

TCF SERVICES PTY LTD

Submission to DIIS&R on responses to the
Green Report - 'Building Innovative Capability' -
recommendations – January 2009

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A – Background to TCF Services Pty Ltd & Declaration of Interest

This submission has been prepared by TCF Services Pty Ltd - Australia's largest private deliverer of advisory and technical support to firms participating in the TCF Strategic Investment Program (SIP), and the Automotive Competitiveness Incentive scheme (ACIS).

Principal authors of this document were Gerry Frittmann, the Managing Director of TCF Services Pty Ltd, and Trevor J Thomas, a Research Director with the consulting entity - Business Communications Group.

The company's directors have been involved in the delivery of Australian Government industry assistance programs for the Textiles, Clothing, Footwear & Leather (TCF&L) industries for over 20 years, beginning with the imposition of tariff-based Quantitative Import Restrictions (ie: Quotas), the creation of the TCF Import Credits Scheme in 1991, the introduction of the post-2000 & 2005 TCF&L assistance packages - particularly the Strategic Investment Program (SIP) – and latterly, debate over new measures to assist economy-wide innovation and new product development.

In its 2007/08 Annual Report, the Department of Innovation, Industry, Science & Research (DIISR) reported some \$97.4 million of TCF post-2005 SIP assistance was administered to some 372 customers. A further \$2.31m was paid to 94 customers under the TCF Small Business Program (SBP), whilst \$5m in concessions was afforded to 59 customers under the TCF Product Diversification Scheme (PDS).

Over the same period of time, TCF Services Pty Ltd provided assistance and advice (including representation services to Government) to over 166 clients across the broad range of Australia's TCF&L sub sectors, comprising large, medium and many small-to-medium sized enterprises (SMEs). In total, our clients are known to have received over \$25.6 million in TCF-SIP grant funds, that is, roughly 26% of total program funds administered to some 45% of all recipients. TCF Services project managed 18 of the 94 SBP applications, and 35 of the 59 PDS applications.

TCF Services Pty Ltd maintains offices in Sydney and Melbourne, and undertakes regular visits to TCF-SIP claimants across all remaining Australian States and Territories. Of a total corporate staff of 14 full- and part-time employees, over 70% are currently focused on delivery of the TCF Strategic Investment Program. As part of the company's ongoing investment to service its clients:

- **We have created a specialist 'clothing' cell** to assist SIP participants who are mainly designers, particularly, small and medium-sized firms, in satisfying Scheme tests for acceptable innovation in the manner currently applied by AusIndustry.
- **Our internal 'engineering' group** works regularly with SIP participants to map out Scheme eligibility requirements in relation in the area of technical textiles, footwear, printing, carpet and leather - essentially those businesses with in house manufacturing capabilities.
- **We support a publications (including 'The TCF Industry Advisor' e-Newsletter) and strategic advice** program which aims to encourage SIP participants to plan their Scheme activities as part of a holistic range of activities designed to improve overall firm efficiencies, and underpin longer-term international competitiveness.
- **All of the above services are also provided by our independent automotive industry advisory unit to service ACIS customers.**

TCF Services Pty Ltd's head office is located at: Suite 3, Level 4, 418A Elizabeth Street, Surry Hills, in New South Wales. Inquiries in relation to the contents of this submission should be directed to Gerry Frittmann, at Gerry@tcf.net.au or by telephone to (02) 8219 4900.

B – Commentary on Government Assistance to the TCF industries

It has been long established (and supported by both sides of Australian politics) that in the successive development of assistance programs for the textiles, clothing & footwear industries, the Government of the day looks to encourage the sector to adjust into activities where it can become internationally competitive with lower assistance, and to improve the overall performance of the Australian economy. This latter objective implies that future support for TCF producers must not be detrimental to Australia's long term economic interests.

In its July 2003 inquiry report, the Productivity Commission observed that Australia's strong and sustained growth performance of recent years "has accompanied an extensive program of microeconomic reform, including the dismantling of most trade barriers. The much greater responsiveness, innovativeness and flexibility now evident in many Australian firms provide a springboard for sustaining strong output and employment growth in the future. It also increases the resilience of the economy to external shocks."

Professor Roy Green, in his own public commentaries subsequent to issuance of his report (ie: ATF, Nov/Dec 2008, p24), acknowledged "there is no doubt that it (SIP) kept firms alive, opened new opportunities ... there has been some ingenious uses of new capital and retrofitting old capital." Such observations underpin the importance of continuing assistance to capital expenditures (Capex) in entitlement grants, as they provide a critical stimulus for local industry upgrade productive capabilities by equipping itself with state-of-the-art plant in order to stay ahead of emerging countries in the ability of Australia to competitively produce high value-added manufactured goods.

