SUBMISSION TO THE

PRODUCTIVITY COMMISSION

INQUIRY INTO THE
TEXTILES, CLOTHING, FOOTWEAR & LEATHER INDUSTRIES

MARCH 2003

This submission is made by the Standard Universal Textile Group comprising Standard Knitting Mills Proprietary Limited (ABN 85 535 117 700) and Universal Dye Works Proprietary Limited (ABN 89 001 867 625). The Group is subsequently referred to as SUTG.

March 11, 2003

Dr David Robertson
Commissioner
Productivity Commission
PO Box 80
Belconnen ACT 2616

Dear Dr Robertson

Re: Submission to the Productivity Commission Inquiry - Post 2005 TCFL Assistance Arrangements

Please find attached the Standard Universal Textile Groups submission to the Inquiry into Textiles, Clothing, Footwear and Leather.

If there are any queries or if you or staff would like to discuss, or clarify, any of the issues raised in the submission please feel free to contact me.

Geoffrey O’Loghlen
Consultant

This review is a critical event for an Australian manufacturing industry that has experienced dramatic change in recent years.

The Standard Universal Textile Group (SUTG) is amongst Australia’s most successful knitting and dyeing companies. The company is a major manufacturer, operating a vertically integrated knitting and dyeing facility at Botany in Sydney. It has extensive research and manufacturing facilities and directly employs over 200 people. It has responded strongly and positively to the challenges in the Government’s textiles plan through investment, product development and process improvement.

SUTG is a key supplier to apparel producers like Trackmaster and Supre who supply high quality, low cost knitted apparel to Australia’s leading department, specialty and discount stores including Myers, Woolworths, K-Mart, Sussans, Just Jeans, Target, Fosseys, Katies Best and Less and Rockmans.

As such the Group is at the forefront of change being brought about by Australian economic and industry policy as well as those stemming from changing consumer preferences, restructuring within the retail industry and technological change in the service and other professional areas.

Since the TCF Strategic Investment Program was announced SUTG has invested some $3 million in new plant and equipment and undertaken substantial and significant product development and process improvement programs. As such the Group has benefited substantially from the rebates available under the scheme.

The Group has also looked to develop new approaches to the total supply chain by encouraging the use of the Expanded Overseas Assembly Provision in order to generate a demand for apparel constructed using SUTG fabric.

As such the Group is in an informed position to comment on the effectiveness and appropriateness of the measures that the Productivity Commission is reviewing.

This paper addresses these issues considering:

- The Australian context
- The international context
- The company’s response

The company’s recommendations and suggestions are also summarized

The Australian Context

The Australian knitting and dyeing industry operates in one of the most open and competitive markets in the world. Today’s industry contrasts sharply with the industry of little more than a decade ago, which was a highly protected and largely inward-looking producer of basic textiles.

Australia’s knitted fabric and dyeing industry, though small by global standards, has been transformed into a more competitive and vibrant industry producing high value and high quality goods.

In addition to the benefits normally associated with local manufacturing activity, i.e. employment, value-adding, company and personal income, government taxation revenue, and technology development, the industry also benefits Australia’s trade and balance of payments performance. Local production displaces what would otherwise be imports of fully made up merchandise.

The industry also has extensive linkages with the wider Australian economy, including the science, technological and information technology systems. A notable feature of the emerging knowledge intensive segments of the industry is the willingness to engage in strategic partnerships with suppliers to develop new generation capabilities and products. The consequence is a spreading of product and process development capabilities such as e-commerce, bar coding and information communication systems across the supply chain.

The industry has always had strong links to the trade, services and transport sectors of the economy, and indeed these links remain strong with the industry remaining a leading edge customer for these sectors.

The industry produced an estimated $626 million of fabric in 1999-2000, a 27% increase over the decade. In physical terms quantities have declined dramatically - circular knitted fabrics have fallen from about 800 tonnes per week in 1998/99 to about 400 tonnes per week in 2000/01. This change has been effected through a significant rationalization of less competitive capabilities. Some major companies are in receivership or have been put up for sale by their parent companies.

These changes have been accelerated by the 2000 tariff cuts, the introduction of the GST without any corresponding reduction in other taxes, and an increase in imports of nearly 200%. These developments were partially offset through an increase in exports to over 12% of turnover, compared to only 2% at the start of the decade.

