PRODUCTIVITY COMMISSION INQUIRY

POST 2005 ASSISTANCE ARRANGEMENTS FOR THE TEXTILE, CLOTHING, FOOTWEAR AND LEATHER INDUSTRY

PRESENTATION BY THE CITY OF GREATER GEELONG TO THE PUBLIC HEARINGS

JUNE 2003

Presentation by the City of Greater Geelong to the Productivity Commission (check against delivery).

INTRODUCTION

The City of Greater Geelong welcomes the opportunity to present its views about the Geelong based TCFL industry and its future development needs to the Productivity Commission in relation to the Inquiry into future assistance arrangements for Australia's TCFL industries.

Presenting on behalf of the City of Greater Geelong is:

- Cr Barbara Abley, Mayor
- Cr Heather Wellington
- Terry Hearne, Manager Economic Development
- Darren Gray, Industry Development Officer

While the presentation is being made by the City Council, it reflects the views and needs of the industry in Geelong and the broader based community that interacts with this important segment of our regional economy. This position has been derived through extensive consultation with the local industry, particularly through the Geelong Manufacturing Council, the Geelong Textiles Network, the Geelong Chamber of Commerce, and directly with local TCFL firms, community groups and unions.

In this presentation, we will:

- Briefly outline the significance of the TCFL industries to Geelong
- Reiterate our view on Geelong industry assistance needs for the future (as highlighted in the City's original submission to the Inquiry)
- Address specific issues raised in the Commission's TCFL Position Paper (released in April) which are pertinent to the industry in Geelong
- Highlight priority actions for the Geelong based industry to ensure its ongoing development and viability
- Outline assistance needed to ensure the industry can fully achieve its potential.

SIGNIFICANCE OF TCFL TO GEELONG

As highlighted in our initial submission, Geelong has a long and noted history of extensive activity in the TCFL industry. It is the most significant regional cluster of TCFL manufacturers in Australia, and the only TCFL cluster with a major education, training and research and development infrastructure at its centre.

There are almost 70 TCFL companies operating in the Geelong region, ranging from small family owned companies servicing the local market, to major internationals with a clear global focus. As is the case for the industry worldwide, the Geelong TCFL landscape is highly diversified, with companies engaged in early stage wool processing and leather tanning, production of intermediate stage yarns, fabrics and technical textiles, through to a wide range of consumer products including carpets, blinds, awnings and of course apparel, most notably surfwear.

The significance of this industrial sector to the local economy cannot be underestimated:

- The industry employs 2,150 people, with a further 2,838 persons estimated to be employed in related industries with a direct dependence on the TCFL sector
    - comprising over 14.2% of the manufacturing workforce (compared to 8.9% for Victoria as a whole)
- Total TCFL turnover contributes some $440 million to the local economy each year
- The industry generates in excess of $70 million in wages and salaries annually.

GEELONG'S POSITION ON FUTURE ASSISTANCE

The City of Greater Geelong articulated the following position on future TCFL assistance arrangements, in our initial submission to this Inquiry (i.e. in March this year):

- TCFL tariffs must stay at their current levels until at least 2010, and any further reduction after this time must be subject to a review process in 2008
- The Strategic Investment Program (SIP) and the Expanded Overseas Assembly Provision (EOAP) scheme must be continued at least at current levels
- The SIP must be modified to allow greater access to it across the TCFL industry and the procedure for applying for funding simplified.

The main reason for adopting this position is the fact that the industries will continue to undergo major transition over the next 10 years as all countries move to reposition their industries as global support measures for the sector continue their process of change. In this environment, it is important that we manage the change process for our own industries to ensure:

- We do not undermine the necessary critical industrial mass that has developed in our region, and

- We develop a strong, viable and international competitive industry building on the very real strengths already evident with the Geelong industry.

RESPONSE TO THE PRODUCTIVITY COMMISSION'S POSITION PAPER

There were many issues raised in the Commission's TCFL Position Paper which require a response. For some of the issues, the Geelong Council concurs with the Commission's views, and for others we believe alternative conclusions are warranted. We address both sets of issues, as well as those where the Commission specifically sought comment.