It is instructive, in terms of current debate on TCF assistance, the Commission also observed much of the impending adjustment in the Australian TCF sector "will occur regardless of the assistance regime. Global pressures mean that more firm closures are inevitable and further declines in sectoral output likely, even at current assistance levels. Moreover, the productivity improvements that will help some firms survive mean that sectoral employment will continue to fall. The value of the Australian dollar will also influence the adjustment process." These observations are all the more relevant in 2009 with the onset of global economic recession driven the continuing Global Financial Crisis (GFC).

1 – Building Innovative Capability

In his review report – 'Building Innovative Capability' – Professor Green found that, contrary to alleged 'manufacturing sceptics', Australia's TCF industries had judiciously utilised the millions of dollars in restructuring assistance provided since the first (1984) Button plan, and thus faced a "promising future" as long as effort (ie: compared to low-wage countries) continued to concentrate on "differentiating products through uniqueness, product quality & design, branding, quick response and new approaches to supply chain management, with a clear emphasis on corporate social responsibility in the application of labour and environmental standards."

Evidence to the review was cited by Green that “the key success factor” for the TCF industries moving forward, as for industries more generally, is the development of “innovative capability at the enterprise and workplace level, which is driven not only by research and technology development, but also by an increasing emphasis on business model transformation, market-led organisational changes, and the integration of firms into collaborative networks and supply chains.” The discussion took Green down a path of contemplating that TCF challenges “are not dissimilar to those faced by the manufacturing sector as a whole”.

To survive and grow in global and domestic markets, he saw the policy emphasis needing to “shift from structural adjustment to the development of innovative capability at the level of the enterprise and the workplace.” Green went on to say this conclusion also reflected the direction of policy thinking in developed economies around the world, and increasingly in Australia, with the clear implication for the TCF industries being that “the process of integrating special assistance into the broader framework of the Australian Government’s evolving industry and innovation policy, should now commence.”

Professor Green’s observations appeared to overlook, however, that in having been asked by Senator Carr to review the status of the TCF industries with a view to recommending post-2010 assistance options, the ‘field of play’ was essentially the back end of the November 2003 post-2005 TCF assistance package implemented by the former Howard Government, but also supported by the Australian Labour Party when being put to the vote in Parliament. At the time, the \$747 million package of measures had been recommended to political representatives on the basis of an acknowledgement by the TCF industries and its principal representative Industry Associations as comprising the Federal Government’s ‘last tranche’ of substantive sectoral assistance - the implication being that, upon its conclusion in 2015, firms would be expected to have become internationally competitive with reliance on only ‘general measures’ assistance from Canberra.

2 – The post-2005 TCF Assistance Construct

The principal post-2005 assistance component was a \$575 million Strategic Investment Program (SIP) set out in legislation, with two grant types: Type 1 - in respect of TCF capital investment (including buildings) expenditure and brand support (and certain IT investment) for clothing and finished textile entities only; and Type 2 – to assist research and development activity by the broader TCF industries - excepting leather and/or technical textiles - and running to 2014/15.

The post-2005 assistance construct came on the back of an accounting of successes and failures of the post-2000 Scheme (and earlier mid-1990s Import Credits Scheme & Incentives for International Competitive grants), which were all predicated upon new investment and organisational adjustment being assisted via subsidies paid according to strict ‘guidelines’ adjudicated upon by a hand-picked group, in the form of the then TCF Development Authority (TCFDA). Further, the front-weighting of the 1990s assistance (particularly, grants to the fibres processing, industrial textiles and footwear industries), was agreed by Government in recognition of its role as a trade off against tariff reductions focused on delivering a beneficial flow-down in terms of reduced manufacturing input costs, with the last sectors to be subject to the elimination of tariff assistance being finished textiles and clothing.

Professor Green’s report failed to comprehend the majority of this extended history of Government assistance to the TCF industries, opting instead to dump the last

post-2005 SIP and product diversification elements (\$112.5m from 2010/11 to 2014/15) intended to help predominantly the finished textiles and clothing complete their adjustment program (and move post-2015 to survivability upon 'general assistance measures' available to all industries), in favour of a new construct which would re-instate substantive assistance to the fibres processing and industrial textiles sectors – themselves previously considered to have graduated beyond the need for sectoral measures.

