Chapter Two

THE BILLS

2.1 This Chapter provides a brief overview of the policy background to the current bills, and an outline of the provisions they contain.

Elements of the TCF Industry

2.2 While it is often convenient to refer to the 'TCF Industry' as a collective, the sector is in fact extremely diverse. It contains a number of quite distinct sub-sectors, which are themselves comprised of a range of distinct products. Under the Australian and New Zealand Standard Industrial Classification (ANZSIC) system, TCF Manufacturing[1] contains 6 separate areas:

- Textile fibre, yarn and woven fabric manufacturing;
- Textile product manufacturing;
- Knitting mills;
- Clothing manufacturing;
- Footwear manufacturing; and
- Leather and leather product manufacturing.

2.3 These subdivisions are further subdivided into 19 different areas of TCF manufacture. Those areas in turn can be divided. In its submission, the Technical Textile and Nonwoven Association gave examples of products which fall within its ambit, but which may not immediately come to mind as TCF products. These include:

- Artificial sports surfaces;
- Carpet;
- Filtration material;
- Hygeine products;
- Specialist medical products; and
- Packaging.

2.4 TCF Industries in Australia also operate at all levels of the supply chain, from the production of basic fibres, through processing and production, to the final transformation into products. Australian companies also add value through design and innovation.

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1 ANZSIC Division C, Subdivision 22.

2.5 Different elements of this diverse industry are in different competitive positions. In some areas, such as some technical textiles, Australian TCF companies are competitive with the best manufacturers in the world. These companies will be successful with or without tariff protection. At the other end of the scale, the Productivity Commission has pointed out that there are some TCF companies who are far from world competitive. These companies are likely to exit the market in favour of their overseas competitors. The Productivity Commission stated:

> For some firms, even raising productivity to world's best practice levels would not enable them to overcome their labour cost disadvantages with developing country competitors. Wage rates in developing countries are a fraction of those in Australia. While low productivity levels overseas have previously reduced total unit labour cost differentials, recent evidence suggests that the productivity of firms in countries such as China (the dominant source of Australia's clothing and footwear imports) often matches or comes close to best-practice developed country standards. Hence, in the standardised product and labour intensive parts of the Australian TCF sector, restructuring and rationalisation will continue regardless of the future assistance regime.[2]

History of protection for the TCF industries[3]

2.6 The TCF industries in Australia, and particularly clothing manufacture, have traditionally been protected by high tariffs and/or import quotas. The early emphasis was on tariffs.

2.7 In 1974, as part of the process of meeting the requirements of the GATT Multi Fibre Agreement, tariffs were reduced and replaced with import quotas. The result was a substantial contraction of the industry in Australia between 1974 and 1977. In 1977, quota arrangements were changed to reduce the flood of imported TCF goods which had followed the reduction of tariffs in 1974. This maintained production levels at the 1977 levels (still well below the 1974 levels).

2.8 In 1980, the Government implemented a seven-year plan involving tariffs, bounties, and quotas to support the industry. Progress was reviewed in 1986, and another program (the "Button plan") was announced in 1987, to cover the period 1988 to 1995. The Button Plan focussed on the removal of quotas, and the management of protection for the industry by imposing appropriate tariffs. The Button Plan also included a program for labour force adjustment, recognising that some contraction in employment was inevitable.

2.9 During the Button Plan period, the government announced further reductions in tariffs, with the eventual effect of reducing the maximum tariff on TCF products to

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2 Productivity Commission (2003) *Review of TCF Assistance*, Report No. 26, p. 16.

3 This section draws on *Textile, Clothing, Footwear and Leather Industries: Action Agendas: A Discussion Paper*, Department of Industry, Science and Resources, March 1999, pp. 7-8.

25 percent in 2000. These reductions resulted in further contractions in employment in the industry. The reductions in 2000 coincided with the introduction of the Strategic Investment Program (SIP) scheme. Tariff reductions have been paused since 2000, in order to give industry an opportunity to prepare for further reductions in 2005. The current bills introduce those post-2005 reductions.