At the outset though, the City of Greater Geelong would like to congratulate the Commission on its very positive contribution to the debate. While we do not fully agree with all the recommendations suggested in the Position Paper, we do note that the Commission has been very cognisant of the continuing pressure that will confront the TCFL industries, and of the potential for key segments of the sector to be internationally competitive in a freer trading environment in the future.

As such, we welcome the thrust and directions of the Productivity Commission's preliminary recommendations, even though we believe the end point falls short of the best outcome to ensure the most desirable future development of the industry.

We would now like to address these specific issues.

TCFL Assistance Package

We note that the Productivity Commission supports a "dual approach of transitional budgetary assistance" during the period of tariff reform. Geelong fully concurs with the need for a balanced approach between tariffs and positive assistance for the industry. Both measures are necessary to ensure the most appropriate, ongoing development of the TCFL sector in Australia.

Tariffs

The Productivity Commission has recommended that TCFL tariffs be 'frozen' at 2005 levels until 2010, and then cut to 5% in 2010, with the exception of clothing, towels and bed linen tariffs, which are cut to 10% and then further reduced to 5% in 2015.

Of all the options presented in the Commission's Position Paper, this is clearly the most preferred, but we consider this is still too severe given the market environment confronting Australia's TCFL companies over the next decade.

The City of Greater Geelong has previously argued that the scheduled tariff cuts for 1 January 2005 should not be implemented, as our major trading partners have not yet reduced their trade barriers to the same extent and nor have the expected micro-economic reforms been implemented within Australia. We do not resile from this position.

However, if the Federal Government is insistent on going ahead with these cuts, then there should certainly be no further tariff reductions implemented after 2010 unless there are demonstrable, matching cuts in assistance on the world scene. We note the Commission believes these relativities are irrelevant, but nothing could be further from the truth as the industry must make its decisions based on its positioning in the global TCFL supply chain.

Duration & Extent of Budgetary Assistance

The City of Greater Geelong notes and fully supports the Productivity Commission's recommendation that SIP type budgetary assistance be extended beyond 2005. And we commend the Commission's foresight in recognising that a 5-year program is too short to generate the full extent of industry restructuring required to ensure a sustainable and vibrant industry in the free trade environment expected by 2015.

However, we are surprised that the Commission has decided that the budgetary support should only apply for 8 years, rather than the full 10 years which will be required by the industry as it undergoes significant change. Moreover, we cannot fathom why the extent of funding should be halved in the second half of that program. The TCFL industries will be subject to considerable adjustment pressure once tariffs start reducing after 2010 and the final years leading to the position in 2015 will no doubt see a major shift in the nature and structure of the industry (note the significant changes that occurred in the industry over the last 5 years as the industry came to grips with the last series of tariff cuts).

The City Of Greater Geelong recommends that Budgetary Assistance be continued beyond 2005, for a period of 10 years, with a funding allocation based on the current annual level.

Nature of Budgetary Assistance

The Commission's Position Paper suggested 3 alternative means for delivering the Budgetary Assistance and has sought feedback on these options, which are:

1. SIP with modifications
2. Bounty based on incremental value added
3. Competitive Bidding Scheme

Whatever the nature of the mechanism for providing this assistance, we agree with the Commission that the scheme adopted must be able to:

- Reward incremental / new activity rather than subsidise activity that would have been undertaken without support.
- Give firms flexibility to judge what spending will best promote their future competitiveness (including, where appropriate, reducing dependence on TCFL manufacturing activity). It is essential that the support lead to strategically desirable outcomes.
- Provide support to firms likely to survive and prosper as a result of that support.
- Provide a sufficient level of support to make a difference to firm behavior.
- Avoid discrimination against small firms, which otherwise meet assistance criteria.
- Promote certainty and transparency.
- Keep administrative and compliance costs low, while minimising the risk of gaming and abuse.
- Minimise the risk of complaints to the WTO.

