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Dr David Robertson
Presiding Commissioner
TCF Inquiry
Productivity Commission
PO Box 80, Belconnen, ACT 2616

Dear Dr Robertson

The Australia Association of Leather Industries has been following your inquiry into the textiles, clothing footwear and leather industries with great interest. The Association was pleased to submit its submission outlining the views of the industry and its participants to the Commission in April. We were subsequently encouraged by the Commissions position paper, as it recognized the strategic intentions of the existing, and previous government programs, and set out a generally balanced approach to designing some replacement strategies for beyond 2005.

Whilst we do not have the necessary expertise to develop a successful whole of industry approach by a government organisation we would like to emphasise a number of what we regard as key points

The Strategic Investment Program (SIP) is a strategic program designed to encourage the development of an internationally competitive industry – that is one able to compete in its own markets and overseas. Given the relatively small size of the Australian market, for any modern manufacturing industry this means a significant export capability. The leather industry has responded to this challenge and has performed, in our opinion, in the most positive manner of all the various sectors involved in the industry.

This concentration upon strategic investment and development is we think the key reason why sectors of the industry have fared differently under the scheme. A key issue for the Commission is whether it will continue this emphasis upon strategic investment or implement a tariff reduction compensation scheme.

I understand that you may have received some comment that SIP has encouraged the development of excess capacity in Australia. The leather industry's export performance and the investment planned over the remainder of the SIP scheme indicates that new leather capacity is replacing outdated capabilities designed to satisfy a largely domestic manufacturing base of clients.

I also understand that there is some support for government funds being paid to firms on the basis of value added (either absolutely or as suggested in your report, incrementally). In our view there is no logical basis for providing support to value added in isolation – such a move would merely reward labour intensive industries with minimal prospect for substantial export earnings.

I would also point out that the SIP methodology for calculating value added discriminates against capital intensive activities, such as leather production. This is demonstrated by the levels of value adding as measured by SIP ranging from about 25% to 85 % - the lower levels being associated with large capital intensive activities such as leather processing and the higher levels with labour intensive assembly activities.

It would be ironic if a system which was intended to reward high value adding activities, (which we have always understood to be associated with capital intensity, technology and exports) turned out that what it really encouraged was labour intensive piece work for the domestic market.

There has been considerable discussion within the industry as to whether any domestic developments, such as tariff reductions, should be conditional on international developments. In our view there is merit in both sides of the debate: industry should be under no illusion as to what the Government's plans are but at the same time Australian tariff levels are potentially valuable negotiating coin in ensuring that our exporters are able to access overseas markets (i.e. 50% general rate on leather into China).

Our suggestion would be to legislate the proposed changes to 2010 and make further enabling legislation conditional upon the outcomes of an objective quantitative review – if more than say 85% of world trade in TCFL was at the Australian nominal tariff levels (plus or minus a margin) then further tariff reductions should occur by 2015.

The attached paper (prepared for an industry working group on the inquiry) makes a number of suggestions regarding what if any modifications should be made to a SIP type scheme. In brief these modifications are designed to:

- promote certainty and transparency.
- provide sufficient support to make a difference.
- give flexibility to the firm to judge what best promotes their future competitiveness.
- provide support to firms that exhibit ongoing solvency.

The key changes would be to simplify types 1, 2 and 3 and make them more relevant to firms that can become internationally oriented and competitive. Types 4 & 5 have been largely irrelevant to industry concerns – partly through their concentration on restructuring in regional areas only. In our view if the Government considered it appropriate to provide support to regional based entities then this would most effectively be done by abolishing the type 4 and 5 elements and introduce a regional uplift factor which would increase the value of any grant by say 10%, subject to the 5% sales cap.

Whilst the industry is able to demonstrate innovation under the existing scheme, we have been concerned that in some instances the hurdles appear to vary – sometimes the test is applied to the outputs we produce, sometimes to inputs used to create a particular output, whilst at other times the issue has been how complex has it been to develop a particular product. This unpredictability is a significant problem in evaluating the future effect of the scheme when considering particular projects.

This could be addressed by broadening the range of eligible expenditures to include a wider range of activities to enable firms to better enhance their efficiency in different ways as suggested by the Commission in its position paper. These included workforce flexibility; supply change improvements; improved marketing & branding; better information technology systems and so on.

