

Productivity Commission's Review of Textile, Clothing and Footwear Assistance.

OVERVIEW

The NSW Government welcomes many of the Productivity Commission's ('the Commission') preliminary findings in relation to the Australian Textile, Clothing and Footwear (TCF) industry. The recently released Position Paper provides a thorough assessment of the future viability of the Australian TCF industry in an increasingly competitive marketplace.

The Australian TCF industry has undergone major structural change over the past 15 years. This has produced 'winners' and 'losers'. Whilst progressive tariff reductions have had an adverse impact on the TCF industry, significant benefits have also flowed to certain sectors of the TCF industry, Australian consumers, and the broader economy. For example:

- The Australian TCF industry has experienced a general improvement in its international competitiveness over the last decade (eg: the value of TCF exports has doubled in real terms since the early 1990's); and
- Australian consumers have enjoyed lower prices for imported and domestically produced TCF products (eg: household expenditure on clothing and footwear - as a proportion of total expenditure - has dropped over the last decade).

These reforms have also opened up the Australian TCF market to greater levels of competition and facilitated further industry rationalisation. This has enabled many Australian manufacturers to become more flexible and responsive to emerging market opportunities.

It is considered, therefore, that the most sustainable long-term strategy for the Australian TCF industry would be to continue this process of micro-economic reform. This proposal sees further tariff liberalisation post 2005, supported by a targeted and transparent industry assistance program. The proposed course of action should ensure that Australia's manufacturing base develops a strong market discipline.

Australian manufacturers should seek to specialise in high quality, differentiated and innovative niche products rather than engage in price competition with its low-cost international competitors. Such an approach would enable them to develop new products, and secure new markets both domestically and abroad.

It is also important to note that the move to establish bilateral trade agreements between Australia and its trading partners will further expose the TCF sector to low cost competition, particularly in the case of the United States and Thailand. This development further highlights the need for the sector to become globally competitive.

POST 2005 TARIFF REFORM AND INDUSTRY ASSISTANCE OPTIONS

The broad thrust of the Commission's findings is supported, that is, that there would not appear to be any reason for indefinitely maintaining preferential treatment for the TCF sector in the form of tariffs that are well above the average for the general manufacturing sector.

As a general principle, support for TCF manufacturers should not be detrimental to Australia's long term economic interests. The combined impact of the current tariff protection measures and assistance package comes at a significant cost to consumers and some other industries. Further reductions in tariffs after 2005 would reduce such costs to consumers. It would also provide the industry with strong economic incentives to improve its productivity and overall performance.

The NSW Government is also aware of the ongoing structural adjustments within the industry and the impact this has on employees in the sector. Accordingly, the NSW Government has implemented the Clothing Outwork Strategy, *Behind the Label*. This strategy addresses the serious industrial issues that face outworkers in the clothing industry. Key aspects of the Strategy include:

- Implementing new legislation, the *Industrial Relations (Ethical Clothing Trades) Act 2001*;
- Formation of the NSW Ethical Clothing Trades Council, which advises the NSW Government of industry initiatives to improve industrial compliance;
- Education and training program to assist outworkers; and
- Assisting employers to comply with their obligations through publications, conducting seminars and workplace visits.

NEW SOUTH WALES PROPOSAL

The following findings were considered (arising from the Commission's Position Paper) in devising the NSW preferred policy position for TCF tariff reforms and industry assistance post 2005:

- Australia's high unit labour costs mean that its TCF firms have a serious competitive disadvantage in producing standardised clothing and footwear items. Policies that seek to offset these competitive realities through higher tariff barriers would be neither effective nor in Australia's interests;
- While some Australian TCF producers have benefited from the tariff reforms and are now operating at internationally competitive standards, further industry rationalisation and job losses are inevitable; and
- Many Australian firms producing standardised clothing and footwear will be unable to compete against their low cost international competitors, regardless of the assistance regime.

TARIFF REFORM

The NSW Government would support a continuation of the TCF tariff reduction policy post 2005 until such time as it reaches the general manufacturing tariff rate of 5 per cent. Once achieved, TCF tariffs could be further reduced in line with any proposed movement in the general manufacturing tariff.

The proposed tariff policy would take the form of transparent, pre-announced, incremental reductions in the tariff level, at a rate that would be similar to the 'Effective Annual Percentage Reduction'¹ between 2000 and 2005 (see Table 1 for proposed tariff movements for specific TCF products).

This position is consistent with the NSW position put to the Commission in its 2002 inquiry into automotive assistance.

