6 March 2003

Y. Flicker
Direct Line: (03) 9313-0155
Tel. No. (03) 9313-0100
Email: yaron@flickers.com.au

Productivity Commission
P.O. Box 80
BELCONER ACT 2616

Dear Sir,

Re: Post 2005 TCF Assistance Arrangements

World Trade in TCF grows every year and is one of the largest traded commodities in the world. Furthermore, consumption of TCF products occurs everywhere in the world and the manufacture of TCF products is desired by most of the world, particularly by the "third world". The reasons are quite clear and obvious. TCF manufacturing combines the high technology requirements of the early stages, namely, spinning, knitting, weaving, dyeing and finishing with huge labour requirements at the cutting and sewing end. TCF provides a springboard for a modern high tech economy with the bonus of providing a livelihood for lower skilled citizens as well. The attractiveness of this industry has lead to a myriad of trade distorting activities in every country in the world. Tariff, non-tariff and quota barriers exist in every country, usually coupled with positive assistance measures. These positive assistance measures exist even in low labour cost countries. These countries clearly recognise the value of a TCF industry, as we should.

Australian business <u>may</u> require policy certainty for planning but more importantly Australian business has an <u>absolute requirement</u> for outcomes to be achieved and policy <u>flexibility</u> to meet the outcomes. The Australian government was elected by the Australian people to govern for the benefit of Australians. It is pure folly to set a policy and ignore the outcomes for 8-10 years irrespective of international changes.

<u>The World Situation</u>

China dominates TCF production in the world with an estimated 35% of world production. Government policy aims to increase this to 60% by 2010. Raw material and labour inputs cost in China are similar to many other countries, particularly India, Pakistan, Indonesia and the like yet China trade dwarfs these economies. The reason is simple, they have the highest rates of assistance to their industry. They recognise that no other field of endeavour will provide sufficient work for their population. Predatory policies exist already and are being used in Australia. Left over production is dumped at below cost in Australia as we have no quota restrictions and no real anti dumping measures. Market segments that have no local domestic competition are already experiencing price rises above and beyond what can be explained by domestic Chinese factors.

<u>TCF in Australia</u>

Flicker's Australia operates predominately in the circular knitted, dyeing, finishing and printing sector. One firm in China, Fountain Set (formerly from HK), has a bigger daily production today than all the companies in Australia in this sector combined. The real question is whether we should have a TCF industry in Australia and why? The answer is YES, and these are some of the reasons:

1. We produce the raw materials at world competitive prices, if we cannot add value to these we will step by step fail to add value to any product.

2. TCF is a foundation for manufacturing, few areas do not involve TCF and demise of this industry will lead to dependence of China.

3. Skills developed in TCF are high-tech in many areas.

4. It provides employment for less skilled, non-English speaking Australians in regions and cities who cannot be employed elsewhere (see economic discussion later).

5. It is chauvinistic, elitist and misguided to believe we can be the "clever country" and Asian ones to be "less clever"!!

<u>The Economy</u>

The Australian government can legislate with certainty in Australia; it's ability to influence the behaviours of our major trading partners, is at best, marginal. In order for Australia to progress from being an exporter of raw materials (mining and farm based) to an exporter of value added products, we must have policies in place to do so. I will outline some salient points in regard to the Australia economy, TCF policy and the economic model used.

<u>The Economy and the model</u>

1. <u>Employment</u>

   In the real economy, jobs are created via:

   i. new demand, eg. economic growth, export growth

ii. new industries, eg. mobile telephony
iii. imported jobs, eg. change in market share to favour domestic products vis a vis imported products

Also, jobs can be divided into:

i. import sensitive jobs, eg. jobs in manufacturing
ii. non-import sensitive jobs, eg. road maintenance, hairdressing, etc.

Similarly, jobs can be lost in two main ways:

i. exporting jobs, eg. increasing market share of imports vis a vis domestic goods
ii. lost jobs, eg. technology replacing jobs, for example automatic telephone exchanges replacing manual exchanges.

Tariff reduction is a job export policy. The jobs will not be lost but simply sent offshore.