Costs of tariff and quota protection

2.10 During discussion of industry protection policy, the focus is inevitably upon the industry concerned, and the impact which changes in the protection regime may have on the industry. There is often too little concern for the implications these protective measures have for consumers and the wider economy. Simply put, industry assistance must be paid for –by governments, through grants programs and bounties, or by consumers paying inflated prices for goods. The Productivity Commission considered this issue in the following terms:

> Further reduction of TCF tariffs would undoubtedly reduce the costs imposed on user industries and final consumers of TCF products. Existing tariffs tax these groups by up to about $1 billion a year.[4]

2.11 This view was reinforced by officials from the Department of Industry, Tourism and Resources, who noted in evidence:

> The tariff cuts are important. They are important because they drive competitiveness at the firm level and they are an incentive for the industry to move from industries which clearly cannot be competitive now. In an environment where the wage rates in labour intensive areas are so low in, say, China compared to Australia—$1 compared to $20—you just cannot compete. In that environment, you would need to move into other areas no matter what the tariff level was.[5]

2.12 These arguments, in themselves, provide good reasons to support the tariff reductions proposed in these bills. Opponents of tariff reductions must explain why consumers and downstream industries should be expected to continue to provide massive subsidies to Australian firms who are unable to compete with their competitiors overseas.

Future tariff reductions

2.13 The current tariff pause, which commenced in 2000, has almost concluded. In 2005, tariffs in most parts of the sector will be reduced. The current bills propose to reduce tariffs on all items except clothing to 5% in 2010. Clothing (and finished textiles) will fall to a 5% tariff in 2015. The following table indicates the proposed fall in tariffs across the sector:

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4 Productivity Commission (2003) *Review of TCF Assistance*, Report No. 26, p. 100.

5 *Transcript of Evidence*, Pettifer, 3 August 2004, p. 50.

Sector	Current	2005	2010	2015
Clothing and finished textiles	25.0%	17.5%	10.0%	5.0%
Cotton sheeting and fabrics	15.0%	10.0%	5.0%	5.0%
Sleeping bags, table linen	10.0%	7.5%	5.0%	5.0%
Carpet	15.0%	10.0%	5.0%	5.0%
Footwear	15.0%	10.0%	5.0%	5.0%
Footwear parts	10.0%	7.5%	5.0%	5.0%
Other (e.g. yarns, leather)	5.0%	5.0%	5.0%	5.0%

Schedule of TCF Reductions

The Strategic Investment Program (SIP)

2.14 The Strategic Investment Program is the government's primary program for developing the competitiveness of the TCF industries. It was introduced in 2000, at the time of the most recent tariff cuts (and, therefore, at the commencement of the current tariff pause).

2.15 The objective of the SIP was to 'foster the development of sustainable, internationally competitive TCF industries in Australia during the transition to a proposed free trade environment under APEC by providing incentives which will promote investment, innovation and value adding in the Australian TCF industries and better exploit Australia's natural advantages in raw materials such as wool, hides and cotton.'[6] The total size of the scheme is $700 million, with $678 million available for grants.

2.16 It is important to note at this point that the SIP was, and remains, inextricably linked to the progressive reduction of protective trade barriers. The SIP has never simply been an industry development program; rather, it was implemented as a program designed to assist the TCF industry to take advantage of the tariff pause between 2000 and 2005 in order to move to a competitive footing for the tariff reductions which are planned.

2.17 The current bills retain that link between the SIP and tariff reductions. Some witnesses and submissions sought to sever the link between the bills. Some went so far as to argue that linking the bills amounted to 'blackmail'. In the Committee's view,

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6 Explanatory memorandum to the Textile Clothing and Footwear Strategic Investment Program Bill 1999, p. 2.

such assertions indicate a lack of understanding of the purpose of the SIP scheme. The Committee rejects any suggestion that, simply because the bills are contingent upon one another, they constitute blackmail.

Grant types under the SIP

2.18 The SIP scheme currently allows for five types of grants, known simply as "Type 1" through to "Type 5" grants. The purposes of each grant type are as follows:

- **Type 1 grants** are principally grants for investment in new TCF plant or equipment. These grants are capped at 20 percent of eligible investment expenditure.