The SIP scheme has been fundamental to the development of the leather industry in Australia's leather industry. These developments, which commenced with the establishment of the import credit scheme in 1991, are starting to show significant benefits for the economy as a whole and with the appropriate nurturing a significant world class industry will develop.

Naturally, if you have any queries or would like me to clarify any issue or point I would be pleased to assist.

Alan Rich
President
18 June 2003

Slide 1

Australian Association of Leather Industries

Review of Post 2005Assistance Arrangements for the TCF Industries

Response to Productivity Commission Position Paper

June 2003

Slide 2

Overview of Australia’s leather industry

- More than 3000 employees
- Major regional employer, customer and supplier
- >$730 million turnover
- Located in major regional and metropolitan centres throughout Australia
- Australia’s leading TCFL exporter - 35% of TCFL exports

Slide 3

LEATHER IN THE 1990's

- Best performing sector:
  - turnover up 33% compared to -6% for TCFL
  - value added up 66% compared to 22% for TCFL
- nearly 210% increase in export values
- most export intensive sector
  - 66% compared to 25% for TCFL
- smallest reduction in employment
  - only down 3% compared to 30% for TCFL
    - » (source TCFL Forum)

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Leather Industry Strategic Direction

- Committed to growth and continuous improvement
- Adopt and develop technology
- Invest in people, equipment and products
- Innovate and export

Slide 5

Leather Industry Strategic Direction

- Technologically complex industry
- Automated processing
- Environmental and waste technologies
- Organic and inorganic chemical research & development
- Engineering, information technologies and logistics

Slide 6

Current Arrangements

- Tariff pause and SIP have provided conducive environment for industry strategies
  - investment
  - innovation
  - export
- Strategic scheme designed to foster potentially competitive areas
  - not an adjustment scheme for sectors that cannot look to export

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Policy Principles

- Australia must have industry policies that are:
  - consistent
  - stable
  - encourage positive adjustment
- Can’t develop or implement in isolation from our trading partners and competitors

Slide 8

PC Position Paper

- Productivity Commission concluded that indefinitely continuing special assistance was not warranted
  - AALI does not support indefinite assistance
  - AALI notes that cost of current arrangements are lower than previous programs and the quantitative assessments are finely balanced

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PC Position Paper

- Productivity Commission concluded that fairness was not an adequate basis for determining policy
  - AALI seeks appropriate,not fair, support to:
    - achieve desirable potential outcomes
    - offset costs associated with previous policy effects
      - decentralization and fragmentation of infrastructure
      - reliance on domestic market

Previous policies include:
State based decentralization programs that lead to structural inefficiencies
Tariff protection
Import replacement and self sufficiency strategies

These have resulted in:
Lack of transferable skills for employees
Shallow labour markets
Mass manufacturing techniques

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PC Position Paper

- Productivity Commission concluded that the magnitude of the adjustment task that still lies ahead provides a reason for erring on the side of caution (pXXVI)
  - AALI agrees

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AALI's Recommended Approach

- Tariffs
- SIP
- Other matters

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Tariffs

- Evaluate international progress towards lower trade barriers in say 2010
  - if more than 85% of world trade in TCFL is subject to Australian nominal tariff levels then consider further reductions between 2010 & 2015
- Legislate tariff reductions through to 2010 as in Commissions recommendation
  - further legislation dependent on review

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Strategic Investment Program

- Continue SIP style program because it is working
  - capital investment & technology
  - innovation
  - strategic improvements

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Strategic Investment Program Improvements

- Type 1
  - increase type 1 rate to 45%
  - include state of art (<10 years old) second hand equipment
- Type 2
  - increase range of eligible type 2 expenditures as outlined by PC
    - workforce flexibility; supply change improvements; improved marketing & branding; better IT systems; etc

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Strategic Investment Program Improvements

- Type 3
  - Increase value added cap to 10%
  - or abolish type 3 and double rate of payment of type 1 and 2
- Type 4 & 5
  - Abolish types 4& 5 and replace with regional uplift factor

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Other Issues

- for companies with program of performance and participation in SIP enter into annual contracts for post 2005 support

- Ministerial fund for projects that are of value to the economy that would otherwise not fit within the guidelines

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Other Issues

- overseas assembly provisions (duty free entry) should exist for goods produced offshore by producers who purchase Australian raw materials
  - i.e. leather footwear and furniture