



Secretary
TCF Inquiry
Productivity Commission
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BELCONNEN ACT 2616

By email: tcf@pc.gov.au

Dear Sir

Review of TCF Assistance – Position Paper

Thank you for providing the Department of Agriculture, Fisheries and Forestry - Australia (the Department) with a copy of the Productivity Commission's Position Paper for its Inquiry into Post 2005 Textile, Clothing and Footwear (TCF) Assistance Arrangements. You requested that interested parties examine the Position Paper and make comment on the Commission's analysis, conclusions and preliminary findings.

The Department has an interest in the development of Government policy relating to TCF industries to the extent it impacts either directly or indirectly on those rural industries involved in the TCF supply chain. Accordingly, the Department welcomes the opportunity to comment on the Commission's Position Paper, and to provide additional information to assist the Commission in its deliberations.

Our comments are limited to consideration of TCF sector adjustment issues impacting on the upstream cotton and wool industries and discussion of arrangements for domestic assistance (Attachment A), and an examination of related trade issues (Attachment B).

Any enquiries regarding these comments or on the attached information should be addressed to Mr Marc Kelly, who can be contacted by email at marc.kelly@affa.gov.au or by telephone on 02 6272 5485.

Yours sincerely

Brian Jones
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Domestic fibre industries – assistance considerations

Domestic industry adjustment

1. The Department of Agriculture, Fisheries and Forestry – Australia (the Department) agrees with the Commission's view that Australian textile, clothing, footwear and leather (TCF) industries have undergone significant structural change over the last decade, primarily as a result of increased competitive pressure placed upon them from competitors in developing countries, changes in consumer demand, and by advances in technology. These factors, linked to the progressive removal of import quotas as agreed in the Uruguay Round Agreement on Textiles and Clothing (ATC), along with a gradual reduction in Australian tariff and non-tariff barriers to trade have forced rationalisation of Australian TCF production.
2. Australian businesses have adjusted by: moving manufacturing processes offshore to reduce labour costs; focussing on low volume, high value production processes responsive to changes in demand; or adjusting out of manufacturing altogether and focussing on design, with sub-contracted production. Further adjustment is likely to occur over the medium term, with lifting of the import quota system in the European Union and the United States giving other countries greater opportunities to rapidly expand exports of textiles and apparel. This will further intensify competition in world markets as market share for exporting countries will be determined by competitiveness in terms of price and quality on a global scale rather than by the amount of quota held.
3. For the upstream cotton and wool industries, ongoing domestic TCF industry adjustment has led to an increased focus on exports. Up to 95 per cent of Australian raw cotton is exported (Cotton Research and Development Corporation) while Australia exports 90 per cent of its wool clip (Australian Bureau of Statistics).

Views on current assistance arrangements and future assistance options

4. In order to provide Australian businesses in the TCF sector with the opportunity to adjust to the changing environment, the Government is providing significant assistance under a number of programs, including a tariff pause until 2005. The Government has legislated to reduce the TCF tariff. From January 2005, items at the 25 per cent tariff level will fall to 17.5 per cent, those at 15 per cent to 10 per cent and those at 10 per cent to 7.5 per cent. Other forms of assistance provided to the TCF sector include: budgetary assistance through the TCF Strategic Investment Program (SIP); policy by-laws specific to the sector which enable concessional entry for certain imported TCF products; and concessional entry for some imports through the Expanded Overseas Assembly Provision Scheme.
5. Continued government assistance, in the form of tariffs, grants or subsidies to the TCF sector distorts both production and consumption of TCF products. For example, assistance measures allow producers to sustain production at levels higher than would be the case in the absence of assistance. Moreover, depending on the nature of assistance measures, they may potentially restrict imports of textiles and clothing and raise domestic prices of these products. Assistance measures also distort international trade as they shield producers from world prices so that supplies to the market do not adjust to normal market forces.
6. The Department does not support the maintenance of tariffs and other industry specific forms of assistance for the TCF sector for an indefinite period as this will result in continued inefficient

allocation of resources as more capital, labour and other resources are drawn to this sector. More resources are allocated to sectors receiving assistance, thereby encouraging production at uneconomic level in those sectors, and discouraging production in other efficient areas in the economy.

