

**Economic Modelling Workshop
– Summary of Proceedings**

Productivity Commission Review of TCF Assistance

University House, Australian National University, Canberra

Thursday 20 March 2003

Presentations and Discussion

Background

The purpose of the workshop was to provide an opportunity for exposure and comparative assessment of the preliminary findings from five modelling studies looking at the impacts of reducing assistance to the TCF industries after 2005. As well as the modellers, representatives from the industry, the major industry union and Commonwealth, State and Local Government entities attended the workshop (see attached list).

Three of the five studies — from the Centre of Policy Studies (CoPS), Econtech and the Centre for International Economics (CIE) — were contracted by the Commission. The two remaining studies — by ACIL Tasman and the Centre for Sustainable Regional Communities — were undertaken on behalf of the Council of Textile and Fashion Industries of Australia and the Wangaratta Council, respectively.

The CoPS, Econtech, CIE and ACIL Tasman studies all incorporate similar scenarios for reductions in tariffs and the cessation of transitional budgetary assistance for the Australian TCF industries after 2005. These scenarios are in turn based on a broader range of scenarios previously notified by the Commission on the inquiry web site. (<http://www.pc.gov.au/inquiry/tcf/scenarios.html>) The CIE study also considers how reductions in TCF assistance in other countries would affect the Australian TCF sector and the economy as a whole.

The study by the Centre for Sustainable Regional Communities is of a quite different nature. It is concerned with the effect on the Wangaratta region in Victoria of a decline in TCF activity — irrespective of whether that results from reductions in government assistance for the sector or some other factor.

All papers were presented as work in progress and, accordingly, were not available for general distribution. Final versions of the papers contracted by the Commission from CoPS, Econtech and the CIE have been separately posted on this web site. The paper by the Centre for Sustainable Regional Communities was submitted as part of submission 46 from the Wangaratta Rural City Council, while the ACIL Tasman paper was subsequently provided as a submission (PP 100) by the Council of Textile and Fashion Industries of Australia. Copies of these submissions can also be downloaded from this web site.

Preliminary modelling results

Despite the inherent differences in the models, the workshop presentations consistently indicated that the economy-wide impacts of reducing TCF tariffs to 5 per cent and ending transitional budgetary support for the sector would be very small. Whether the projected economy-wide outcome was a small negative or a small positive largely depended on the extent to which improvements in allocative

efficiency offset the adverse effects of projected declines in Australia's terms of trade. In this regard, the Econtech model projected a small net gain, whereas the CoPS, CIE and ACIL Tasman models projected that adverse terms of trade effects would be slightly larger, leading to small welfare losses.

However, none of the studies took into account either the economy-wide benefits of any productivity improvement in the TCF sector induced by the reduction in assistance, or the adjustment costs associated with the movement of resources out of the TCF sector.¹ Projected long term reductions in sectoral output and employment ranged from 3.5 per cent in the CoPS study to 15 per cent in the Econtech study.

At the sub-sectoral level, the presentation by the Centre for Sustainable Regional Communities used multiplier analysis to indicate how agricultural industries and wholesale and retail trade in the Wangaratta region would be adversely affected by declines in regional TCF activity. However, as the authors of the study acknowledged, this sort of analysis focuses on first round negative impacts which overstates the longer term impacts of the policy changes or other factors that cause the initial reduction in regional TCF activity.

Finally, the CIE study introduced an international dimension to the analysis, considering how changes in TCF assistance in other countries would affect local TCF suppliers. Specifically, the Centre's projections indicated that reductions in TCF assistance in the US, the EU, China and/or APEC would lead to contractions in the Australian TCF sector (although of smaller magnitude than those induced by the changes in domestic assistance described above). One reason for this projected damping effect is that barriers on Australian TCF products into the US and the EU, for example, are low compared with those on imports from many Asian countries. Hence, reductions in generally applicable tariff rates were projected to lead to displacement of Australian TCF exports in these markets.

Discussion

In discussion following the presentations, various technical modelling issues were raised by workshop participants. A number of these related to the differing assumptions made by the modellers regarding export demand and import substitution elasticities, with particular emphasis on the implications for the magnitude of projected terms of trade losses. In a terms of trade context, the ramifications of modelling unilateral assistance reductions by Australia were also canvassed. Workshop participants noted that the CIE's projections suggested that while Australia would incur a small terms of trade loss from unilateral removal of TCF tariffs, it would benefit from a terms of trade improvement if other countries removed their TCF protection.

