# Textile, Clothing & Footwear

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Submission to Productivity Commission Inquiry

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# Contents

# 1. Executive Summary

The National Farmers' Federation (NFF) is the peak industry body representing farmers at a national level. Our members include producers of fibres such as wool and cotton, which are key inputs into the textile, clothing and footwear (TCF) industries.

NFF is adamant that tariff reform must continue, and therefore advocates the rapid removal of tariffs in the TCF industries. Tariffs have an inherently negative impact on farmers due to the higher prices they must pay for inputs and the upward pressure tariffs put on the exchange rate (Australian farmers export around 70 per cent of their production). Essentially, tariffs are a tax on Australian consumers and exporters.

Economic reform has served Australia well. Australia is growing strongly, with falling unemployment. Even in the car industry, the reduction in tariffs has seen exports grow strongly, to the point where cars and car parts are our largest manufactured export. This shows that industry support is not needed to ensure international competitiveness; in fact industry support is mostly detrimental to competitiveness. Conversely, tariffs will not isolate the TCF sector from global trends for increased efficiency.

It is often argued that tariffs are needed for regional development and employment. NFF rejects this view; tariff reductions are actually necessary to ensure agriculture can continue to employ people in rural and regional Australia (we do accept that some adjustment assistance may be required to assist those affected by tariff reductions). NFF also argues that tariffs are not justified to protect particular industries that are 'strategic'. In any case, arguments that the TCF sector is strategic are without substance.

Those who argue against tariff reform run the risk of causing significant disadvantage to Australian exporters in vital free trade negotiations, such as the WTO Doha round. Australian farmers are fighting hard to reduce tariff barriers around the world (agriculture is the most distorted sector in world trade). Continued domestic tariff protection in Australia, in any industry, hinders our ability to maintain leadership (such as through the Cairns Group) in this important liberalisation endeavour.

NFF therefore recommends that TCF tariffs be reduced as originally planned from 2005, and the rapid elimination of these tariffs by 2010 in line with our APEC commitments. At the same time, adjustment assistance may be provided to TCF employees to re-skill and find employment elsewhere. Non-tariff support programs must be reviewed and reduced in line with the tariff reductions, while ensuring that these programs do not create perverse investment incentives in the industry.

# 2. The importance of farming to Australia

Despite the current drought, farming remains an important sector of the Australian economy.

- Agriculture makes up approximately 3 percent of Australia's GDP, having a value added of $20.5bn in 2001-02[1].
- It provided approximately 20 per cent ($30bn) of our goods and services exports in 2001-02 (estimated 17 percent or $27bn in the current drought year)[2].
- Many rural communities depend upon agriculture for their prosperity. Agriculture contributes more than 30 per cent of employment in 66 per cent of small non-coastal towns[3].
- Farmers are vital custodians of the land, with agricultural activities covering 60 percent of the Australian landmass[4].
- Agriculture is one of the largest employers in Australia, providing over 380,000 jobs in 2001-02 (or 4 percent of Australia's labour force). This level has increased in the past five years, even with substantial improvements in productivity over this timeframe[5]. While employment numbers have fallen recently due to the drought to 304,000 in February 2003, we expect that these numbers will recover.
- Agricultural productivity increased by 3.3 per cent per year between 1988 and 2000, well above the average of 1.2 per cent and the second highest in the market sector (after communications)[6].
    - This fact in particular should dispel the myth that the agricultural sector is 'old economy'. Farmers have been adopting new technologies and improving practices with fervour.
    - This productivity growth has been driven by declining farm terms of trade (prices received divided by prices paid). Since 1960, farmers' terms of trade have declined by 55 percent[7].
- Agriculture also represents a significant input into many other industries, particularly the food processing industry, which had a value added of $14.7 bn in 2000-01 (2.2 percent of GDP). Food processing is the largest industry subdivision of total manufacturing by value added and second largest by employment. It employed 189,600 people, had a turnover of $56.6 bn and provided over $12.5 bn of exports in 2000-01[8].

