PRODUCTIVITY COMMISSION POSITION PAPER

REVIEW OF TCF ASSISTANCE

COMMENT FROM THE DEPARTMENT OF INDUSTRY AND RESOURCES, WESTERN AUSTRALIA

July 2003

Background

In November 2002, the Federal Treasurer referred post 2005 assistance arrangements for Australia's textiles, clothing, footwear and leather (TCFL) industries to the Productivity Commission for inquiry and provision of an information report. The Commission was required to hold hearings for the purpose of the inquiry and report its findings by 31 July 2003.

In April 2003 the Commission released a Position Paper outlining preliminary options for continued assistance to TCFL industries beyond 2005.

The Commission invited comment on the Position Paper in writing and/or through attendance at public hearings in Melbourne, Geelong and Sydney. Outside of these hearings, 20 June 2003 has been nominated as the preferred last date for comment.

The Options for Post 2005 TCFL Assistance

Australian TCFL industries are assisted through tariff protection as well as direct subsidies under the Strategic Investment Program. Both forms of assistance are scheduled to conclude in 2005.

Tariff Protection

The Productivity Commission has declared a preferred future tariff protection option beyond 2005. Identified as Option 4, this involves maintaining all TCF tariffs at the legislated 2005 levels until 2010, at which time most would be reduced to 5%.

The exception is tariffs on clothing and certain finished textiles, which would not be reduced to 5% until 2015. The tariff on these items (currently set at 25%) is due to reduce to 17.5% from 1 January 2005 and is much higher than those on other TCF products. For example, carpets and footwear (currently at 15%) are to reduce to 10% from 1 January 2005, while sleeping bags, table linen and tea towels (currently 10%) will reduce to 5% from 1 January 2005.

Strategic Investment Program (SIP)

The Productivity Commission proposes that subsidies under a successor to SIP be extended for a further 8 years beyond 2005 to help TCF industries adjust to further tariff cuts. However, it considers that current levels of funding should only be retained for the first 4 years, halved in the subsequent 4-year period and then be terminated.

Although the Commission favours an extension of subsidy assistance it recognises deficiencies in the current SIP. It suggests that progressive changes to the Program could be introduced prior to its scheduled conclusion in 2005.

Unlike the assistance measures afforded by tariff protection, the Commission does not have a preferred position on SIP style assistance. It canvasses the *pros and cons* of the following three options and is seeking comment other possible improvements:

- Option A: a modified version of the current SIP
- Option B: a value added bounty
- Option C: a competitive bidding scheme

Option A would leave most of the basic parameters of the current SIP in place but with adjustments to address specific shortcomings in present arrangements. A new SIP would continue to focus on investment and R&D/innovation, with some assistance provided for value adding. Grants supporting restructuring in TCF dependent regions would also be retained but potentially broadened in coverage.

Option B would provide assistance to firms solely on the basis of increases in their value added, measured against a base period.

Option C would require firms to apply for assistance on expenditures that would improve their viability in a lower assistance environment. Applications for funding support would be assessed against a range of selection criteria by an 'expert' panel, in similar fashion to a number of other industry support programs.

The Department of Industry and Resources, Western Australia

In February 2003 the Western Australian Government created the Department of Industry and Resources through an amalgamation of its industry and trade development functions and its mineral and petroleum resource development functions. The new Department continues to provide information and advice to the Western Australian TCFL industries. It has for example, contributed to the deliberations of the Fashion Industry Taskforce created by the Western Australian Premier in August 2002. The Taskforce anticipates presenting its report in July 2003.

It should be noted that the new Department is a successor to a previous agency (ie Department of Commerce and Trade) which partnered the Federal Department of Industry, Tourism and Resources in delivery of the AusIndustry-style TCF 2000 Development Package in Western Australia.

The TCF 2000 Package preceded the development, consultation with industry and introduction of SIP, aided by the accumulated knowledge and expertise of "in-field" TCF Officers based in the States and Territories. Although an independent federally managed AusIndustry was eventually selected as the preferred delivery mechanism for SIP, serious consideration was understood to have been given to its delivery through the joint State/Federal partnership arrangement.

The Department facilitated Western Australian TCFL industry participation in the development of the TCFL Forum Strategic Plan and subsequently provided feedback to the Forum's consultants, The Strategy Shop. It is also planned to assist the Forum conduct a workshop in July 2003 to update it on the views of the Western Australian TCFL industries concerning its "blueprint" for TCFL strategies over the next 10 years.