However, most economic models do not allow for these differences and in fact most models are <u>full employment</u> models which assumes a lost job is found elsewhere. Paradoxically, “full employment” is said to be 5, 6 or 7% unemployment. A further assumption most models make is that labour is freely mobile whereas in the real world a lost job is lost and exported job is exported and labour is not mobile.

<u>Myth 1 - TCF workers are low skilled</u>

<u>Myth 2 - ex TCF workers are mobile (NB. labour per se is poorly mobile)</u>

<u>Myth 3- Capital will be confined to Australia. Capital is mobile or lost.</u>

<u>Specific responses to questions asked by the Government to the Commission</u>

1. Current Assistance Programs

   The current programs cannot be looked at in isolation to the rest of State and Federal government policies. The current SIP program has been effective in the textile area promoting investment in modern efficient machinery and innovation. The program is appropriate in making a more efficient textile industry notwithstanding some modifications needed to improve the program. However, the effectiveness of the policy has been undermined by other government policies. These policies have the likely potential to destroy TCF in Australia. These include policies that can be divided into State and Federal responsibilities:

Federal

i. GST and tax "simplification" which has had negative end product demand and negative cash flow implications associated with higher compliance costs unrecoverable in the market place. This was never part of the original landscape in the post 2000 assistance package.
ii. The bringing forward of income tax payments prior to the cash being realised from debtors. This is associated with heavy penalties for errors in predicting final profits and the ATO/government assuming straight-line monthly profit figures and ever increasing profits has lead to cash flow implications.
iii. Ever increasing government "red tape".
iv. An industrial relations environment with winners and losers, not winners and winners where productivity gains plus more are paid to the workforce leaving an inability to maintain or reduce prices.
v. A failure of social policy whereby 50% of unemployed ex TCF workers are still unemployed 2 years after losing their job at huge social and economic cost.

State

i. Failure to really reduce business taxes and input costs, ie:
   a) "claytons" payroll tax reductions whereby the percentage falls but the base increases!
   b) rapacious and opportunistic growth in the collections of stamp duty and fire services levies on hugely inflated insurance premiums,
   c) failure to rein in costs and reasonable outcomes in Workcover, and using workcover to mask the real number of unemployed,
   d) oligopolistic and monopolistic price rises in utilities with inability to negotiate on regulated prices,

and e) the Homeworkers Code/Laws which single handedly will destroy the final stage of apparel manufacture where responsibility is deemed on garment suppliers where they have no "down the line" control.

2. Major impediments to long term TCF viability

Current policy settings, tariff levels and positive assistance measures allow reasonable competition between domestic producers and the whole world <u>except China</u>. Since the labour and other input costs in China are similar to India, etc., the assistance given to firms in China allow these firms to act in a predatory manner to close out TCF industry in Australia (and the Western world). The non-market economy of China has both the ability and will to circumvent all custom barriers and thus threaten TCF viability in Australia.

Furthermore, the recent changes to <u>duty free</u> entry from LDC economies will clearly hurt TCF and have the nett effect of "de facto lower tariffs". There is broad recognition that other trade flows and revenues will hardly change but TCF will be hurt. This effective reduction in average tariffs should preclude any consideration of further tariff reductions. Already anecdotal evidence suggests these LDC's, especially Bangladesh, are preparing an assault on the Australian TCF market. Also anecdotal evidence is growing on other countries exports being "transhipped" through these countries and/or origin documentation being forged.

3. Major Opportunities

Major opportunities possible are adding value to our own natural resources and niche markets. However, the whole world (except China) is looking for the same niche markets and China's policy is to first grab all the volume markets then take the niche markets as well.

