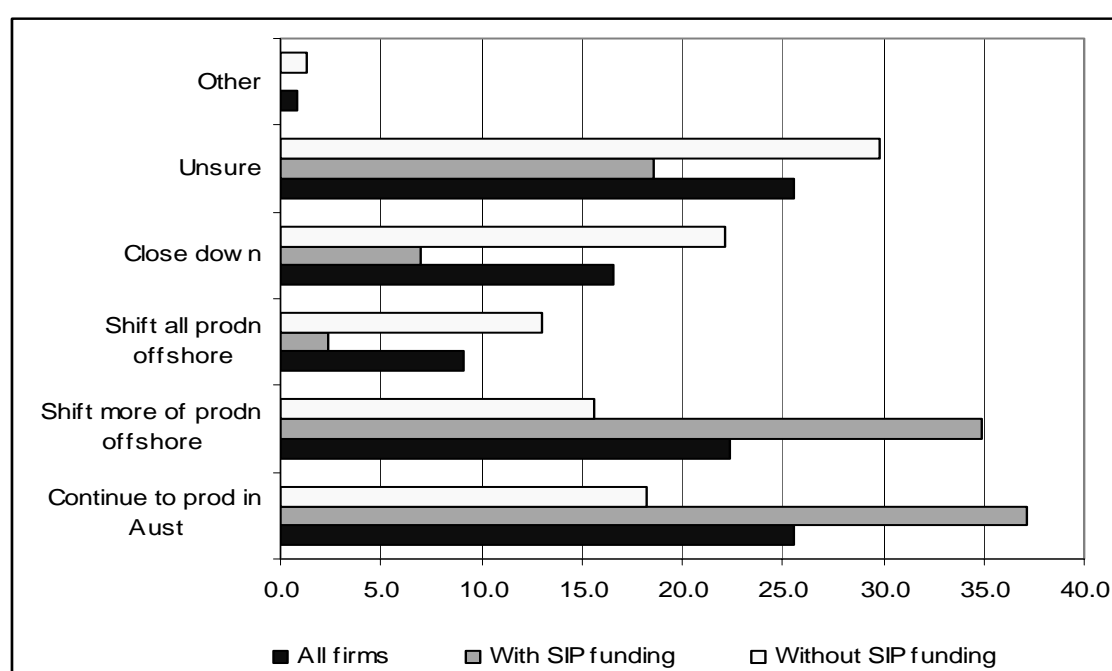
Of firms not receiving SIP funding, only 32% supported a fall in tariffs (subject to other ongoing assistance to the TCF sector).

Responses to the Ai Group survey indicated that a reduction in tariffs to say 5% in 2010 would have significant implications the future growth strategies of firms based on domestic production (chart 10). Firms receiving funding under

the SIP were more likely to continue to produce in Australia, but were also more likely to move more production offshore. Those firms not participating in the SIP appear more likely to either close down or shift all production offshore. In total, 17% of firms said they would close down entirely and 31% shift more or all of their production offshore.

Only one in four firms indicated they would continue to produce in Australia. However, for firms receiving SIP funding, almost one in two firms indicated a desire to continue producing in Australia if tariff fell to 5%. This is in contrast to non-SIP firms where only one in five companies would continue to produce in Australia.

Chart 10 Impact on production of further tariff reductions after 2005



Going Forward

1. Import tariffs

The process of adjustment to legislated tariff reductions in 2005 has been difficult for many companies, leading to plant closures, job losses and a shift of production offshore. In adjusting to these changes, TCF companies supported by the SIP program appear to have been better able to respond to these pressures.

It is clear that further reductions to tariffs after 2005 will force more closures and transfer of operations offshore, particularly for those firms who are not supported through the SIP program. This is a heavy cost to pay if our trading partners are slow or resistant to lower both their tariff and non-tariff barriers.

Ai Group holds strongly to the view that there should be a pause in tariff reductions after 2005. It therefore recommends:

Rec 4 No reduction of import tariffs after 2005 be contemplated until tariff and non-tariff barriers in overseas countries are reduced proportionately to levels that exist in Australia.