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1. Source: ABS, *National Income, Expenditure and Product,* table 47.
2. Source: ABARE, *Australian Commodities*, table 5 and 27. Exports are greater than value added, because export value includes value added in non-agricultural industries.
3. Agriculture contributes more than half of total employment in 28 per cent of small non-coastal towns. Source: ABARE (2001), *Country Australia*, p38
4. Source: ABS, *Agriculture* (Cat no 7113.0), table 5.1
5. Source: ABARE, *Australian Commodities*, table 10.
6. Source: OECD, *Economic Surveys – Australia 2000-01*, p82
7. Source: ABARE, *Australian Commodity Statistics*, table 17.
8. Source: ABS, *Manufacturing Industry* (Cat No 8221.0), *Australia*

# 3. The Textile, Clothing & Footwear sector in Australia

## 3.1 Assistance to the TCF sector

According to the Productivity Commission, the TCF sector directly employs 64,000 people and has an effective rate of assistance of 25.6 percent. This is much higher than the average rate of assistance for manufacturing, which is around 5 percent. Direct budget and tariff assistance is about $800m, or $12,500 per employee. In comparison, the Commonwealth's Newstart unemployment assistance is around $10,000 per person.

Just two sectors in Australia have tariff rates greater than 5 percent – TCF and motor vehicles. TCF products imported into Australia are subject to tariffs at the following rates:

| Product | Current tariff | Proposed from 2005 |
|---|---|---|
| Clothing and finished textiles | 25% | 17.5% |
| Cotton sheeting, fabric, carpet and footwear | 15% | 10.0% |
| Sleeping bags, table linen and footwear parts | 10% | 7.5% |

TCF tariff rates have been frozen from 2000 to 2005 to give the sector time to 'adjust to lower assistance'.

The main form of budgetary assistance occurs through the Strategic Investment Program (SIP), providing $678 million over 5 years funding to assist TCF firms to restructure and achieve efficiency gains prior to 2005 tariff reductions. The SIP provides subsidies for investment in plant, equipment, buildings, research and development. This is a poorly targeted program. There is nothing special about investment in TCF industries; there is no justification to provide assistance beyond the standard assistance for all firms.

In addition, the SIP creates the perverse incentive for firms to invest in a declining industry. If any special assistance is provided to TCF firms, it should only be to encourage orderly adjustment to a post-tariff environment, with minimal disruption to employees and communities.

There is also the Expanded Overseas Assembly Provisions Scheme (EOAP) worth almost $5 million in 2001-02 to the industry in duty foregone. Under the EOAP, firms can assemble goods overseas from predominantly Australian fabric and be imported for local consumption with tariff duty payable only on the value of overseas processing and content.

## 3.2 Recent developments in the TCF sector

The TCF sector has had to adapt to large changes over recent years. In the ten years to 1999-2000, the effective rate of assistance for the TCF sector declined from 85.5 percent to 25.6 percent. Over the same timeframe, turnover in the sector contracted by almost 16 percent and employment declined by 37 percent, while productivity as measured by turnover per employee increased by almost 48 percent. Spending on clothing and footwear has declined from 4.9 percent of total household goods and services expenditure to 3.9.

Over the past ten years, TCF exports have doubled in real terms. Domestic support programs have had little or no beneficial effect on exports; in fact, NFF argues that domestic support programs adversely affect Australia's international competitiveness and thus may be reducing our exports, even of TCF products.

While the TCF industries provide substantial employment, particularly in NSW and Victoria, it should be remembered that many more people are employed in sectors that do not support tariffs. Agriculture employed 381,000 people in 2001-02, almost six times as many people as the TCF sector.

# 4. NFF views on TCF assistance

## 4.1 Agriculture as an input into the TCF sector

Farmers provide vital inputs into the TCF sector, particularly wool and cotton. However, this does not mean that NFF shies away from its strong free trade line for TCF industries.

As outlined in Section 6 below, NFF considers that international trade negotiations are vital and would not want to see them jeopardised for any reason.

Australian wool and cotton producers rely overwhelmingly on international markets. Therefore, protection of the Australian TCF industries provides little or no benefit to our members. In fact, Australian TCF protection increases the cost of clothing, reducing demand for clothing and thus cutting the demand for Australian fibres by the local TCF sector. In addition, the export of Australian fibres may be curtailed to the extent tariffs increase exchange rates or discourage importation of clothes made overseas from Australian fibre.