TABLE 1 Category of TCF Product	Proposed Tariff Policy Option			
	Effective Annual Percent Reduction* (2000-05)	PREFERRED OPTION: Proposed Annual Tariff Reduction (post 2005)	Year in which 5% tariff rate is achieved under the Preferred Option	Year in which 0% tariff rate is achieved under the Preferred Option
Clothing and Finished Textiles	1.7%	1.5%	2014	2017
Footwear	1.1%	1.0%	2010	2015
Woven Fabrics, Cotton Sheets etc	1.1%	1.0%	2010	2015
Table Linen, Tea Towels, F/wear Parts	0.6%	0.75%	2009	2015

This option is preferred above all other options because it would establish tariff reductions that are broadly consistent with the effective annual tariff reductions that:

- are currently being imposed upon the industry (between 2000 and 2005); and
- had previously been imposed upon the general manufacturing sector between 1991 and 2000 (of around 1.1 per cent p.a.)

Such a policy would be desirable because it would:

¹ The 'Effective Annual Percentage Reduction' represents the average annual percentage reduction in tariffs that will be imposed on the TCF industry between July 2000 and January 2005. It is calculated by dividing the total percentage reduction in tariffs (between 2000 and 2005) by the period of the tariff pause (i.e. 4.5 years).

- be in line with broad industry trends for continuing microeconomic reform policies;
- reduce input costs for other sectors and lead to lower costs for consumers;
- facilitate the growth of a TCF import/ distribution industry in Australia; and
- signal to other countries Australia's continuing commitment to the APEC trade liberalisation process.

As illustrated in Table 1, the proposed tariff reductions would see most tariffs reduced to 5 per cent by around 2010 (with the exception of 'Clothing and Finished Textiles' which would reach the 5 per cent level by 2014).

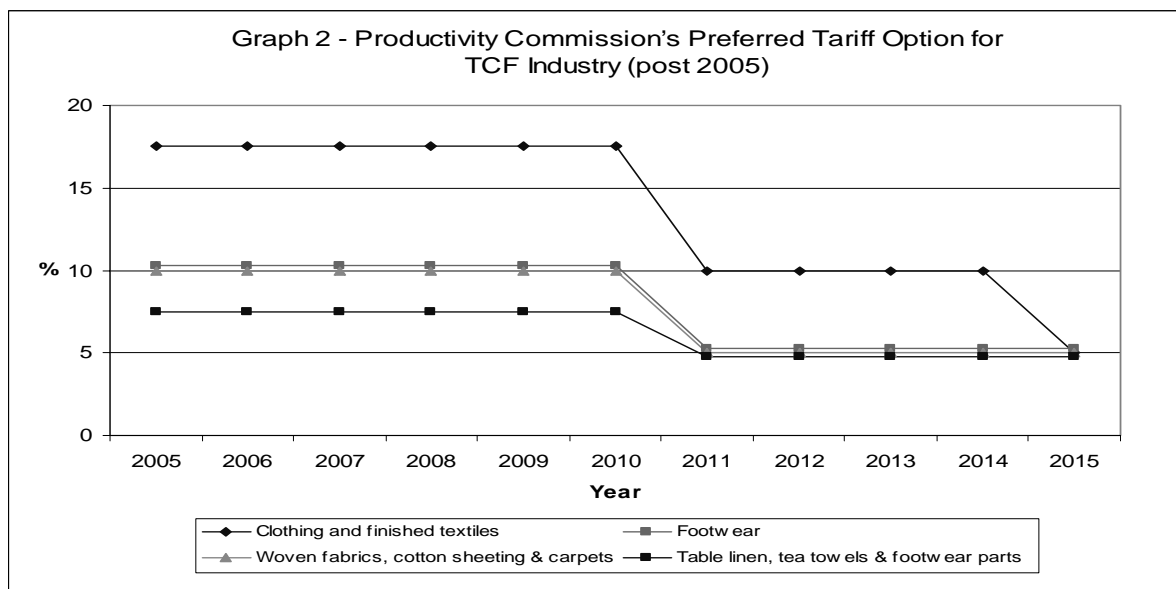
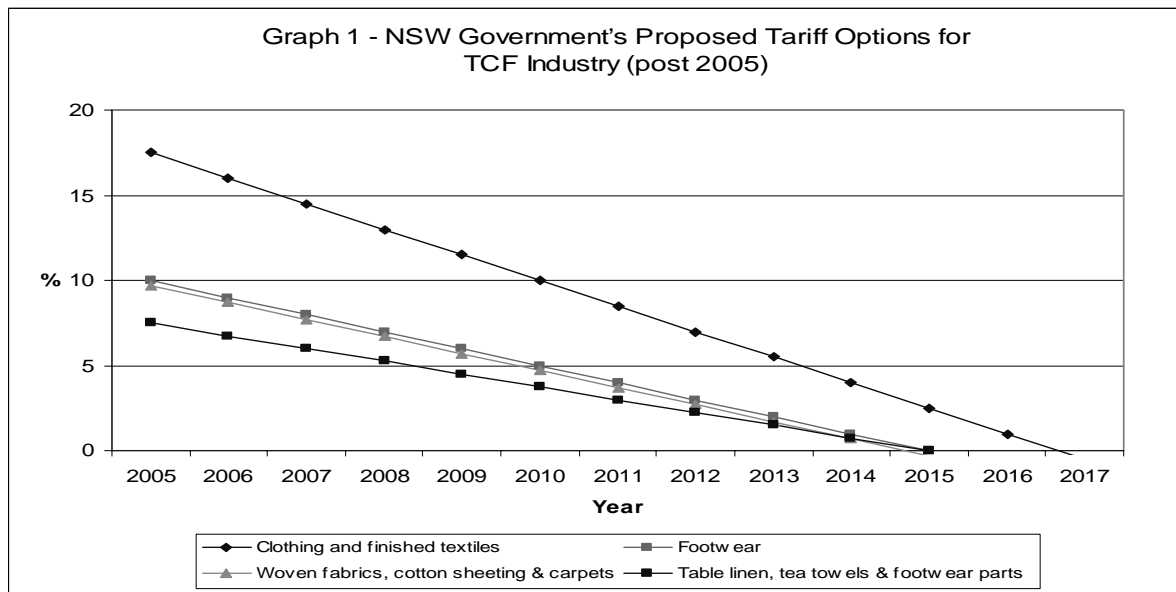
It is proposed that further reductions should depend on what happens with the general manufacturing tariff rate, whether it were to remain at 5 per cent for the foreseeable future, or whether the Commission were to reduce it during its proposed 2005 review of the general manufacturing tariff. Continuation of the above proposed annual tariff reductions below the 5 per cent level would see most tariffs reduced to zero by 2015 (with the exception of 'Clothing and Finished Textiles' which would be reduced to zero by 2017).