4. Policy Options

The policy options are really quite simple. Australian government has an obligation to act responsibly for its citizens, their health, livelihood and the like. Policies whose outcome, if successful, accelerates and increases long-term unemployment is not responsible. Similarly, policies designed to structurally worsen our trade deficits is irresponsible, in particular, where no <u>nett</u> benefit is gained. The primary policy required is <u>outcome</u> based where policy flexibility <u>must</u> occur in order to achieve the desired <u>outcome</u>. This is not a new concept but one that needs some determination by government. For example, if the <u>outcome</u> desired was that we spin, knit or weave, dye, finish, cut, make, sew and sell 15% of our cotton in Australia, we need to change the policy settings until we achieve this outcome. We should use the same model as the <u>outcome</u> based policies in relation to private health cover, our attack on the road death toll, attracting sufficient soldiers to the armed services, etc. To set a policy with an expected outcome; to find that the outcome is not achieved and then to blame everyone except the policy is intellectually vacant. If a policy is so rigidly set and fails to achieve the outcome needed and is not changed is as stupid as sending wave after wave of human cannon fodder from the WWI trenches into machine gun fire and blaming the soldiers for failing when the blame lay with the army strategists.

Thus the policy options can be summarised as:

i. Headline tariff pause to continue:
A policy to reduce tariffs will be "successful" if it leads to greater import penetration (therefore a higher current account deficit), revenue loss to the Australian government (with con committant domestic tax rises = more taxes on consumers) and higher long-term unemployment. As tariffs are currently at marginal rates, any final price reductions are likely to be minimal and any "spare consumer dollar saved" is more likely to be spent on other imported goods and services. Tariff reductions from punitive

rates to marginal rates has a different economic effect than the reduction of marginal rates. The peculiarity of TCF imports is that they are mainly end products, dwarfing intermediatory product imports; thus the worsening current account results has no redeeming features. Make tariff cuts consequent on quantifiable micro economic reform successes not precedent.

ii. Positive assistance measures include:
   a) Extension of Type 1, 2, 3, 4 and 5 SIP program.
   b) Enhanced Export market Development Grants and market access activities.
   c) Payroll Tax rebates of 100% if reduction of taxes on consumers is to be seriously considered.
   d) Workcover rebates.
   e) Removal of duty on EOAP offshore costs.
   f) 100% funded environmental fund (ie. to reuse scarce water resources).
   g) A proper bilateral Import Credit Scheme with Fiji.
   h) Normal commercial and contract law to apply between parties from principal to homeworker. This would require amendments to the Homeworker Bills to occur to ensure normal commercial relationship are occurring.
   i) Labour adjustment programs.
   j) Others – such as promotional projects, ministerial special projects, regional bonuses, etc.

5. Australia's International Obligations

Australia's international obligations exceed WTO/APEC obligations. We have obligations to not promote:

i. child labour
ii. near slave labour
iii. environmentally polluting manufacturing
iv. greenhouse gas emission worsening manufacturing
v. unsafe and unhygienic work practices
vi. use of carcinogenic products

Australia denies the importation of goods made from endangered species, we should be no less vigilant to importation of goods breaching our other international obligations.

Conclusion

In conclusion, a few economic matters need to be raised, some shibboleths need to be dispelled:

1. Further import penetration will lead to TCF demise/reduction in Australia and a permanent and structural worsening of the current account deficit.

2. Government revenue will fall and in a revenue neutral situation this will need to be made up by tax increases.

3. Long-term unemployment will increase.

4. THERE CAN BE NO NETT BENEFIT to the economy as tariff revenue lost is replaced by tax increases elsewhere domestically or by reduced domestic government spending.

5. If one did believe tariff reduction contributed to increase economic growth one must equally accept that it contributed to an increased current account deficit, a cap on growth due to a blow out of imports, increased baseline unemployment (real and hidden) and increased number and percentages of Australian dependant fully or partially on Government Transfers (25% to 38% over 15 years). One cannot pick and choose only the positive economic indicators which "prove" ones previously held belief.

6. The policy of no tariffs from the poorest 50 countries in the world will probably lead to false certificates of origin on garments entering Australia and the growth of their TCF industries in order to access Australia preferentially.

7. The size of the current account deficit is huge; arguments go to and fro whether this will be significant. I do not know if it is or not significant but if it will become a problem (as in Argentina), any policy that structurally increases this is sheer madness especially when there will be no benefit to the community.