## 4.2 Economy-wide issues

The utilisation of tariffs to protect inefficient industries is poor policy that favours import-competing industries at the expense of export-orientated industries, such as agriculture. Australia's manufacturing industry tariffs add $95 million to the costs of primary production inputs in 2001-02[9].

Tariffs divert scarce resources from industries such as agriculture to the protected producers. Within the protected industries, tariffs can also reduce the propensity of industries to seek new markets and innovate - there is generally less pressure to be efficient[10].

Tariffs hurt consumers and the more efficient operation of the economy as a whole. This lowers our growth rate, in turn reducing employment growth and therefore limiting opportunities for unemployed Australians.

Australian farmers are particularly harmed by domestic tariffs because the nature of international commodity markets mean that these costs cannot be passed on in the international market. In addition, tariffs can increase the exchange rate, hurting exporters. In effect, non-protected industries involuntarily subsidise the inefficient protected industries.

Tariff protection has a negative impact on industrial relations because protected manufacturing industries face less pressure to constrain labour costs, and less incentive to advocate industrial relations reforms that promote efficiency. Reductions in tariffs are required if beneficial industrial relations reforms are to be achieved. In addition, wage increases in protected manufacturing sectors flow on to other sectors which are not protected, raising their costs.

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9. Source: Productivity Commission *Trade and Assistance Review 2001-02*, table 3.2 page 3-12.
10. The Strategic Investment Program, outlined in Section 3, is very poorly designed as it does not really encourage innovation, but rather it encourages firms to remain in a declining sector.

## 4.3 Equity

It is generally recognised that taxes on clothing are regressive. This is supported by the Household Expenditure Survey[11], which shows that the proportion of income spent on clothing diminishes as income increases:

| | Quintile (by gross income) | | | | |
|---|---|---|---|---|---|
| | Lowest | Second | Third | Fourth | Highest |
| Spending on clothing | 12.76 | 18.44 | 24.66 | 39.76 | 63.94 |
| Income | 159.62 | 413.96 | 712.31 | 115.75 | 1996.29 |
| **Percent of income spent on clothing** | **8.0%** | **4.5%** | **3.5%** | **3.6%** | **3.2%** |

Clothing is seen as a basic necessity. It is entirely unclear why a tax should be placed on the very poorest people (who are often without jobs) to enable others to retain their jobs.

There are also horizontal inequities created by tariff support. There is nothing particularly unique about firms or employees in the TCF sector; yet they are provided with massive levels of industry support that is unavailable to other firms or employees involved in similar industries.

11. Source: ABS (2000) *1998-99 Household Expenditure Survey*

# 5. The arguments for TCF industry support

There are a number of erroneous arguments used to advocate industry support. These arguments have been accepted in the past by policy makers because the voices of a small few who support assistance are louder than the voices of the almost 20 million Australian consumers (as well as businesses) who lose from industry support.

## 5.1 Regional development and employment arguments

NFF accepts that there may be employment effects from removal of protection. The fear of job losses drives much of the argument against tariff reductions.

NFF rejects this view. Agriculture is a much larger regional employer than the TCF industries, and is hurt by TCF tariffs. Continued tariff reform is needed to ensure farmers remain competitive and can provide employment in rural and regional Australia.

As argued above, the costs of tariffs are greater than the benefits they provide. Experience in Australia and overseas shows that employment losses from tariff reductions are soon recovered by increased employment in other sectors. As the Industry Commission noted in its 1997 report on the TCF sector: "Tariff protection cannot be expected to increase or even maintain the total level of employment in the economy. Evidence — contrary to popular perception — from Australia and other countries is that it does not do so."[12]

Tariffs have not stopped the TCF industry from losing market share or employment. Over the past 10 years, the share of imported clothing on the domestic market rose from 19 percent to 45 percent and imported footwear rose from 36 percent to 65 percent. Employment fell by more than 40 percent over the same time period. This indicates a continuing need for the industry to adjust – tariff support will not prevent these pressures.