In determining the scope for further tariff reductions post 2005, consideration would need to be given to the rate of reduction that the industry could effectively sustain without significantly impacting on profitability, investment, market share, exports and productivity.

Comparison with the Commission's Proposed Options

This position is preferred over the Commission's preferred position (Option 4 in the Position Paper) involving large step-down tariff reductions in 2010 (as illustrated in Graphs 1 and 2 respectively) because it would:

- impose greater economic incentives on the industry (through incremental tariff cuts), which would help achieve the necessary 'dynamic' efficiency gains and improve overall productivity;
- provide a clearer path to tariff reform - thus providing greater certainty to the industry;
- facilitate a smoother process of structural adjustment within the industry; and
- reduce the scope for any future deferral of the proposed tariff reductions.



The NSW preferred option is broadly similar to the Commission's Option 2, which would see tariffs for all TCF sectors reduce to 5 per cent by 2010. Whilst the incremental nature of the proposed tariff reductions is supported in principle as in Option 2, it is considered that the reductions for the 'Clothing and Finished Textiles' sector in this option would impose significant adjustment costs.

The NSW proposal is essentially a hybrid of the Commission's Options 2 and 4. It incorporates incremental tariff reductions (Option 2) with a slower transition path for the 'Clothing and Finished Textiles' sector (Option 4).

It is considered that the Commission's proposed Options 1 and 3 (like Option 4) are unlikely to provide sufficient economic incentives (through the pressure of annual tariff cuts) to encourage the industry to achieve the necessary efficiency gains. These options may unnecessarily exacerbate any structural adjustment pressures on industry.

INDUSTRY ASSISTANCE

The NSW Government support for the Commission's tariff reduction strategy is conditional upon a transitional support program being provided for the TCF industry (as a successor to the current SIP). To this end, the NSW Government was encouraged to see the Commission's proposal for such support, the key components being:

- the scheme operate over eight years from 1 July 2005 to 30 June 2013;
- total funding for the four year period 2005-06 to 2008-09 be set at \$560 million (matching notional annual funding under the current SIP in nominal terms); and
- funding be halved in the subsequent four year period 2009-10 to 2012-2013 to a total of \$280 million.