- **Type 2 grants** are grants for research and development, including innovative product development. These grants are capped at 45 percent of eligible innovation expenditure.

- **Type 3 grants** are known as value adding grants. Eligibility for these is more complicated. In order to be eligible for a type 3, grant, a company must receive a type 1, type 2 or type 4 grant in the same grant year. They can then qualify for a grant amounting to the total amount of their type 1, 2 and 4 grants.

- **Type 4 grants** are available for the purchase of state of the art second hand equipment for restructuring by firms in TCF dependent communities. Grant recipients can obtain up to 20% of eligible expenditure.

- **Type 5 grants** are special miscellaneous grants for restructuring initiatives in TCF dependent communities. Grant recipients can obtain up to 20% of eligible expenditure.

2.19 In order to qualify for type 1, 2 or 3 grants, a company must spend $200,000 in that grant year on the relevant activity (investment for type 1 grants, research and development for type 2 grants, and value adding for type 3 grants). Smaller companies can build towards the $200,000 threshold over a series of years.

2.20 Finally, the total amount of grant funding cannot exceed 5 percent of a firm's sale of eligible products in the previous year. This provision is deigned to minimise risks that the SIP scheme will be seen as a trade barrier, potentially subject to action through the World Trade Organisation (WTO).

Takeup of grants

2.21 To date, the SIP scheme has been somewhat undersubscribed. Most grants have been type 1, 2 or 3 grants. While the SIP scheme contains 'modulation' provisions to be used in the event that grants eligibility exceeds available funding, these provisions have not been used. Latest available figures from the Department of Industry, Tourism and Resources indicate that grants have been awarded under the SIP scheme as follows:

Year	Type 1	Type 2	Type 3	Type 4	Type 5	Total
2000/01	53,999	28,291	46,714	430	1,413	130,847
2001/02	21,675	35,769	44,440	86	33	102,003
2002/03	23,902	42,124	52,451	1,192	20	119,689

SIP Scheme Grants (x $1000)

2.22 Funding for SIP scheme grants to the end of 2002/03 therefore amounts to just over $350 million, leaving more than $300 million available for grants in 2003/04 and 2004/05.

Impact of SIP grants on the industry

2.23 During its hearing on these bills, the Committee heard evidence that TCF companies have been using SIP scheme grants as intended, to improve their competitive position. The Carpet Institute of Australia, for instance, stated in evidence:

> The strategic investment program has enabled the industry to internationalise itself to ensure that it is not simply building manufacturing capacity but producing differentiated capacity.[7]

Recent reviews

2.24 In 2002, the Department of Industry, Tourism and Resources conducted a review of the SIP scheme. While the review made minor suggestions for improvements to the scheme, its conclusion was as follows:

> The review team found that the Scheme, on the whole, has been well received by industry. Nevertheless, there remains considerable pressure on the industry, with some industry participants noting that the TCF sector had undergone more rapid and significant change in a short period than had been anticipated at the inception of the scheme. […]
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> Nevertheless,the experience of the Scheme to date, including the evidence of the claims process for the first year, does provide some confidence that the TCF sector is undertaking significant investment in new plant and equipment and R&D/product development.[8]

2.25 In July 2003, the Productivity Commission concluded a major review of assistance to the TCF industries. While the Commission's terms of reference were

7 *Transcript of Evidence*, Garrett, 3 August 2004, p. 3.

8 Department of Industry, Tourism and Resources, *Review of the Textile, Clothing and Footwear Strategic Investment Program Scheme – Report*, September 2002, p. 41.

substantially wider than the SIP scheme, the scheme was given significant consideration. Relevant findings in the Commission's report include the following:

- The tariff pause coupled with SIP support allows time for consolidation and appears to be encouraging some additional investment and R&D in parts of the sector that should improve international competitiveness.
- However, various elements of the package seem likely to limit its overall effectiveness. Moreover, tariffs and the SIP impose large costs on consumers, user industries and taxpayers.
- Changes are therefore required so that future support for the sector will better contribute to the Government's objective of encouraging the TCF sector to become internationally competitive at lower levels of assistance and to provide a better balance between this objective and the interests of consumers, taxpayers and the wider community.[9]

2.26 While the current bills do not simply implement the recommendations of the Productivity Commission, they were significantly informed by the Commission's report.