Market demand is expected to continue to grow slowly – consumer expenditure on clothing is declining and the switch to casual knitted clothing from more structured woven fabric garments is largely complete. In fact there is probably a greater probability of demand switching back to more structured garments to the detriment of the knitted fabric industry.

Australia probably has the most concentrated retail sector in the free world, with Coles Myer (and its various chains) and Woolworth’s holding dominant positions. These big retailers are under pressure to produce higher profits, which leads them in turn to seek higher gross margins by importing directly, and through their suppliers, garments from low cost countries.

As a result the knitted apparel sector is being driven into market niches supplying some branded and commodity merchandise to the major retailers and other distributors. The textile and apparel industry is therefore significantly affected by these retailers and their sourcing strategies – whether from local suppliers with faster turnaround and greater stockturns or from lower cost imports but slower turnaround and reduced stockturns.

In response to these pressures large-scale factory based apparel cutting and sewing clothing manufacturing has largely been restructured out of existence. Most manufacturers are importers as well while outworking now dominates clothing production in Australia, perhaps representing some 95% of all knitted clothing made up in Australia. Outworking in this context includes small companies that operate low-overhead cut & sew cutting operations, and the home working sector, often family-based, where garments are sewn in people's homes.

Despite the alleged growth in home working it is clear that this sector is also under pressure due to the emergence of various legislative mechanisms aiming to regulate the use and cost of outworkers.

It was in response to the pressures of falling tariffs, quota abolition, and the rising cost of local assembly labour that the Overseas Assembly Provision was originally introduced in 1991. By providing apparel producers with access to cheaper offshore labour but still requiring the use of Australian produced fabric the plan was intended to combine the strengths of the local textile industry with lower cost apparel assembly.

The effectiveness of this facility was reduced by the concomitant establishment of the import credit scheme and the abolition of duty on TCF imports from SPARTECA countries, primarily Fiji. These independent but simultaneous policy decisions provided the basis for using Fiji as an overseas apparel supplier to convert Australian fabrics whilst benefiting from both the import credit and the duty free entry provisions.

Clothing imports from Fiji went from practically nothing in 1991-92 to $40 million in 1992-93. By 2000 this supply source was providing nearly $215 million of apparel to Australia.

As a result of the phase out of the ICS from 1998 and the political turmoil in Fiji in 2000 these advantages have been lost. Fabric exports to Fiji are down from nearly $100 million in 1998-99 to $47 million in

2001-02. Imports of clothing from Fiji have fallen from $211 million to $106 million over the same period.

THE INTERNATIONAL CONTEXT

While the Australian knitted fabric industry has become one of the most competitive in the world as a result of unilateral tariff reductions and the abolition of quota controls over the last decade the industries are also subject of special and significant attention by policy makers around the globe, reflecting the special features that the knitting and apparel industries offer individual economies.

In most developed countries, market access for imported apparel remains less open than for virtually all other manufactured products. As demonstrated in the Market Access Industry Participation Report the tariff on knitted fabrics ranges between 10-40% while developed economy apparel imports are controlled quantitatively, rendering any tariff comparison meaningless.

A range of other supporting measures is also in place and has become relatively more important as tariffs have fallen and quota’s expanded. The USA for example is implementing a stringent compliance monitoring and policing regime involving the interagency Textile Subgroup on Compliance and Enforcement, the Textile Compliance Task Force and an Industry Sector Advisory Committee to slow down or dissuade potential exporters to that country.

In many developing countries, tariff and non-tariff barriers also remain high. Tariff liberalization in textiles and apparel products is slow under the WTO’s Agreement on Textiles and Clothing, and the current lobbying by the various advanced economies for new “safeguard” measures to be adopted in 2005 suggests that even with the conclusion of the ATC in 2005 other instruments or circumstances will arise to limit any significant improvement in market access.

Whilst these restraints do not directly affect Australia, a readily accessible market such as Australia acts as an important safety valve for opportunistic traders, as shipments of knitted fabric and apparel fabric can be easily diverted if market access cannot be obtained elsewhere. Such merchandise characterizes much of the international trade in knitted fabrics. As a result distortions in other markets such as the US and Europe where stringent non-tariff barriers are enforced make the backwash to the relatively exposed Australian market extremely damaging for Australian producers.