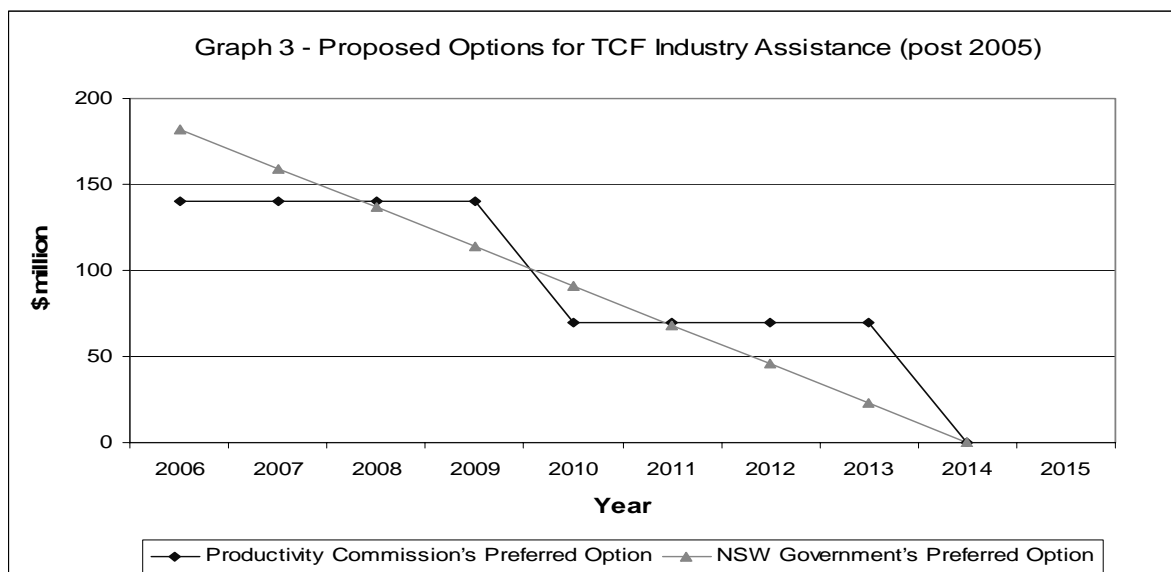
It is considered preferable, however, that such subsidies be progressively reduced in even, annual steps over the proposed tariff reduction period. This proposal would see funding commence at \$182 million in 2005-06 and reduce by around \$22 million per year until annual funding reached zero in 2013-14. The proposed approach would be consistent with the transitional price paths used by most regulators to ease structural adjustment pressures on affected parties.

As illustrated in Table 2, the proposed policy would bring forward a larger quantum of financial assistance in financial years 2005-06 and 2006-07 (when compared to the Commission's proposal). The proposal would soften the initial impact of continuing the tariff reduction process immediately after the 2005 legislated tariff cuts.

The Commission's proposed assistance program, with its large step-down cuts in funding in 2008-09 and 2012-13, would unnecessarily impose significant financial pressures on the industry at a time when tariffs were being progressively removed. Graph 3 provides a graphical representation of the contrast in the two approaches.

TABLE 2 Proposed Options for TCF Industry Assistance (post 2005) (Notional Annual Funding - \$M of the year)		
Financial Year	Productivity Commission's Proposed Option	NSW Proposed Option
2005-06	\$140	\$182
2006-07	\$140	\$160
2007-08	\$140	\$137

2008-09	\$140	\$114
2009-10	\$70	\$91
2010-11	\$70	\$69
2011-12	\$70	\$46
2012-13	\$70	\$23
2013-14	\$0	\$0
Total Funding (nominal dollars)	\$840	\$820
Total Funding (Net Present Value)	\$655	\$659
Note: The Net Present Value (NPV) calculations are based on a 7 percent discount rate.		



Managing Structural Adjustment

The NSW Government agrees with the Commission's key finding that "*adjustment issues should be to the fore in the formulation of post 2005 assistance options*". The proposed assistance program should therefore seek to achieve the following key objectives:

1. provide sufficient incentives for the creation of new firms/ activities to take advantage of emerging market opportunities;
2. provide support for existing firms that are likely to survive and prosper as a result of that support; and
3. provide targeted and clearly-defined assistance measures to enable those firms that would be most affected by the proposed tariff reforms to 'exit' the industry (subject to firms meeting a range of 'eligibility' criteria).

The above objectives recognise that the form and application of any budgetary assistance would need to be assessed against a number of competing efficiency and equity considerations. The NSW Government considers that such an approach would facilitate a smoother process of structural adjustment within the TCF industry.

It is also essential that the transitional funding arrangements:

1. Do not impose an administrative and commercial burden on companies seeking access;
2. Provide for a greater degree of flexibility in funding investment, R & D and process improvement activities in order to maximise modernisation and incorporation of new technologies; and
3. Reduce the \$200,000 SIP threshold to \$100,000 to allow small businesses easier access to funding.

Finally, the Commission must ensure that the Commonwealth Government pursues further trade liberalisation within Australia's trading partners through the World Trade Organisation to ensure better and fairer access to global markets for Australian goods and services.