7. In addition, tariffs reduce the real income of consumers as they are forced to pay higher prices for TCF products. The result of this twin burden of inefficient resource allocation and higher prices paid is a reduction in national wealth below what it would be in the absence of government assistance.
8. However, in consideration of significant adjustment costs associated with abrupt reduction in tariffs, and to provide opportunities for TCF industries to adjust to the changed environment, the Department supports the gradual reduction of TCF tariffs. Of those options presented in the Position Paper, the Department views option two or three (involving previously proposed tariff reductions in 2005 before further gradual reductions to 2010) as the most suitable, in line with Australia's APEC commitment (under the 1984 Bogor Declaration goal of free and open trade and investment in the region by 2010) and broader trade policy interests.
9. In relation to the future of the SIP (the other major form of government assistance available to the TCF sector besides tariffs), the Department is of the view that other Commonwealth non-sector specific assistance initiatives such as the R&D Start Program and the Innovation Investment Fund Program, need to be taken into account when considering programs to alleviate the adjustment burden.
10. The Department welcomes the draft modelling studies of industry and economy-wide impacts of reductions in domestic assistance presented in the Position Paper. However, further work may be warranted to investigate the impact of any proposed post-2005 budgetary assistance measures on the TCF sector, and on upstream cotton and wool producing industries.
11. The Department does not expect upstream domestic fibre producers to suffer adversely from a reduction in TCF assistance. Rather, the export profile of Australia's cotton and wool industries suggests that domestic TCF manufacturer demand for wool and cotton inputs is not a significant enough determiner of agricultural production and prices for these fibres to significantly affect the cotton and wool industries.
12. While considering the establishment of a new assistance package for the TCF sector, it is essential to take into account that the benefits of assistance measures may be negated by market forces over which the Government has little or no control. For example, the recent appreciation of the Australian dollar is likely to reduce the competitiveness of the TCF sector by making products more expensive in the world market. In the face of these uncertainties, the most sensible option is to enhance the competitiveness of the industry.
13. The Department is of the view that Australia needs to support an ambitious outcome in the current WTO round of negotiations on industrials in terms of offering to reduce tariff barriers, including for products such as TCF. Such an approach would be consistent with that advocated by Australia in the agriculture negotiations and importantly provide an inducement for those WTO members with high support and protection for agriculture to accept reform of global agriculture trade. (More detail on trade related issues is provided at Attachment B.) Moreover, in the face of growing demand for government resources for other important issues, the Government needs to consider alternative arrangements to make the TCF sector viable and competitive in the long-term.

Domestic fibre industries – trade considerations

World Trade Organization Agreement on Textile and Clothing

1. Since 1 January 1995, international textile and clothing trade has been going through fundamental changes under the 10-year transitional programme of the WTO Agreement on Textiles and Clothing. Under the Agreement, WTO members have committed themselves to remove quotas by 1 January 2005 by integrating the sector fully into the WTO framework. In particular, quotas will come to an end and importing countries will no longer be able to discriminate between exporters.
2. As part of the package agreed in Doha, Ministers have also approved the Decision on Implementation Related Issues and Concerns (Annex II of Doha Declarations). It contains important provisions to encourage faster movement on textile quota liberalisation, and agreement by liberalising countries to exercise restraint in the application of anti-dumping for two years after the full integration of textiles and clothing into the General Agreement on Tariffs and Trade (GATT) 1994. However, the impact on the world trade of textile and clothing will depend on how these provisions will work in practice.
3. Over the last decade global barriers to trade, particularly in relation to textile and clothing have declined, yet tariff and non-tariff barriers to trade are still very high in many countries. The WTO framework including the Doha round of WTO negotiations and the new trading environment after the expiry of the Uruguay Round Agreement on Textiles and Clothing (ATC), from 1 January 2005 would create significant opportunities through opening up of new markets for wool, cotton and other fibres. Many important markets such as India, China, Pakistan and Egypt that restrict the import of textile products may begin to open up, and many countries will find that their comparative advantage of low labour costs or geographical location allows increased textile production in the post-ATC trade environment. Wool processing industries in China, Italy and India will also become more competitive, leading to a possible increase in global market share vis-à-vis synthetic fibres. Australia is also likely to face competition for export markets from developing countries whose unit labour costs are lower than those of Australia.
4. It is to be noted that the overall impact of reducing tariff and other assistance on TCF industries would depend on the nature and extent of non-tariff measures such as import licensing, veterinary inspection requirements, intellectual property rights including protection of logos and trademarks, preferential access arrangements and rules of origin. These issues are critical to Australian wool/cotton producers, governments, traders and wool fibre products manufacturers and importers. Any future trade negotiations under the WTO framework need to recognise these issues.
5. Market access activities have also been facilitated through technical cooperation projects aimed at stimulating demand for Australian wool through developing the export market for processed garments/fabrics. These activities have encouraged wool-importing countries to focus on the processed and semi-processed wools rather than raw wool in an attempt to maintain a wool processing industry within Australia. Taken together, the possibility of lower tariff pressure and increased technical cooperation designed to build wool demand bode well for increased Australian exports.