The Commission suggests that not all the objectives can be met simultaneously, as some level of trade off will be required. However, we believe the objectives can be met through the continuation of the current SIP scheme, provided certain modifications are introduced for any extension of the program beyond 2005. These will be discussed later, but first we thought we should briefly comment on the other two alternatives raised in the Position Paper.

The Value Added Bounty approach would create more problems than it would resolves. As the Commission itself highlights, the definitional problems alone would make the scheme unworkable. Then there is the issue of firms that generate a high degree of value added in their outputs, but whose overall turnover is reduced. They would be achieving the desired outcome (increasing the value add share of total sales) but in absolute terms their total value added may have declined as their market contracts. Alternatively, the prospect for "gaming" would be high, inducing some firms to alter their accounting systems to generate the required result. The compliance cost and uncertainty about such an approach suggests that it is an inappropriate means of budgetary assistance.

The "picking winners" approach would certainly enable more targeted assistance and would ensure that funding was provided for activities that have been determined to foster the desired outcomes for the industry's ongoing development. However, the Government would need to be confident that it had identified the most appropriate criteria for awarding the funding, to be certain that the assistance was indeed channelled towards the sustainable and growth sectors of the industry. This has proved difficult in the past, as clearly evident from a review of the funding recipients under the former TCFL Development Authority programs.

Furthermore, while SIP is an entitlement scheme, it is based on firms undertaking spending on various eligible activities. These activities in themselves are based on an assessment of the necessary attributes to be nurtured to ensure a sustainable industry in the future – i.e. would undoubtedly form part of the criteria for determining "winners" in the industry. Surely therefore, it is better to continue with the SIP scheme, but introduce modifications which will ensure that it is the "winning characteristics" within firms that are rewarded?

Modifications to the Strategic Investment Program

The Position Paper identified a number of areas in which modifications to the SIP scheme may be warranted, but stopped short of making any recommendations on these. The possible modifications included:

- Clarifying innovation
- Providing advance rulings
- Relaxing audit requirements
- Prompter payment
- Reducing the $200,000 minimum spending threshold
- Allowing eligibility for 2nd hand equipment
- Including early stage processing

With regard to innovation, the City of Greater Geelong's understanding is that the definition of innovation (for SIP) is well understood and is now working well. Certainly in the first year of the Program there was a great deal of confusion about this matter, but Ausindustry now appears to be working closely with claimants to clarify the nature of projects undertaken and the companies concerned have every opportunity to explain the nature of the innovation implemented.

However, where the difficulty arises is in the uncertainty as to whether certain project expenditures will be eligible. This often hinders firms committing as much time and effort as they should to certain projects (particularly in the early stages until they are more confident about the commercial outcomes). The problem could be overcome if the delivery agency (whether it is Ausindustry or some other forum) provided advance and binding rulings. This would eliminate much of the uncertainty that still exists with the scheme.

The audit requirement does not appear to be particularly onerous on the industry. Only those firms required to prepare audited accounts under the Corporations Law need to provide such accounts in support of their Claim. Otherwise, all that needs to be audited is the Claim itself. We accept that this is inevitable if companies are seeking to obtain funding on the basis of eligible expenditure that they have undertaken. The Government clearly must have some proof that the expenditures have occurred for the purposes claimed, and in the absence of audited statements some other form of proof or checking may be required. We can see no reason why any such alternative would be less onerous than the audit, and therefore see no reason for the suggested modification.

From our understanding, payments on Claims are made relatively quickly. Moreover, with the advent of the Advance payment, firms are able to get 50% of their expected funding entitlements before they actually have their claims (and where necessary, their accounts) audited. The only way that payments could be made more promptly would be if the payment system where not made in arrears. But this would mean a fundamental change to the scheme.