It should also be noted that the Australian anti-dumping system is unable to inhibit or remedy the damage associated with one-off shipments of finished consumer items that are each individually off-loaded at opportunistic prices in Australia. However the cumulative effect on the local producers however is direct, immediate and apparently inevitable.

To address this, anti-dumping provisions should be set in place to automatically initiate an inquiry and apply a bond when potentially injurious shipments enter Australia.

THE COMPANY'S RESPONSE

The Standard Universal Textile Group (SUTG) was established in New South Wales Australia in 1954. The Group, which comprises Standard Knitting Mills and Universal Dye Works, manufactures, dyes, finishes and distributes:

- interlock
- fleecy
- rib
- double jersey
- single jersey
- spandex blend
- special purpose fabrics.

The group also acts as a commission dyer and employs over two hundred people. The company is a major customer for a variety of trades and professional service providers, contributing to the employment of a further estimated 500-600 people.

In response to the restructuring pressures arising from local and international sources SUTG has made significant new capital investments and undertaken on-going programs of research, product innovation and development, to capitalize on the opportunities emerging in the smaller and more concentrated industry.

The company now produces a consistent stream of new products that compete with the very latest techniques and capabilities whether incorporated in finished imported apparel or fabric form. The ability of SUTG to offer world-class products and performance underpins the ability of the Australian knitted apparel industry to compete in the local and overseas markets.

SUTG has an excellent reputation as a supplier of high quality, high volume fabrics that are available on a just in time basis for manufacturers of apparel, furnishings and other industrial uses of fabric. In particular the Group services apparel suppliers who cut, assemble and finish finished apparel items such as t-shirts, polo shirts, trousers, and tracksuits.

The company is not just in the business of manufacturing fabric – it is in the business of transforming simple inputs into interesting, technically advanced knitted and dyed fabrics and delivering them to take advantage of as late as possible commitments by manufacturers, retailers and consumers.

This recognises that the company is dependent upon the investigation, analysis and development of solutions and possibilities related to the physical manifestation of fibres, fabrics and processes. The development and application of the Group's intellectual property is undertaken within the context of an integrated knitting mill and dyehouse. As the activities are intensely knowledge based the company is at the forefront of an advanced Australian technological industrial capability.

A decade ago about 75% of SUTG's throughput was of a stable, predictable fabric. This commodity type fabric could be produced in comparatively large runs due to the apparel industry's high local market share, underwritten by high tariffs and quota controls.

Now only about 35% of SUTG's throughput is of such commodity type fabrics. The rest of the company's throughput has had to be developed through product development and innovation – identifying and servicing small market niches. This fragmentation of the market has therefore involved the loss of the scale economies of production associated with commodity type fabrics and imposed additional costs in order to develop new products. SUTG now develops over 100 new fabric structures every year. These structures are moreover speculative – the apparel producer may ultimately decide not to proceed with that construction.

This commitment to innovation and development is exemplified by the range of projects the company has undertaken in recent years to improve the company’s technological basis and consequently its product capabilities:

- chemical and mechanical finishing of knitted fabrics for specialist performance properties
- development of ‘just-in-time’ finishes to impart unique handle characteristics for weft knitted fabric
- automated dyehouse systems improvements
- development of dyeing and dyestuffs and their application to novel fibre types and blends
- wet processing of delicate fabrics
- dyeing and finishing of fabrics produced from novel yarn structures
- computerized chemical delivery processes
- waste elimination in dyeing, finishing
- surface moisture retention characteristics of fabrics
- structural stability in materials handling processes
- physical and chemical influences on fabric geometry
- computerized chemical delivery processes
- waste elimination in dyeing, finishing and knitting.
- emission control for santex dryers
- chintzing and shreinering elastomerics
- emission ionisation and condensation
- dyehouse and stenter automation
- small run fabric finishing
- redesign of mill processes to incorporate electronic knitting machines
- chemical finishing
- mechanical finishing

These developments have been complemented by a significant capital investment program of nearly $3 million involving inter alia:

- circular knitting machines
- automated dust free blower and scrubber
- automated dyers

- computerised process controllers
- stenter automation
- dye cycle controllers

These activities and capabilities now enable the company to develop and create products such as

- modal fibre fabrics
- high bulk acrylics
- metallic fibre fabric structures
- novel weft knitted yarn structures
- knitted woven like jacquard fabrics
- interlock, knitted rib and double jersey development

These capabilities combined with SUTG’s short response times developed through process developments and improvements enables our strategic partners to capitalise on their proximity to the Australian market.