NFF accepts that tariff reductions may cause temporary disruption to firms and workers in the TCF sector. This is clearly not a reason to delay or cancel the necessary reforms; instead targeted adjustment assistance could be provided to re-skill employees and make the employment transition as easy as possible.

## 5.2 Strategic industry arguments

Protection is also advocated on the basis that particular industries are strategic for reasons including security, increasing returns to scale and value adding.

Australia is a vocal opponent of the strategic industry argument used overseas to defend protectionism in agriculture. Since September 11, the argument that "an army marches on its stomach" has gained attention. Australia will have no credibility opposing this argument overseas in agriculture policy if we resort to the same argument at home to defend tariffs.

While increasing returns to scale may be relevant in some industries with very large capital investments, this is largely not true for the TCF sector. Thus the increasing returns argument is largely irrelevant for the TCF sector.

Another tired argument used for support of the TCF sector is that value-added production and exports are more important for Australia than production with low value added. This view is erroneous on a few levels. Firstly, if high value added is very important, then we should actually support the service industries instead of manufacturing, as they have even higher value added. Secondly, there is nothing particularly unique about the value adding in TCF industries – how does this differ from value adding in any other industry?

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12. Industry Commission (1997) pXXIX

In any case, NFF naturally does not support the argument that value added products are inherently better, because Australia has important advantages in farming which go beyond the narrow value added definition used for this argument. In particular, many farmers have invested in improving quality (for example by reducing wool microns), they have demonstrated high rates of productivity growth, and utilise leading edge technology to compete in a global market place. We have some of the most efficient agriculture producers in the world.

## 5.3 Broader arguments against trade liberalisation

There are also broader arguments used against free trade. These include that free trade exploits workers in poorer countries (particularly children), causes environmental degradation, or causes inequality (both in the exporting and importing countries). NFF does not feel it needs to address these erroneous claims; they have been addressed in many other forums.

Behind these arguments is often the idea that imports are bad and exports are good. There are many problems with this thinking. It of course ignores the basic concept of comparative advantage, which means that unilateral tariff reductions are in Australia's benefit.

In addition, Australia needs imports as inputs in order to enable us to export; imports also contributing to higher standards of living. In any case, it is not clear that TCF protection is beneficial in this regard – tariffs reduce Australia's ability to export competitively.

Arguments relating to specific trade negotiations are discussed in Section 6 below.

# 6. International trade negotiations

Australia is a strong advocate for trade reform. Farmers view the current multilateral trade liberalisation round (the Doha round) as vital for securing greater access to distorted world markets and reducing levels of distortionary support. The rest of the world watches Australia closely and our international credibility could be totally undermined if we say one thing at the WTO but do the opposite back home. This is particularly important given our leadership of the Cairns Group. It is clear that lack of movement on TCF tariffs would reduce our authority at the WTO.

It has been argued that Australia's already aggressive tariff reductions are ahead of our trading partners and we should give time for other nations to "catch up"; and, that the future of trade liberalisation in the world is bleak and a likely surge in protectionism might catch us unawares.

NFF argues against these views. Trade is a "win-win situation", not a struggle to preclude foreigners from access to local markets. As noted above, unilateral tariff reductions are in Australia's interest. NFF advocates that the reform undertaken by Australia in the late 1980s and 1990s has, far from reducing negotiating power, enabled Australia to negotiate internationally with a leadership role and from "a position of strength"[13].

13. See NFF submission to Productivity Commission *Review of General Tariff Arrangements*, 2000

# 7. Conclusion

TCF tariffs and industry support are detrimental to Australian consumers and exporters, are inequitable, provide little benefit even to firms and employees in the TCF industry, and damage Australia's credibility in arguing for free trade internationally, especially in trade of agricultural products.

As a result, the Government should reduce the TCF tariffs, in line with earlier commitments, from 2005. Tariffs should then be eliminated by 2010 in line with our APEC commitments. Industry support programs should be reduced in line with tariff reductions. Any remaining support programs must not create perverse investment incentives in the TCF sector. These programs should instead be used to assist TCF industry employees with re-training and skills development to facilitate transition to ongoing employment.