In relation to the $200 000 threshold, this is certainly a disincentive for many of the smaller businesses in the industry. Certainly, we are aware of many of the Geelong based businesses that have found this to be an unduly inhibiting factor of the current SIP scheme. And it is these small to medium sized businesses that often have the energy and the drive to pursue innovative practices and market opportunities, yet they are effectively precluded from the scheme.

However, it is not just the spending threshold, but the sales cap that acts against the interests of small businesses seeking to use SIP. For many of the innovative ideas that the companies wish to pursue, the expenditure will ultimately become significant. But the sales generated by such innovation will not eventuate for a period of years, yet the funding the companies can receive will be limited to 5% of their current turnover.

Many companies investing in new processes and treatments are finding that the funding entitlements they can generate are well over the allowable amount (given the turnover cap), and this acts as a real disincentive for small businesses to embark on major change. Firms with annual turnover of less than $10 million find it very difficult to obtain the full incentive under SIP for this purpose. Special consideration must be accorded to the smaller sized firms, especially as it is unlikely that the activities of such firms would create even a ripple on the world scene (and therefore would not come under the scrutiny of the WTO).

The SIP type 1 funding should include eligibility for second hand equipment. The industry is able to source state of the art second hand equipment on the world market at very competitive prices. It is counterproductive to insist on brand new plant and equipment when the equivalent is available at a fraction of the cost.

We understand that the SIP assistance is provided to facilitate the development of a sustainable industry in the longer term and to help it overcome transitionary pressures, beyond its control, in the short to medium term. The early stage wool processing industry is one such sector that is confronting significant trading pressures at the moment and we believe special assistance is warranted to help it through this period. This need not necessarily be provided through SIP, but rather through stand alone assistance provided for the specific purpose of helping that sector of industry restructure.

On the issue of industry restructuring, the Greater Geelong Council also believes that the type 4/5 arrangements should be modified to ensure they provide a real incentive for further industry rationalisation. Such funding should not extend to provide exit funding for people leaving the industry, but it should enable restructuring within individual corporate entities as well as within industry (with two or more entities).

Market Access and Market Development

As discussed earlier, the Productivity Commission appears to have taken the view that international trade barriers are irrelevant for the Australian industry. While the Position Paper encourages the Government to pursue improved market access in other countries, it argues that there is no case for TCFL specific market development program (especially as generally available programs exist).

However, barriers to market penetration overseas are a real issue for the industry. Often these barriers are not just the regulatory impediments imposed by Government, be they tariffs, licensing requirements, technical standards, port procedures or whatever, but the openness of accessing the distribution channels that can be a real impediment, especially for the smaller businesses (even if this is just an awareness or relationships issue).

This is particularly important for the TCFL sector, comprising a high percentage of small businesses, as it is of paramount importance that it establishes a foothold in export markets as the domestic market, already small, continues to contract. Thus it is imperative that special attention be accorded to the sector, firstly to help raise its awareness about prospects in international markets and secondly, to help it develop and research new markets. This can be achieved by either allowing such activities to be eligible under the SIP replacement program, or by implementing a dedicated TCFL Market Development Program. The former would be of greatest value to the larger firms that will undertake such activity with their own resources, while the latter would be more suitable for smaller firms that may need to collaborate to get the best result from their efforts.

Enhanced Overseas Assembly Provisions

The City of Geelong notes that the Productivity Commission has agreed with its recommendation that the EOAP should be continued in its current format. We commend that position.

Labour Adjustment

We note that the Commission's Position Paper suggests that further consideration needs to be given to adjustment support for displaced TCFL workers (including outworkers).

As highlighted in the City's initial submission, social issues are an integral element in need of consideration in this debate. The Commission itself has recognised the implications of the fact that a large percentage of TCFL workers are women from non-English speaking backgrounds with skills not readily transferable to other industries.

Previous research clearly shows that these people have difficulty gaining alternative employment. Yet, since the time of the previous inquiry into the TCFL industries, employment in this sector in the Greater Geelong area has declined by 21% (based on available Census data for 1996 and 2001 respectively). Unfortunately, the effect of this displacement is not always readily apparent in the available unemployment figures, as many of the displaced workers have ceased to seek new positions because of the difficulties confronted and the negative perceptions of TCFL workers.