Comment from the Department of Industry and Resources

Tariff Protection

The Department endorses the Commission's preferred Option 4 based on the additional breathing space it provides to the clothing and certain finished textile segment amongst the wider TCFL industries.

The Commission has rightly cast doubt about the capacity of this segment to absorb the significant hit that a more rapid reduction in tariffs would cause. And from a

Western Australian perspective, it is this segment, particularly the designer clothing component, which potentially offers superior growth prospects.

The forthcoming report by the Premier's Fashion Industry Taskforce is likely to recognise this potential and provide recommendations to aid its further development.

Strategic Investment Program (SIP)

The Department shares the Commission's view that the current SIP has various deficiencies. In particular, the eligible expenditure entry threshold of $200,000 has arguably discriminated against most small businesses in the TCFL industries.

This was a serious concern raised at joint Federal/State information and feedback sessions conducted in Perth prior to the introduction of the SIP. The concern was, and continues to be, based on the fact that the overwhelming majority of TCFL industries in Western Australia fall into the small, mini and micro business category.

In the Department's view, even a modified version of the current SIP as outlined in Option A, is unlikely to address the difficulties faced by many small businesses in accessing funding assistance under the SIP. As the Commission observes, spreading overall funding more thinly would reduce the capacity of the SIP to induce changes that would improve the competitiveness of firms.

Indeed, the Department considers improvement in competitiveness as the singularly most important contributor to future growth in the TCFL industries. Improved competitiveness not only ensures survival in a lower tariff environment; the resultant enhancement in business viability is what aids the further development of firms, including an increased confidence to enter export markets.

Option B, which canvasses an increase in a firm's value added (usually synonymous with an improvement in competitiveness) as the basis for funding support, would be a better option as a successor to the existing SIP.

The Commission notes various shortcomings including exchange rate fluctuations and the absence of specific references to investment in capital equipment and expenditure on R&D/innovation, the latter in particular, exposing Option B to WTO sensitivities. This could simply be overcome by the inclusion of such references in a value added bounty scheme to overcome such sensitivities.

However, the Department reiterates its concern that the minimum level of capital and R&D/innovation expenditure inherent in the current $200,000 threshold discriminates against small TCFL business in Western Australia. In the event that the Commission ultimately favours Option B, a reduction in the eligibility threshold to say $50,000 would positively signal an appreciation of the significant role of small business, throughout Australia, in the future growth and development of the TCFL industries.

Option C by comparison, appears to be the most equitable of the three options.

While recognising the disadvantages outlined by the Commission, the Department is of the view that the existing SIP is in need of revamping to make it more accessible to those (particularly small) firms that continue to see a future in the TCFL industries.

In regard to the Commission's perception of the conceivably greater effort and cost involved in preparing claims under a competitive bidding approach, it is the Department's experience that should the benefit from a claim outweigh its cost, a firm will happily proceed. If on the other hand, the claim procedure is considered "all too hard" as has been the experience in respect of the current SIP, most small firms will simply withdraw interest in the scheme.

The Department favours Option C as a competitive bidding scheme would:

- be more open to small TCFL businesses in Western Australia;
- target those prepared to accept the challenges of operating in a lower tariff environment; and
- reward those committed to improving their competitiveness.

In addition, as noted by the Commission, an Option C type scheme has already been preceded by previous such TCF assistance programs and is also able to draw on the experience of such other industry grant programs as the Pharmaceutical Industries Investment Program and the R&D Start Program.

Duration and Future Funding Levels for Successor to SIP

Finally, concerning the duration and level of funding for a new SIP-style assistance scheme, the Department accepts the Commission's views in respect of placing a timing limit on the scheme. However, it is considered preferable that the timing coincide with the reduction of all tariffs to 5% in 2015.

Ending all forms of financial assistance – tariff protection and direct grants – in the same year would create a mindset and help the TCFL industries focus on targeting 2015 as the "Year of Australian TCFL Independence".

This would mean a two-year extension to 8-year time frame envisaged by the Commission for the eventual termination of transitional support. The Department agrees with the Commission's view that higher levels of funding support than apply under the existing regime would be difficult to justify. Thus, based on the notional annual funding levels provided by the current SIP, it is suggested that the following modifications apply to Commission's original suggested timing following expiry of the current SIP in mid 2005:

- Total funding for first 5 years (ie 2005/06 to 2009/10): $700 million;
- Half funding for next 5 years (ie 2010/11 to 2014/15): $350 million
- Transitional support terminates on 30 June 2015.

The Department appreciates the opportunity to provide these views and comments to the Commission and would be pleased to respond to any queries or provide further information or clarification concerning this submission.

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