Despite this imports are continuing to increase, undermining the effectiveness of SUTG’s efforts. Therefore SUTG has bee looking to encourage local supply chains that incorporate low cost offshore apparel manufacturing facilities using the government’s overseas assembly arrangements and regional trading agreements.

SUTG is therefore able to comment on the effectiveness of the current arrangements for the textile and clothing supply chain and directions for the future.

Strategic Investment Program

SUTG’s assessment of the SIP scheme is that it has provided a basis for continuing to invest and develop the company whilst the textile and apparel industry sector undertakes a major rationalisation and concentration.

Given the “blood on the floor” evidenced by the Australian industry and the lack of progress in establishing a fair and reasonable international market place in terms of access, conditions and behaviours it is difficult to maintain an optimistic view. By providing some security as to the type of support that SUTG can expect to 2005 the SIP has been an essential component in accelerating and maintaining the company's efforts to improve and innovate.

However the scheme could be improved in a number of areas. While there are a number of alternative ways any positive support could be provided to the industry commercially and strategically sensible decisions have to be made in regard to whether support is:

- directed to every firm in the sector (the yarn bounty model) or targeted at those meeting some specified criteria (expanded overseas assembly provisions)

- provided at the discretion of an allocating body (the TCFDA model) or an automatic entitlement (a la the import credit scheme)

- calculated on the basis of expenditures incurred/activities undertaken (SIP model) or on results achieved (import credit model)

- focussed on marginal changes in or total levels of activities

In SUTG's experience any scheme should be:

- directed to those likely to represent the future of a competitive industry
- be predictable, transparent and certain
- encourage desirable activities
- applicable to all strategic activities – technological development are not determined by quantity but by quality.

Consideration should also be given to facilitating the rationalization of industry capacity. Significant capacity is maintained as firms seek to avoid realising their deferred liabilities (long service leave, retrenchment packages etc) by finding alternative buyers. SUTG has also been offered the opportunity to purchase other major mills around Australia for the operating business. This locking in of capacity is detrimental to the efficiency and longer-term viability of more efficient operations.

To improve predictability and certainty whilst reducing administrative complexity refinements could be made to the existing scheme without altering its intent. These could include:

- a production bounty as an alternative to the type 1,2 and 3 method for calculating entitlements
- removal of the regional and unemployment related restrictions on the type 4 and 5 elements
- payroll tax should be regarded as eligible expenditure under the type 2 element of the scheme
- freight charges on exported goods should be regarded as eligible expenditure under the type 2 element of the scheme
- the 5% cap on value added should be removed
- the pro rata and special determination adjustments of eligible expenditure for type 1 grants should be abolished
- any entitlements not paid in a particular year because of the 5% sales cap should be automatically and totally rolled over to subsequent years
- the rate of type 1 payments should be increased to the same level as type 2
- the registration, notification of variations to business plans, variations to expected claims and special purpose audits should be abolished.
- expenditure on repairs and maintenance of capital equipment should be regarded as eligible value added
- eligibility of state of the art second hand equipment should be extended from type 4 and 5 categories to type 1.
- the minimum additional expenditure threshold should be abolished
- the modulation provision should be abolished
- the distinctions between determinations and payment should be abolished

- eligible activities should be defined as those undertaken to design, develop and produce goods as defined in the Customs Tariff rather than the Australian and New Zealand Standard Industrial Classification.

Tariffs

Clothing tariffs are scheduled to fall by 33% to 17.5% on 1 January 2005. Tariffs on fabrics are scheduled to fall by one-third to 10%. The Government is committed to eliminating all tariffs on trade with APEC members, which includes most of the countries of concern to the textile and apparel industries by 2010. The Government is also moving to implement free trade agreements with America and ASEAN (which could also include China)

It should be noted that Australia’s policy of unilateral and unconditional reductions is at odds with international practice and stated policy for these negotiations. This could result in any reductions made by Australia prior to any such negotiations not being reciprocated.