Government has a moral responsibility to address the social consequences of any policy decisions it makes. To the extent that undue hardship is imposed on individual TCFL workers that are displaced, a program to help them readjust and find new work is warranted. A labour adjustment program to help retrenched TCFL workers, especially in TCFL dependent regions, should be a major prerequisite of any future policy program for the sector.

OTHER ISSUES OF RELEVANCE TO GEELONG

The TCFL industry structure in Geelong is unique in that it is the only area in Australia where the sector is so heavily clustered and concentrated, within such a clearly defined region. This provides both opportunities and threats.

The City of Greater Geelong has initiated the development of a Strategic Action Plan for the local TCFL industry to help build on existing strengths and to address inherent weaknesses evident in the industry.

A major strength of this structure is that it is well served by a highly developed and focussed training, education and research infrastructure, provided through CSIRO Textile and Fibre Technology, Deakin University, International Fibre Centre and the Gordon Institute of TAFE.

However, a weakness of the existing industrial configuration is that it is highly diverse, comprising many small singularly focussed businesses that lack the resource and knowledge base to readily respond to changing market conditions.

These are the two areas that we specifically are seeking to address in the Action Plan. However, Federal Government programs could help significantly in the achievement of the desired development of this industry.

For instance, programs to encourage the industry's use of the research and development facilities at the various institutions (such as the former TCFL Technology Development Fund) would help build a greater interaction between the two parties and foster a greater focus on innovation within the industry.

Similarly, programs to promote greater collaboration between firms would help the development of industry driven clusters to realise competitive advantages that exist for the industry collectively. The former TCFL Market Development Program had the potential to assist in this regard, but this was for a specific purpose and similar outcomes could be achieved through a more broadly focused (in terms of outcomes) small business or regionally oriented TCFL program.

The City of Greater Geelong strongly advocates the re-introduction of sector specific programs aimed at encouraging improved performance for the industry overall. These have the potential to realize significant outcomes with relatively small outlays (i.e. in the order of $2 – 3 million per year).

CONCLUSION

The City of Greater Geelong reaffirms the significance of the TCFL industry to the region's economy. It is extremely important to the well being of the local community. It is a vibrant sector with considerable potential to continue to be a key plank in the Geelong region's economic development.

However, the sector will undoubtedly undergo significant structural change over the next decade, and to facilitate this change will require a combination of support and nurturing to achieve the desirable outcomes. At the very least this will require:

- The retention of TCFL tariffs at their current levels until at least 2010
    - With any further reduction after this time, subject to a review process in 2008 and contingent upon demonstrable, matching reform by our major trading partners

- The extension of the SIP and EOAP schemes for a further 10 years, at least at current levels, with the following modifications for SIP
  - Provision for advance rulings
  - Elimination of $200,000 threshold and 5% cap for small businesses
  - Eligibility for state of the art second hand equipment under Type 1
  - Greater incentive for industry restructuring and consolidation (both within and between firms)
- Introduction of special sectoral TCFL programs for early stage wool processing, market development, small business and/or regional development.

In closing, the Victorian State Government has completed economic modeling based on the regional economic impacts of the Productivity Commission's preferred option. This work was carried out by the Department of Treasury and Finance and the National Institute for Economic and Industry Research.

The modeling shows that there are currently around 5,100 people that live in Greater Geelong with jobs dependent upon the TCFL industry and there are about 4,777 people that work in Greater Geelong with jobs dependent on the TCFL industry.

The TCFL industry contributes significantly to the local economy, accounting for 4.5% of Greater Geelong's gross regional product.

If the Productivity Commission's preferred option is adopted then it is estimated that 651 jobs would be lost in Greater Geelong, including 342 direct TCFL jobs, and the industry's contribution to gross regional product would decline by .02% per annum by 2020.