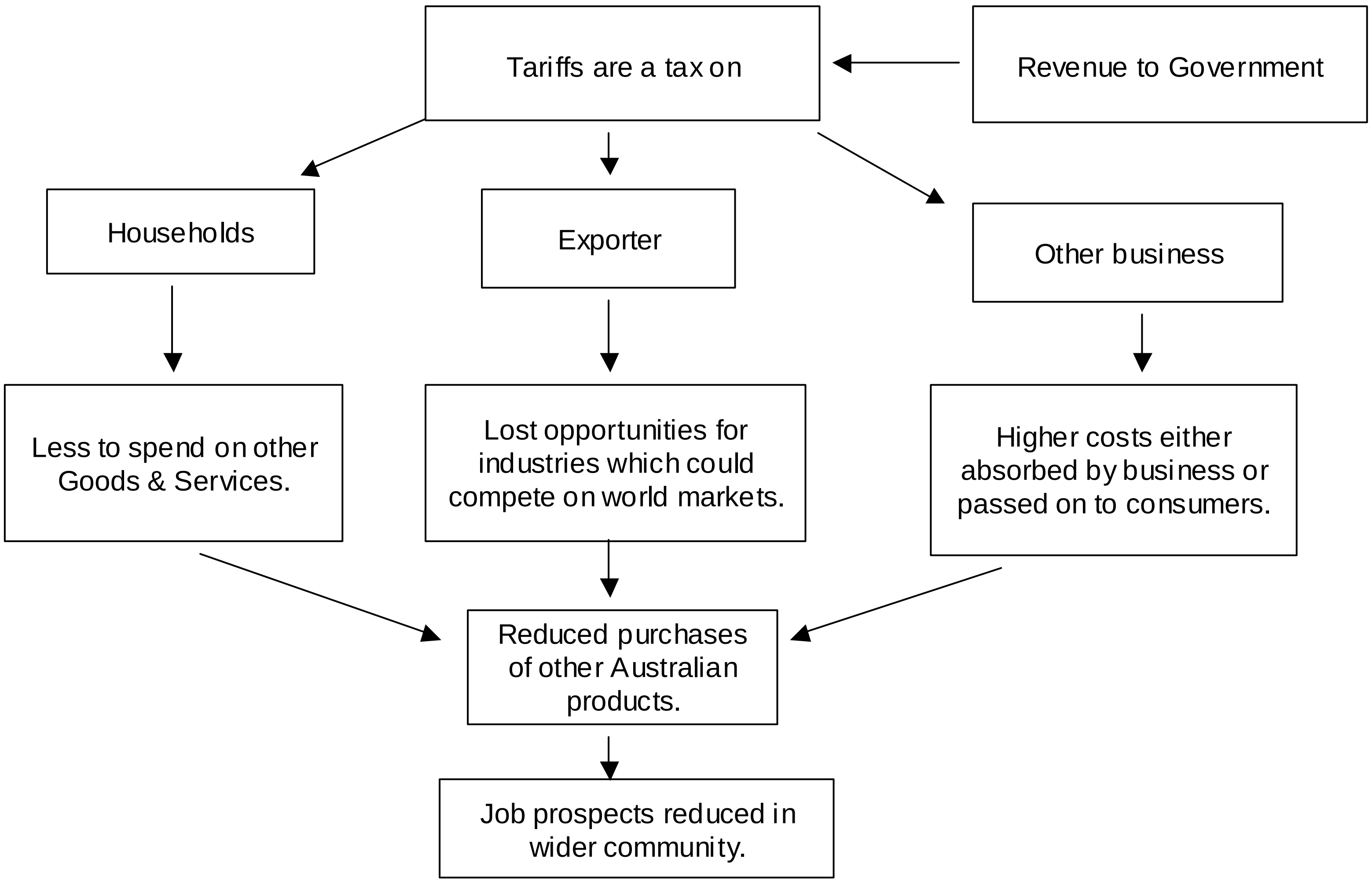
8. Finally, if it can be justified as a benefit for the consumer to remove taxes (tariffs) from imported <u>end products</u> (ie. clothing), surely, it can be even more justified to remove taxes from Australian made products. Taxes contribute to the well being of our society and the burden must be spread on all products that have access to the Australian market and consumer.

