Dr. David Robertson
Commissioner
TCF Inquiry
Productivity Commission
Belconnen ACT 2600

Dear Dr. Robertson,

Supplementary Submission – Productivity Commission Inquiry Into Post 2005 Assistance for the TCF Sector

The Carpet Institute has welcomed the various opportunities to present its views to the Productivity Commission during the course of this Inquiry, as evident in our previous two submissions and in our presentation to the Public Hearing.

We noted that in the course of the Hearings the Commissioners specifically sought further feedback or clarification on a number of key issues. The purpose of this submission, therefore, is to comment on the matters raised.

Weighting of Key Drivers

The Commission highlighted in its TCF Position Paper, the type of design criteria and objectives that could be appropriate for a TCF Industry Development Program, post 2005. The Institute agrees that all the stated objectives are desirable, but notes the Commission's observation that some of these requirements have conflicting impacts and could not be satisfied simultaneously.

Given the obvious need for trade offs to be acknowledged and accommodated, the Institute would rank the desirability of meeting the Commission's stated objectives in the following order:

1. Provide a sufficient level of support to make a difference to firm behaviour
2. Provide support to the firms likely to survive and prosper as a result of that support
3. Give firms flexibility to judge what spending will best promote their future competitiveness
4. Reward incremental/new activity rather than subsidise activity that would have been undertaken without support
5. Promote certainty and transparency
6. Keep administrative and compliance costs low
7. Not discriminate against small firms which otherwise meet the assistance criteria
8. Take account of the extent of tariff reductions facing firms in different sectors
9. Minimise the risk of complaints to the WTO

The top 4 criteria are all important to ensure that the assistance program drives meaningful change in the industry, but that there is sufficient flexibility to allow firms to exploit their own unique points of difference in positioning in the global market place.

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The issue of discriminating against small firms should not arise if the criteria have been set properly and are being adhered to. The complaints under SIP are not that small firms miss out when they meet the criteria, but that the criteria are inappropriate for small firms. But there are many good and significant examples of small to medium sized firms benefiting under SIP.

The tariff reductions are imposing significant adjustment pressures on all sectors of the TCF industry. Even if a particular sector is not the subject of major tariff changes in its own right, the inter-relationships between all sectors in TCF are such that its market will no doubt be affected by the tariff reductions. But in any event, the focus of positive assistance should not be simply to help hold up industry suffering from increased import competition, but to develop the industry so that it can become internationally competitive and sustain this position. Such positive development is vital for all sectors.

While we recognise the imperative for Government to abide by its international trade obligations, the risk of complaints to the WTO about any scheme introduced by Australia is unlikely to be high. Australia is a small player in the world scene, and the extent of our exports into any market is proportionately minor in all major markets.

Capital Investment and Excess Capacity
Type 1 expenditure is not necessarily leading to over-capacity. The Type 1 funding available under SIP is actually encouraging the uptake of latest technology which otherwise would be at risk because of the very real concerns about overcapacity. The capital investment undertaken is geared specifically towards having more efficient and flexible operations not at generating higher volume output. In many parts of the industry such investment is necessary just to “stay in the game”.

There is a clear link between investment undertaken with SIP support and the development of differentiated product, rather than a focus on increased capacity.

Duty Credits
The industry is aware that the automotive scheme provides a component of support based on duty credits and that this is considered by both Government and the automotive industry to work well. There was a suggestion that because it does not constitute a budgetary outlay, but is more a form of revenue foregone, that the Government may be more relaxed about providing such assistance.

However, there is no question that a credit system discounts the actual level of assistance directly received by the company in question. So, if such an approach does not alleviate the budgetary constraints/pressures on Government then industry preference would certainly be for direct funding grants to be provided.

Market Access
This provides the key platform for the carpet industry’s future development. It is fundamental for the industry in the future to be growing on the basis of an export platform, especially as the domestic market share will become more and more pressured as import penetration grows.

That is, the industry will need to maintain an export focus to retain scale and thus enable critical mass to be sustained and unit costs to be constrained. But the industry's ability to break into overseas markets is seriously inhibited due to the wide scale control of trade by most countries around the world.

The extent of the trade barriers adopted by other countries and the implications of this on world trade was highlighted in a recent report by Werner/Kreitals on Global TCF Market Access prepared for the TCFL Forum. A copy of this Report has been made available to the Productivity Commission.

The Werner/Kreitals Report confirmed that the global textile landscape is undergoing a major shift in production and supply as a result of the various global and regional trade agreements being negotiated and implemented.

The Report highlights that the global textile & clothing industries are not yet subject to free competition, and will not be even after 2005, with many significant tariff and non-tariff barriers still existing, even in so-called 'open economies'.