6. While we acknowledge results of the modelling work described in the Position Paper, which indicate a –0.1 per cent reduction in agriculture sector output arising from a reduction in tariff assistance, the Department does not expect upstream domestic fibre producers to suffer adversely from a reduction in TCF assistance. Our reasons are that the modelling described in the Position Paper does not take in to account the benefits likely to flow to Australian producers from an environment of global tariff reductions. On balance, we expect the increase in wool exports resulting from global trade liberalisation to more than offset any negative impact resulting from lower Australian TCF tariffs. It may also be that lower TCF tariffs are a necessary quid-pro-quo for obtaining lower wool and wool top tariffs from our trading partners.
7. A recent study by the Centre for International Economics indicates that if all border measures restricting imports of yarns, textiles and clothing sanctioned under the ATC were removed, world cotton consumption would increase by nearly one per cent. The incomes of Australian cotton growers would increase by an estimated \$16 million in aggregate (or nearly \$11 000 per grower). In addition, removal of price and income support measures to overseas competing producers is estimated to add \$177 million to the net income of the Australian cotton industry. The Department considers that, given the potential for significant gain for Australian farmers and also for the world economy, Australia and other non-subsidising countries should concentrate on pushing for a global consensus in reducing production subsidies in the next WTO round.

World Trade Organization Doha Round negotiations

8. Under the Doha Ministerial Declaration, WTO member countries have agreed to negotiations which shall aim to further reduce or as appropriate eliminate tariffs for non-agricultural products, which includes amongst others textile, clothing and footwear products. The mandate also calls for reduction or elimination of tariff peaks, high tariffs, and tariff escalation as well as non-tariff barriers. The negotiating timetable required agreement on modalities (the formula to reduce tariffs) on non-agricultural products by 31 May 2003. However, this deadline has been missed. Many negotiators are of the view that progress on non-agricultural market access modalities must await movement in agriculture. The chair of the negotiations has indicated that he will continue to work towards consensus on elements of the modalities, which can then be put to ministers at Cancun in September 2003.
9. The chair issued a first draft modalities paper on 16 May 2003 with the following key components:
 - A tariff reduction formula reducing higher tariffs by bigger margins. However, in order to address developing country demands for special treatment, the formula reduces tariffs in countries with high average bound tariffs (mainly developing countries) less than it reduces the tariffs of countries with low average bound tariffs (mainly developed countries);
 - Formula reductions to be supplemented by ‘zero-for-zero’ sector tariff elimination;
 - A proposal for WTO members to consider elimination of low duties;
 - Identification, examination and classification of non-tariff barriers; and
 - Special and differential treatment for developing countries through:
 - a three-phase sectoral elimination approach in order to eliminate and bind all tariffs on products (including TCF products) of particular export interest to developing and least-developed country participants;
 - longer implementation periods for developing countries; and
 - duty and quota-free access for non-agricultural goods from least developed countries, although they are expected to increase their level of binding commitments.