3 – Moulding Assistance to the National Innovation System

Drawing on the findings of Productivity Commission analyses in 2003 & 2008, Professor Green was persuaded against the temptation to immediately move to 'mainstream' or "integrate the TCF industries into broader economy-wide measures", and advanced instead a case to continue special assistance from 2010 to 2015, justified on the basis of enabling the broader industries "to complete the process of adjustment to scheduled tariff reductions, and to generate longer term gains in productivity and competitiveness." The major differences with any new assistance program (ie: from those of the past) he said, was that any new assistance program "should be informed by the priorities of the evolving National Innovation System (NIS), as influenced by Dr Terry Cutler's review of Australia's national innovation system.

Releasing his 'Venturous Australia' report on 9 September, Dr Cutler stated "Australia's innovation system is now a generation old ... our understanding of innovation has changed and our approach to innovation and our innovation policies must change accordingly. Today, innovation is more than just research and development and technology. It is also about improving the capacity of firms to modify technologies and services in response to customer demand."

Central to Dr Cutler's recommendations is a new research and development (R&D) construct and accompanying benefits. This involves replacing the existing 125% R&D Tax Concession (and 175% Premium, R&D Tax Offset & International Premium) with a Tax Credit, all framed as a less complex and more predictable support mechanism for applicants. Large firms would be afforded a 40% tax credit, with small firms (turnovers <\$50m) afforded a 'refundable' tax credit of 50%. The new approach would apply to all R&D undertaken in Australia meeting 'relevant definitions', with refundable tax credits paid at least quarterly in arrears. Regard would also be given to risk managing benefit payments relative to administrative compliance costs. R&D undertaken in Australia by foreign-owned firms would attract the 40% tax credit, but not the refundable tax credit.

Dr Cutler also recommended a Competitive Innovation Grants Scheme to assist innovative firms, with limited access to capital, in the high-risk, proof-of-concept and development stages. Dr Cutler's approach to rejuvenating the R&D tax concession playing field enthusiastically responded to Labor's 2007 election campaign for a 'new deal' in terms of a national innovation strategy. Professor Green's recommendations, on the other hand, are more conservative, thus begging the question of longer term effectiveness when compared to the option of immediately integrating TCF programs within Dr Cutler's new National Innovation System.

Further, Green's proposal would disadvantage finished textiles and clothing companies, as to pay for wider subsidy eligibility for others, funds already budgeted specifically for SIP and PDS are proposed to be hijacked. Green, in short, opted for a return to the 'bad old days' of interventionist and highly structured TCF assistance overseen by a \$12m reincarnation (in the form of Innovation Councils) of the former TCFDA, bringing with it all the uncertainty associated with new bureaucratic guidelines and interpretative complexity, and the risk of grant applications running foul of political machinations and social considerations promoted by

stakeholder interests within industrial councils, and foreign to commercial drivers used to govern investment project viability.

4 – Onset of the Global Financial Crisis

Added to this is the onset of the global financial crisis which, in Australian terms, has seen government fiscal and stimulatory responses - as outlined in the mid-year fiscal and economic outlook (MYEFO) and subsequent \$10.4 billion stimulus- literally vaporise the budget surplus as revenue falls from lower taxes on mining export and royalties, company tax collections, and rising welfare payments and related expenses. Substantive wash-in of the GFC has also seen a 30% devaluation of the Australian dollar against the US currency (thus delivering TCF firms a major de facto increase in protection against imports), whilst the Reserve Bank has slashed its interest rate benchmark, with further cuts to come over the course of early-2009. Against this, the Treasury has written down economic growth forecasts by around 2% in 2008/09 and 2009/10, albeit with international commentators such as the International Monetary Fund predicting zero growth over 2009/10.

Contrasting the chaos above is an alternative ‘no change’ scenario, involving a more a more practical and fiscally responsible decision by the Government to sustain TCF industry certainty by opting to continue the SIP Scheme under current legislative arrangements - as the main delivery platform of innovation incentives for the clothing and finished textile products sectors - until 2015, and funded within the existing \$17.5m per annum already built into the forward budget estimates.

Such an option would honour original undertakings made to these two TCF industry segments by the Parliament, with administrative certainty underpinned by industry familiarity with existing legislation and AusIndustry administrative experience and grant decision precedents. Any advancements in innovation reform reflective of the Cutler review that the Federal Government is able to fund over the next three financial years, could then be accessed by those TCF industry segments proposed by Professor Green to fall within an expanded definition of the industry.