As well, the Federal Government operates an Expanded Overseas Assembly Provisions Scheme (EOAP), which enables Australian firms to import duty free finished products using Australian pieces. This program is supported by companies who make use of the EOAP scheme (although many TCF firms who don't have mixed views) and enables Australian TCF firms to combine their expertise in product design and global marketing with the benefit of low cost of production from offshore sites to remain competitive on the domestic markets with imports. Ai Group therefore recommends:

Rec 5 That the Expanded Overseas Assembly Provisions Scheme be continued beyond 2005.

2. Market access

Consideration of domestic assistance arrangements for firms participating in the TCF sector, must be viewed in the context of a fully global TCF market. Accordingly, Ai Group believes it is vital to consider assistance regimes in other economies.

Tariff and non-tariff barriers imposed by other countries are significant constraints to developing exports of Australian TCF products.

The removal (or indeed significant reduction) of import tariffs would have an immediate impact on Australian exports of TCF products. Tariffs remain a significant barrier for the TCF industry, particularly in the developing world.

Non-tariff barriers are certainly harder to identify, substantiate and possibly eradicate. It is vital that they are not overlooked however, as their practice can be equally restrictive. The benefits of multilateral tariff reduction could well be negated if NTMs are permitted in their place. Accordingly, Ai Group makes the following recommendations.

Trade liberalisation

Liberalisation has already presented substantial opportunities and challenges for Australia. However, in order to achieve its full potential, continuing opening of markets must be pursued. Negotiations in the World Trade Organization (WTO) is an important avenue for gaining better access for Australian goods and services to global markets, and for rules that allow Australians to trade on equal terms with others.

Bilateral trade conditions

Movement at the multilateral trading system level is, by its very nature, a slow process. Whilst the WTO has made significant inroads towards opening

markets, conflicting interests, such as those between developing and developed countries, are weighty and complex to resolve. Whilst this process should not be undermined, it is vital that Australia continues to progress the various regional and bilateral free trade agreements (FTAs) it has already initiated or could initiate to our advantage. Within the context of this submission, this particularly relates to Australia's key TCF trading partners.

The proliferation of bilateral and regional trade agreements has had a significant impact on the pattern of global trade. Increasingly trading blocs are being created which potentially disadvantage those countries not included. NAFTA is a good example of an FTA which potentially puts Australia at a competitive disadvantage with South American countries for US market access. The conclusion of an Australia-US FTA could position Australia as a similarly favoured nation, as say the NAFTA countries, or indeed the 34 countries of the proposed FTAA, or FTA of the Americas.

Liberalisation among key trading partners

Australia's key trading partners should at least match our efforts to achieve an open trading system. Australia's TCF industry is not unlike its counterparts across the globe which have, or continue to, enjoy varying degrees of protectionism and government support. Preparing for liberalisation is a somewhat painful process that requires adjustment, and an appropriate amount of time in which to do it. To ensure a level playing field, however, it is essential that the rate with which the Australian TCF industry opens its market, is at least matched by our key trading partners.

In summary, Ai Group recommends that:

***Rec 6 The Australian government pursues trade liberalisation
via the World Trade Organisation.***

Rec 7 Simultaneously continue to seek favourable bilateral trade and sub-regional trade and economic conditions with key overseas markets.

3. INDUSTRIAL RELATIONS

The TCF sector has had its fair share of difficult industrial relations issues. In the more recent past the disputes at Feltex Australia and Godfrey Hirst Australia over enterprise agreements are just two examples. The emotional issue of protection of employee entitlements involved significant and very disruptive stoppages.

Results from the Ai Group survey of firms in the TCF sector show that only 16% of firms viewed the industrial relations climate as good or very good. In comparison, 54% described the climate as average, and 30% poor or very poor.

Industrial relations is clearly affected by the nature of the industry, which is characterized by the fact that it is made up of mostly small to medium sized companies with only a small number of larger companies.

Only the larger companies are able to employ specialized human resource management and industrial relations personnel. The smaller and medium sized companies must rely on operational management for their day to day expertise in these areas.