I would welcome an opportunity to discuss this further.

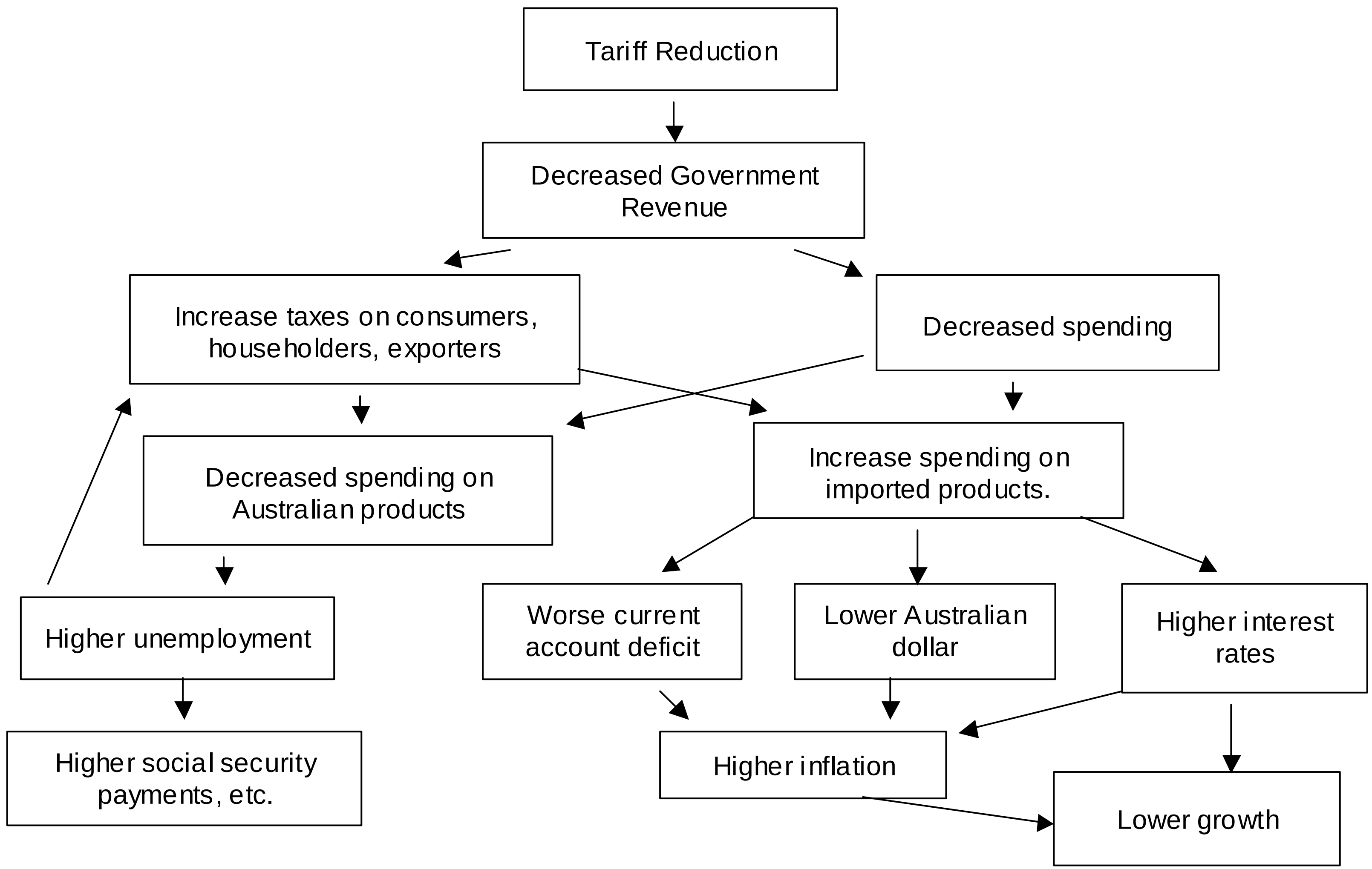
Yours faithfully,

Dr. Yaron Flicker, MBBS (Melb), MBA (Monash)