5 – Innovation Projects Already Driving SIP Type 2 Investments

After all, Professor Green’s re-branding in his ‘Building Innovative Capability’ report of the justification for ongoing TCF sectoral assistance (ie: shifting from ‘structural adjustment’ to ‘building innovative capacity’) is partly a misnomer, as DIIS&R statistics quoted in his report (see Chapter 4: Evaluation of Programs at page xxxx) indicate that 93% of all grants paid to the clothing sector already relate to SIP Type 2 Innovation projects. Terminating SIP in favour of the creation of a new TCF-ICP scheme will see many innovative projects claimed to date by this sector in future being forfeited, as clothing firms in the ICP world will find it much harder to compete for the available dollars, when compared to a broader range of science-based applications from the larger industrial textile firms. This would be unfortunate as, theoretically, the latter segment was already proposed to be graduated from the need for specialised sectoral assistance by 2010 (ie: it had achieved Government ‘intent’) under the post-2005 TCF plan. Further, science-based industries would also be able to claim such investments (ie: Type 2 under SIP) following implementation of the Cutler NIS recommendations, thus obviating the need for the same investments to be doubly assisted under the new competitive ICP program.

C – Observations on the ‘Building Innovative Capability’ Report

Recommendation 1: The approach of public policy to the development of Australia’s TCF industries should take the opportunity of this Review and the wider Review of the National Innovation System to manage a shift in the organising principle of industry assistance from structural adjustment to a new focus on building innovative capability at the level of the enterprise and workplace. It is recommended that a new ‘TCF Innovation Assistance Package 2009-2015’ be introduced with a total budget of \$250 million.

RESPONSE: TCF Services does not agree with this recommendation. The proposal to switch assistance focus half-way through the SIP is unnecessarily disruptive (in terms of requiring new legislation, administrative guidelines and the accumulation of claim precedents) at a time when the industry is facing unprecedented challenges due to the onset of the Global Financial Crisis (GFC). To change tack now with an entirely different program (ie: given the far lower level of funding and short 5-year timeline) will be both costly and administratively inefficient. Based on TCF Services analysis of prior program uptake when new Schemes have been introduced, it usually takes the industry 2-3 years to acquire a optimum understanding of Scheme entitlements. Contrasting the benefits of a shift to the IAP, the fashion clothing sector is generally regarded as having more to offer government in terms of innovation potential to drive exports, than Carpet and textiles. This is because the latter industries principally adapt internationally developed product offerings to suit local Australian conditions. Further, if such interests already hold a large share of the local market, the question must be asked as to why they would need further sectoral support.

TCF Services believes the SIP Scheme should thus continue as the main platform for the delivery of adjustment assistance for the TCF industries, as originally promised by the then Government to the Clothing and finished textiles sectors, and as acknowledge by Parliament (including Labour) in legislation to be progressed in tandem with tariff reductions. Funding would remain at the existing \$17.5m per year, whilst allowing for other TCF firms whose tariff assistance drops to 5% to continue to claim Type 1 grants for capital expenditure (Capex) and Trade Shows only. This way, the \$37m per year proposed for the new TCF Innovation Capability Program (ICP), might be more productively diverted to the SIP.

Recommendation 2: The definition of the TCF industries, for the purpose of future public policy and greater ‘connectivity’ among TCF firms and organisations, should be modified and expanded to encompass a broader range of activities in textiles, fashion and accessories in the context of a TCF Innovation System that is driven by more collaborative approaches to design, research, technology, branding and supply chain management.

RESPONSE: TCF Services does not agree with this recommendation. Reflective of the cross-politics objective to encourage the TCF sector to progressively adjust into activities where it can become internationally competitive with lower assistance, and to improve the overall performance of the Australian economy, it does not make any sense to be broadening the dependency group (ie: in terms of access to grants) in the current economic environment. It will only create a larger constituency in the future that can be guaranteed to argue for continued assistance, even after economic circumstances improve in future years.

Recommendation 3: The scheduled tariff reductions for the TCF industries to 2015 should be allowed to take their course, as it is widely recognised that tariff protection is a blunt instrument for the promotion of innovative and competitive capability at the enterprise level and can in any case have only marginal impact in the context of large exchange-rate movements. On the basis of

evidence provided to the Review, it is recommended that the emphasis of future policy should instead be on well designed industry assistance measures.