The Report noted that in the TCFL sectors, tariffs rates are historically high. Despite tariff cuts during the Uruguay Rounds, tariff peaks remain common with the largest TCFL exporting countries having the highest tariffs protecting their own domestic markets. Most Asian countries report tariff rates for textiles in the range of 20 to 35%, and for clothing 30 to 50%. Added to these are various and significant taxes and other NTB's.

The Werner/Kreitals Report highlights that Non-Tariff Barriers (NTB) have mushroomed all over the world over the last decade. All major TCF producing countries (developing and developed) have some forms of non-tariff protection with virtually every country maintains some sort of subsidy or grant for its domestic TCF sector. But it is the developing countries in particular that have introducing a wide and various range of NTB's to more than offset the impact of any tariff reductions that they may have introduced.

Delinking Type 3 Grants

The issue about delinking Type 3 grants from Type 1 and 2 arose due to the confusing nexus between capital investment, R&D and value adding inherent within the current SIP Scheme.

However, the real problem occurs because of the disproportionately low capping of the value added component. Given that a cap of 5% of sales applies to the total grant that a firm can receive in any given year, it would appear unnecessary to apply a second tier cap on the Type 3 grant. However, given that most firms (and certainly all the more efficient and capital intensive firms) have a total value added that is less than 50% of turnover, the 5% cap on the value added component is unduly low. If it is considered necessary to maintain a cap on type 3, then it should be raised to 10% of value added, which would more realistically accommodate the standard industry practice.

Provision for SMEs

As highlighted above, the current threshold for eligible SIP (total) expenditure does not seem unreasonable. Expenditure of $200,000 over 5 years is not significant, nor does it represent an unattainable target. This is reflected in the fact that all SIP recipients to date account for 80% of the total output by the industry. So if greater access was made available, it is not going to have a significant impact on the overall operation of the sector. Indeed, it would not seem that SMEs have been unfairly treated, as we understand quite a few SMEs have commented on the type of activities they have undertaken due to the availability of SIP.

However, we do understand that by the time the smaller companies have reached the total threshold to warrant the return, or where they do undertake significant investment in eligible activities, that the sales cap on funding significantly reduces their entitlements simply because their sales are still low. So, there may be merit in providing specific support to SMEs for specific activities that will lead to future growth. But this would need to be a stand-alone program, with a specific amount of funding quarantined just for that purpose.

Rationalisation

As the Commission itself identified, we have two streams of industry in the TCF sector – those businesses that will exit and those that will continue. For all of these the journey has only just begun, with further industry development and restructuring still to occur. The industry needs support to achieve the desired outcomes as quickly and effectively as possible.

However, assistance to restructure and rationalise should be geared towards positive incentive to strengthen the businesses that are retained, and there is no need to provide funding for businesses exiting the industry.

It was considered that when the Types 4 and 5 components of the SIP scheme were first mooted, that this would provide an appropriate delivery mechanism to facilitate and accelerate further industry restructuring. Unfortunately, in practice this element of the scheme has provided insufficient incentive to generate the desired outcome.

Any future industry development arrangements should retain a Regional Adjustment element, designed to provide assistance for industry reconfiguration to selected firms (and separate sites within individual organisations) operating in designated regional areas (both metropolitan and non-metropolitan). This will provide necessary assistance in bringing local companies together with the intention of restructuring, rationalisation, consolidation, mergers and acquisitions, to deliver "demonstrable improvements in business efficiency and output as well as net economic benefit (through) a strengthening of the supply chain".

The "Regional Adjustment" element of the Program must be treated with as much flexibility as possible, with each application judged on its merits, at the time. Relocation costs associated with the merger of two firms, or consolidation of operating sites by any one firm, where the merger/consolidation serves to contribute towards the development of a sustainable consolidated enterprise, must be eligible. Such costs would include not only the decommissioning and dismantling of plant and equipment, the cost of transportation, and reinstallation and recommissioning, but the full costs of the acquisition.

Definition of Innovation
There is much confusion within industry over the issue of innovation and whether certain activities/expenditures will be deemed as innovative by AusIndustry and therefore eligible for SIP funding.

The suggestion seems to be that there are major sectors of industry “missing out” because of an unduly tight or uncommercial interpretation of this term, by AusIndustry. Yet, there appears to be ample evidence of companies in all sectors receiving considerable support under the Type 2 component of SIP. Indeed, there are many clothing and footwear companies that have benefited considerably under the Scheme.

This would suggest that there is no need to change the current arrangements, especially as both industry and AusIndustry now seem to have developed a better, clearer understanding about what is intended under the Scheme. In practice, if a firm has been able to convince AusIndustry about the extent of innovation in a particular project, there has been no problem in obtaining the entitled funding. It is only where the firm finds it difficult to describe where the innovation lies that claims are rejected. But even if the firm is not sure about what innovation exists in a project, why then should it receive government support?

Yours sincerely

Allan Firth
Executive Director
Carpet Institute of Australia
20 June 2003