Managing Director

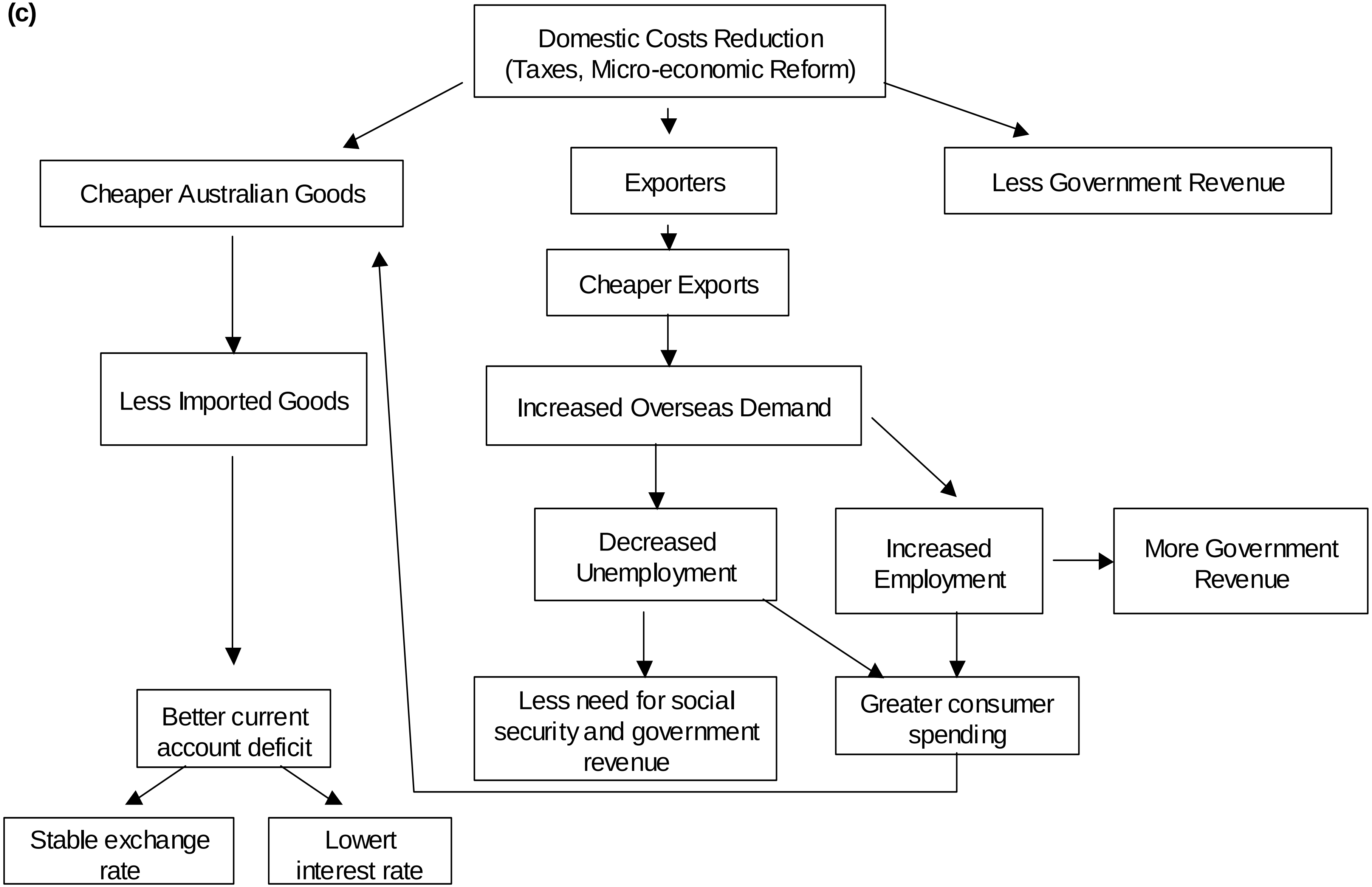
Appendix I (a) TARIFFS - ONE SIDE



(b) But Tariffs – the real story



(c)



EVERYBODY WINS