RESPONSE: TCF Services agrees with this recommendation in view of our comments regarding Recommendation 1. Tariff cuts represent the second part of the compact between industry and government settled upon legislation of the revised SIP Scheme to help assist the structural adjustment process. For all practical purposes, the planned tariff reductions have generally been nullified by the radical devaluation of the dollar since October 2008. Further, the tariff cuts appear to be already built into the Federal Budget - as reflected in the MYEFO estimates - which already predict a rough halving of Customs duty collections for TCF and Passenger Motor Vehicles in the projections for 2010/11

Recommendation 4: A TCF Innovation Council should be established, with funding of \$12 million to commence in 2009, as one of the proposed sectoral innovation councils with the task of advising the Australian Government on key priorities for the TCF industries in the context of the broader National Innovation System. The TCF Innovation Council would include appropriate representation from TCF industry stakeholder groups.

RESPONSE: TCF Services does not agree with this recommendation. Dr Green admitted himself that the TCF industries had done quite well in recent years relying on market influences to help drive the innovation cycle on the basis of entitlements laid out in legislation. The socially engineered appointment of an Innovation Council smacks of a return to the days of the old TCF Development Authority (TCFDA), where large sums of money were allocated to projects that had little public visibility, and ultimately turned out to be unsustainable over the longer term. A TCF Innovation Council made up of industry, unions, Government and industry experts deliberating on how program funds will be disbursed risks the formation of an exclusive club that over time will become increasingly divorced from mainstream industry concerns. Given that we already have AusIndustry set up as the SIP delivery mechanism (with reference back to the Department), there appears little merit in setting up yet another closed shop akin to the old TCFDA. The proposed \$12m of funding should be re-directed to either the ICP if this proposal continues to stand, or to the SIP if the ICP recommendation ends up not being progressed.

Recommendation 5: A new \$200 million TCF Innovation Capability Program (TCF ICP) should be introduced to support the development of innovative capability in the TCF industries at the enterprise and workplace level, with an allocation of at least \$15 million for small businesses. This program would supersede current assistance measures in the final transitional period of tariff reductions—2010 to 2015—and make funding available to individual applicants or consortia on a contestable basis.

RESPONSE: TCF Services does not agree with this recommendation. The proposal to raise a new ICP mechanism whose benefits will most likely be directed to a limited number of larger players introduces new potential for distortions in the industry base. There is no evidence to suggest large players are any more sustainable than smaller firms, whilst at the same time it is generally accepted small firms are more innovative than larger firms – a point made more relevant by the challenges of the accumulating GFC. In the current economic climate, Professor Green's quest for 'additionality' in the provision of investment assistance has become much less relevant. It is doubtful in the near term (ie: 3-5 years) that any firms – including the larger entities – will be able to secure the funding for a major strategic 'chess' move to achieve sector-wide consolidation and operational efficiencies. The current domestic climate is more akin to rationalisation and downsizing, not bold moves to enhance productive capacity to serve growth markets that no longer exist. The proposed ICP should not be proceeded with, and its funding of \$37m per year

should be redirected into the SIP, and parallel initiatives to assist small businesses refocus on new-generation (ie: energy efficient/environmentally friendly) products and services.

Recommendation 6: Eligibility criteria for the TCF ICP should include: (1) value-adding to the Australian economy; (2) ethical production and supply chain standards; (3) additionality of program funding; (4) employee involvement in change projects; and (5) accountability for delivery of project aims, with dissemination of key learning outcomes.

RESPONSE: TCF Services does not agree with this recommendation. On the basis SIP would be maintained, any need to incorporate such criteria into legislation should be properly argued and referred back to the Parliament for consideration and action in terms of amendments to existing SIP legislation.

Recommendation 7: Operational criteria for the TCF ICP should be developed by the Australian Government on advice from the TCF Innovation Council in the following funding categories: (1) innovation, research and design capability; (2) collaboration, networks and supply chain participation; (3) accessing global market opportunities; (4) new business models and strategic repositioning; (5) high-performance work and management systems; (6) education, skills and employment services; and (7) environmentally sustainable and ethical practices.

RESPONSE: TCF Services does not agree with this recommendation. On the basis SIP would be maintained, any need to incorporate such criteria into legislation should be properly argued and referred back to the Parliament for consideration and action in terms of amendments to existing SIP legislation. Some of the new criteria, whilst socially admirable, will impose significant costs upon firms with potential to increase costs at a time the GFC is having the effective of rapidly increasing the competitiveness of overseas supply sources.

Recommendation 8: While decisions on funding under the TCF ICP will be made by the Department of Innovation, Industry, Science and Research, the business advisory services of Enterprise Connect should be provided with additional funding to constitute both the primary access point for TCF firms and organisations and the focus of a nationally coordinated TCF Innovation Network.