Provisions of the current bills

2.27 Key provisions of the two bills are outlined below.

Customs Tariff Amendment (Textile, Clothing and Footwear Post-2005 Arrangements) Bill 2004

2.28 The purpose of this bill is to prescribe the tariff reductions set to occur in 2005 and 2010, and outlined earlier in this chapter.

2.29 Items 1 to 137 of Schedule 1 of the Bill deal with a range of textile yarns, fabrics, certain finished textile goods and footwear parts. These goods currently have a 10% tariff rate. From 1 January 2005, the tariff on these goods will fall to 7.5%. Under these provisions, the tariff rate will fall further, to 5%, on 1 January 2010.

2.30 Items 138 to 432 of Schedule 1 of the Bill deal with footwear, cotton sheeting, and woven and knitted fabrics of various textile materials. The tariff rate on these goods is currently 15%, and will fall to 10% on 1 January 2005. Under the current bill, tariffs on these goods will fall to 5% on 1 January 2010.

2.31 Items 433 to 671 of Schedule 1 of the Bill deal with clothing and some finished textiles. These currently receive the most protection of any TCF goods (a 25% tariff). On 1 January 2005, the tariff rate on these goods will fall to 17.5%. Under

9 Productivity Commission (2003) *Review of TCF Assistance*, Report No. 26, p. XLIV.

the current bill, the tariff rate will continue to step down in five years intervals, to 10% in 2010 and 5% in 2015.

Textile, Clothing and Footwear Strategic Investment Program Amendment (Post-2005 scheme) Bill 2004

2.32 The primary purpose of this bill is to establish the SIP scheme for the period after June 2005. In addition, it contains a number of other provisions relating to the operation of the SIP scheme.

Conditional Grants

2.33 Item 10 of Schedule 1 of the bill sets out a scheme whereby SIP grants can be offered on condition that the Commonwealth may undertake activities 'necessary to ensure that the monies paid by the Commonwealth are used for the purpose specified by Parliament and not for other purposes.'[10] During this inquiry, the Committee did not receive evidence objecting to these provisions.

Post-2005 SIP Scheme

2.34 Item 12 of Schedule 1 of the bill sets out the post-2005 SIP scheme. As with the original legislation (the *Textile, Clothing and Footwear Strategic Investment Program Act 1999*) the current bill sets out enabling provisions which delegate to the Minister the power to devise the TCF Post-2005 (SIP) scheme.

2.35 Proposed section 37C sets out the objectives for the scheme. Proposed Section 37D sets out the maximum amount of grants. Most of the $575 million total is to be spent in the first 5 years of the program. $487.5 million will be spent between 2005/06 and 2009/2010, while $87.5 million will be spent between 2010/11 and 2014/15.

2.36 Proposed section 37F states that the post-2005 scheme will have two grant types, corresponding to the current Type 1 and Type 2 grants.

2.37 Proposed section 37G sets out guidelines for the Minister in establishing the Type 1 grants component of the scheme. Type 1 grants will continue to relate to investment in new TCF plant or buildings. It allows for any eligible TCF company to obtain funding in the period 2005-2006 through 2009-2010, and limits the availability of grants to clothing or finished textile expenditure from 2011-2012.

2.38 Proposed section 37H sets out similar provisions for type 2 grants (relating to research and development expenditure). It allows for any eligible TCF company to obtain funding in the period 2005-2006 through 2009-2010, and limits the availability of grants to clothing or finished textile expenditure from 2011-2012. Activity relating to technical textiles and to leather is not eligible for type 2 grants at any time under this scheme.

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10 *Explanatory Memorandum*

2.39 Proposed Part 3B sets out a new program, to be called the TCF Small Business Program. This program sets out to 'provide support for projects by small firms that do not meet the SIP eligible expenditure levels … [and to] contribute to their international competitiveness in ways other than through investment and innovation.'[11] Funding for this program is set at $25 million over ten years.

11 *Explanatory memorandum*