While regional trade blocs such as NAFTA, the EU and, in time, AFTA have and will open up increased trade opportunities for their members, at the moment at least, Australia is not a member of any of these agreements and runs the risk of being locked out of them. If Australia unilaterally reduces its tariffs further it will have given away any inducement it may have had to facilitate reasonable access to these blocs.

Recognizing the trend towards abolition of all tariffs on imports into Australia, a key issue for the Australian industry is the rate and structure of tariff reductions:

- should any reductions occur immediately and totally, gradually and progressively or deferred totally until the last possible minute?
- should the structure of any reduction program be across the board, tops down or of equal proportional reductions?

From SUTG’s perspective the preferred option is to defer any further reductions in tariffs until at least 2010 pending the results of a review of international progress in reducing trade barriers.

Overseas Processing

The policy environment for the Australian textiles industry also needs to address the situation of the local clothing industry – without any demand from Australian suppliers of apparel there will be minimal demand for Australian produced textiles. If fully made up clothing imports are not to completely replace Australian textiles it is advisable to develop some alternative form of outward processing zone that requires the utilisation of Australian sourced fabric

The current expanded overseas assembly provisions are of minimal benefit – the advantage of not paying a 15% duty on the fabric value of apparel whilst incurring it on the labour content is not sufficient to justify the extra complexity and cost involved in such an extended supply chain, compared to importing fully made up garments with no Australian fabric.

The system of excess local area content points developed to replace the import credit/Fiji supply chain is too complex and cumbersome.

Solutions to these problems require a pragmatic integrated approach to policy development. Such measures could include the complete rebate of duty on EOAP apparel or the development of an apparel industry in for example Timor. This would however require significant assistance in infrastructure development and the application of some form of material input subsidy, a la the import credit scheme.

SUTG RECOMMENDATIONS

Tariffs: - the company accepts that tariffs on knitted apparel and knitted fabric will be cut by one-third in 2005. The company strongly recommends there be no reduction beyond this point.

Positive assistance: - the existing Strategic Investment Program is a critical component of the industry's further development and should be continued if the intention is to ensure that the economic and social benefits of having a world class technologically advanced textile industry along with a sophisticated design oriented apparel industry are to be realized.

Strategic Investment Program: - refinements to improve predictability and certainty whilst reducing administrative complexity should be made. These could include:

- **a production bounty as an alternative to the type 1,2 and 3 method for calculating entitlements**
- **removal of the regional and unemployment related restrictions on the type 4 and 5 elements**
- **payroll tax should be regarded as eligible expenditure under the type 2 element of the scheme**
- **freight charges on exported goods should be regarded as eligible expenditure under the type 2 element of the scheme**
- **the 5% cap on value added should be removed**
- **the pro rata and special determination adjustments of eligible expenditure for type 1 grants should be abolished**
- **ensure any entitlements not paid in a particular year because of the 5% sales cap are automatically and totally rolled over to subsequent years**
- **the rate of type 1 payments should be increased to the same level as type 2**
- **the registration, notification of variations to business plans, variations to expected claims and special purpose audits should be abolished.**
- **expenditure on repairs and maintenance of capital equipment**

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- **eligibility of state of the art second hand equipment should be extended from type 4 and 5 categories to type 1.**
- **the minimum additional expenditure threshold should be abolished**
- **the modulation provision**
- **the distinctions between determinations and payment should be abolished**
- **eligible activities should be defined as those undertaken to design, develop and produce goods as defined in the Customs Tariff rather than the Australian and New Zealand Standard Industrial Classification.**

A strategic trade strategy: the selective negotiation and implementation free trade and preferential trade agreements so as to provide direct and immediate commercial benefits to the manufacturing and design elements of the Australian textile and apparel supply chains.

An offshore assembly arrangement: EOAP apparel based on Australian woven or knitted fabric should be re-imported completely duty free.

Anti-dumping provisions: criteria be set in place to automatically initiate an inquiry and apply a bond when potentially injurious shipments enter Australia