The union with most coverage in this sector is the Textile, Clothing and Footwear Union of Australia. The practice of this union is to engage mostly shop floor activists as union organizers.

Unfortunately this combination has not promoted the development of HR/IR skills generally across the sector. This is evidenced by the fact that there is a tendency for grievances to escalate into disputes because of the inability of parties to develop practical solutions. This may have the further consequence of damaging relations between management and employees.

Given the obvious importance of effective grievance resolution at the workplace, it would be appropriate to establish effective training in this area, run by a genuinely independent body.

The issue of pattern bargaining is also of major concern to some sectors of the industry. Again there is a significant divide in the sector with regard to enterprise agreements, as they tend to be confined to the medium and larger companies.

The proposition that a 'one size fits all' agreement is appropriate for a sector with such varying needs, is not one that Ai Group believes has merit.

The need for enterprise agreements to be negotiated on the basis of a genuine consideration of individual company issues is fundamental to the basic premise of enterprise agreements.

To reinforce this Ai Group recommends several amendments be made to the Workplace Relations Act. These include

- Providing the AIRC with enhanced powers to suspend or terminate bargaining periods.
- Outlawing protected industrial action in pursuit of pattern bargaining.
- Providing the AIRC with the power to order a cooling off period.
- Introduction of secret ballots before protected action can be taken.
- Outlawing protected industrial action in all circumstances during the life of a certified agreement.

Central to these recommendations is the Ai Group position that the maintenance of an efficient and fair system of enterprise bargaining is essential to the TCF sector.

The issue of broader cooperation between the union and employers in the industry is one that requires serious consideration, especially given the

findings of the Ai Group survey, which found that only 4% of firms believed union activity helped in the development of the TCF sector. In total, 68% of firms indicated union activity hindered the development of the sector (27% were unsure).

The opportunity exists to set up the infrastructure that would facilitate liaison between union leadership and a cross section of industry leaders to identify issues of mutual concern and possible practical solutions.

This sort of forum has been seriously lacking in this industry. The only real current and ongoing example of such a forum is the management committee for the Outworker Code of Practice for the Clothing Trades Award. This body's operational functionality is however highly limited.

Industry is generally skeptical about such forums. At a purely competitive level, companies who find themselves party to the code of practice can be at a disadvantage in bidding for contracts. This is particularly so for government contracts where employers and employees workplace practices are ignored in awarding contracts.

At the industrial level, the fear is, and it seems to be well based, that the union will manipulate the forum to push its own agenda, including pattern agreements and specific industrial issues.

Such an outcome would obviously be a recipe for failure and further erode trust and goodwill between the parties. Any forum would need the serious and positive goodwill of both sides. The objective being to genuinely examine issues of mutual concern to the viability of the industry, both short and long term and to seek mutually acceptable positions.

Implementing the recommendations of the Ai Group will help ensure the industrial relations environment in the TCF sector is not as disruptive to production and investment as it has been in the past.

In order to facilitate the continued development of a sustainable and competitive TCF sector to the end of the decade Ai Group recommends:

- Rec 8** *Suitable training programs dealing with effective grievance resolution and employee relations be developed and overseen by a genuinely independent body.*
- Rec 9** *Additional powers be available to the AIRC to suspend or terminate a bargaining period. The additional powers would relate to situations where protected action is:*
- *Causing significant damage to an enterprise*
 - *Significantly endangering the welfare of employees in an enterprise*
- Rec 10** *Protected action be outlawed for the purposes of pattern bargaining.*
- Rec 11** *The AIRC be given the power to establish a cooling off period in appropriate circumstances.*
- Rec 12** *Secret ballots be mandatory before protected action can be taken.*
- Rec 13** *The Workplace Relations Act be amended to clarify that protected action cannot be taken prior to the expiry date of a certified agreement.*
- Rec 14** *An industry representative body including representation from the Ai Group and the ACTU and TCFUA be set up to explore various industry-level*

***matters of mutual interest and endeavour to develop
worthwhile initiatives of benefit to the industry.***