¹ The final version of the CoPS paper looks at some of the adjustment costs associated with the displacement of employees from the TCF sector. Also, as part of a sensitivity analysis, the final version of the ACIL Tasman paper incorporates an assumed improvement in productivity in the TCF sector of 1 per cent for every 10 per cent reduction in tariff protection.

Participants also queried the validity of the usual assumption in economy-wide models that aggregate employment remains fixed, meaning that projected reductions in employment in the TCF sector consequent on reductions in assistance are necessarily matched by increased employment elsewhere in the economy.² The limitations of multiplier models of the sort used by the Centre for Sustainable Regional Communities were discussed briefly.

There was broad discussion of how adjustment costs and the potential for assistance reductions to induce productivity improvements should feed into the policy calculus. In this regard, given the very small economy-wide outcomes projected by the models, some participants suggested that more information on productivity implications, regional effects and adjustment costs would be useful.

² This outcome requires wages to be flexible in the short run. The CoPS study also provides projections under the alternative labour market assumption that wages are sticky in the short run, meaning that reductions in TCF assistance can lead to a short run decline in aggregate employment.

Workshop Agenda

- 10.30 Tea and coffee
- 10.45 Introduction
David Robertson (Chair of Proceedings)
- 11.00 Modelling Australian Assistance Arrangements
Chris Murphy (Econtech) and discussion
- 11.35 Modelling Australian Assistance Arrangements
Peter Dixon (Centre of Policy Studies, Monash University) and discussion
- 12.10 Modelling Regional Impacts
Ian Pinge and Matthew Nichol (Centre for Sustainable Regional Communities, Latrobe University) and discussion
- 12.45 Lunch
- 1.45 Modelling Domestic Assistance Arrangements and International Developments
Peter Crowley and Matthew Saunders (ACIL Tasman) and discussion
- 2.20 Modelling International Developments
David Pearce (CIE) and discussion
- 2.55 General discussion
- 4.30 Conclusion
David Robertson

Workshop participants

Ms Rosalyn Bell	Productivity Commission
Mr Rob Brooker	Department of Treasury & Finance (Vic)
Mr Matthew Canavan	Productivity Commission
Mr Phillip Chindamo	Department of Treasury & Finance (Vic)
Mr Peter Crowley	ACIL Tasman
Prof Peter Dixon	Centre of Policy Studies (CoPS)
Mr Ian Gibbs	Productivity Commission
Mr Kevin Hanslow	Productivity Commission
Mr Bill Henderson	Productivity Commission
Mr Tingsong Jiang	Centre for International Economics (CIE)
Mr Gerry Kitchener	Textile, Clothing & Footwear Union of Australia
Mr Peter Kreitals	Kreitals Consulting Group
Mr Terry Maidment	Productivity Commission
Mr Tony McDonald	Council of Textile & Fashion Industries of Australia Limited
Prof Warwick McKibbin	Australian National University
Ms Joy Mettam	Department of Industry, Tourism & Resources
Ms Jill Murphy	Department of Industry & Regional Development (Vic)
Mr Chris Murphy	Econtech
Mr Matthew Nichol	Centre for Sustainable Regional Communities (CSRC)
Mr John Papadimitriou	Productivity Commission
Ms Bonny Parkinson	Access Economics Pty Ltd
Mr David Pearce	Centre for International Economics (CIE)
Dr Jonathan Pincus	Productivity Commission
Mr Ian Pinge	Centre for Sustainable Regional Communities (CSRC)
Ms Catharine Pruscino	Australian Business Limited
Mr Jim Roberts	Productivity Commission
Dr David Robertson	Productivity Commission
Mr Greig Ryan	Department of Industry, Tourism & Resources
Mr Matthew Saunders	ACIL Tasman
Mr Ross Smith	Wangaratta Council
Mr Philip Weickhardt	Productivity Commission
Mr Andy Weiss	Access Economics Pty Ltd
Ms Jodie Yates	Econtech