10. Whilst expressing some disappointment at the level of ambition, which is less than some of the more ambitious proposals previously tabled in the negotiations, Australia has welcomed the draft especially due to its cross-cutting formula that does not exclude specific sectors. Australia would, however, have difficulty supporting the proposal for tariff elimination in specific sectors, one of which is TCF. Initial assessment of the draft suggests that the high level of special treatment afforded developing countries in the draft, particularly in the proposed tariff formula, may prevent the market access concerns of some Australian exporters in developing countries from being adequately addressed. Australia is currently working with other like-minded members to raise the level of ambition in the draft, particularly for those countries with high average bound tariffs.
11. Supporting an ambitious outcome on industrials could provide a basis for some other WTO members to accept a trade-off in reduced support and protection levels in agriculture. Agriculture is the key to the Doha round and Australia, along with many developing countries, stands to gain considerably from a successful outcome in this area of the negotiations.

Accession of China to the World Trade Organization

12. The recent accession of China to the WTO and the potential for market opening reforms including the current Chinese agricultural reforms should ensure an expanding market for Australian agricultural products including wool and cotton in China. Further, strong economic growth in China is expected to lead to increased domestic consumption of fibre and fibre products. However, Australian Wool Innovation Ltd indicates that wool is likely to fare better than other agricultural products including cotton as China is limiting entry to imported cotton for domestic market purposes. Because of the rule that imported cotton must be processed and re-exported, the total amount of cotton imported to China is effectively restricted. China has set the 2003 quota for imported cotton at 856 kt. The import quotas for wool and wool top in 2003 are expected to be 275.75 kt and 79.75 kt respectively, which are unlikely to be restrictive for Australian exports.
13. China maintains a split in its wool import quotas between wool destined for the domestic market and wool to be processed and re-exported. The Department is of the view that the Australian Government needs to pursue the removal of this split through bilateral processes and the WTO framework, even though the split in the wool quota has not restricted entry of Australian wool into the Chinese domestic market in the past few years.
14. The State Owned Enterprises in China, which are involved in the textile industry, are unprofitable despite nominal tariff protection of the sector of more than 20 per cent. Their performance is likely to deteriorate further as a result of significant reductions in tariffs and the reduction or removal of subsidies following accession. So far, low quality textiles produced by China have been used largely for the manufacture of clothing for domestic consumption, and imports of high quality clothing have been restricted by high tariff rates. Liberalisation of clothing imports could shift domestic demand in favour of high quality clothing, which may lead to increased imports of high quality textiles. This phenomenon is likely to favour Australian textile exports to China.
15. The overall impact of China's accession to WTO on world trade, particularly on Australia's export of wool and cotton depends to a large extent on China's adjustment policies towards its transition to a new trading environment and the nature/modalities of its participation in world trade. There will be an increase in China's imports of a number of commodities including wool and cotton, as a freer world trade environment would make imports cheaper. However, China could invoke the provisions of Article XIX of the GATT and the Uruguay Round agreement on safeguards, which enable countries to take trade-restrictive actions to prevent serious injury to domestic industries, or threat thereof. Import penetration to Chinese markets, therefore, would

be determined by how the safeguards measures are applied, and the continued adjustment measures by the Chinese government.

Proposed free trade agreement between Australia and the United States

16. Although there is uncertainty about the outcomes of the proposed free trade agreement (FTA) between Australia and the US, it can be reasonably concluded that the negotiations for the proposed FTA would cover issues such as: trade in goods; rules of origin; technical standards and regulations; agricultural trade; customs procedures; government procurement; services; investment; telecommunications; competition policy; intellectual property rights; and electronic commerce.
17. Australia exports limited amounts of wool and cotton to the US compared to markets such as China and the European Union. As a result, the FTA with the US may have a limited direct impact on trade in these two commodities. However, any adjustment to the US domestic support regime in the context of the FTA or multilateral negotiations would impact on the world prices, especially for cotton.