RESPONSE: TCF Services does not agree with this recommendation. On the basis SIP would be maintained, any need to incorporate such criteria into legislation should be properly argued and referred back to the Parliament for consideration and action in terms of amendments to existing SIP legislation. Enterprise Connect appears in part to be a reincarnation of the old National Industry Extension Service (NIES), which ultimately evolved into AusIndustry.

Recommendation 9: A new Australian Ethical Quality Mark should be devised, with a budget allocation of \$8 million, to reflect the incorporation of defined ethical standards relating to labour conditions, animal welfare and environmental sustainability in TCF production and supply chains. This will enhance consumer choice and confer competitive advantage on firms that achieve certification.

RESPONSE: TCF Services agrees with this recommendation. There is merit in spending \$8m in advancing an Australian Ethical Quality mark given the increasing penetration of non-utility criteria in consumer purchasing decisions.

Recommendation 10: A new Australian National Sizing Standard for clothing and footwear is long overdue and should be developed as a matter of urgency, with a funding allocation of \$5 million, to meet the changing needs of customers and ensure that Australian TCF firms and organisations are not placed at a competitive disadvantage.

RESPONSE: TCF Services agrees with this recommendation. There is merit in spending \$5m in advancing a new Australian Sizing Standard to be applied on a recommended, but non-mandatory basis.

Recommendation 11: Australian Government procurement policy should encompass capability building for Australian TCF firms and organisations so that they are in a better position to tender successfully for contracts both individually and in broader networks. In addition, consideration of value for money in tendering should take account of labour and environmental standards, as evidenced by the Australian Ethical Quality Mark. The Review notes and supports concern expressed about the US Berry Amendment, which excludes Australian TCF firms from the US defence apparel procurement market.

RESPONSE: TCF Services agrees with this recommendation. There is merit in the Australian Government taking initiatives to aggregate Government Procurement volumes as a means to providing focus for innovation, as well as collaborative activities between firms to address larger business opportunities that individually, they would not be big enough to exploit.

Recommendation 12: The TCF ICP should have as a priority the improvement of R&D performance in Australian TCF firms, especially technical textiles, both through individual projects and through broader innovation partnerships and networks with research and educational institutions. There should also be an opportunity for TCF firms and organisations to access programs resulting from the Review of the National Innovation System.

RESPONSE: TCF Services does not agree with this recommendation in an environment where the SIP runs for its full term, and science-based industrial textile entities are able to claim innovation expenditure under reforms to research and development assistance as proposed in the Cutler/NIS report. Accordingly, it would then be left to individual TCF industrial players to decide on the split between continuing to claim for innovation under SIP Type 2 provisions, or alternatively, under generally available assistance for R&D, especially for those entities that have graduated beyond the need for sectoral-specific assistance.

Recommendation 13: A further priority of the TCF ICP is to provide additional targeted support to TCF firms and organisations in meeting their needs for training and skills development, where this is required over and above the expanded range of programs available through the Department of Education, Employment and Workplace Relations.

RESPONSE: TCF Services does not agree there is sufficient justification to terminate the SIP and introduce a new ICP, especially in light of the Cutler review recommendations. We would argue it is more consistent with the long term national interest for Government to encourage industries to graduate out of sectoral assistance, thus allowing more robust reform of generally available assistance measures which can then be progressively enhanced for all players. There is nevertheless merit in continuing to sustain education and training programs directed at displaced workers to undertake education and training programs that will equip them with new skills to transit into other industry sectors. However, these are currently catered for by the SAP program, and other measures available via the Department of Education, Employment & Workplace Relations. Efficiency principles relating to program delivery would suggest there is no case for the duplication of such programs.

Recommendation 14: The commitment to Part 1 of TCF SAP, which provides assistance to retrenched workers in the TCF industries, should continue to 2015, with a budget allocation of \$25 million, but preferably in an enhanced form to meet concerns expressed about its operation. There should be a greater role for the industry stakeholders in facilitating access by workers to

employment and training services, and a feasibility study should be conducted into the potential contribution of a TCF group training company.

RESPONSE: TCF Services agrees with this recommendation. There is merit in continuing to sustain structural adjustments to encourage the transition of assets and intellectual property into other industry sectors. This is consistent with the long standing practice of successive governments seeking to encourage the TCF sector to adjust into activities where it can become internationally competitive with lower assistance, and to improve the overall performance of the Australian economy.

Recommendation 15: Better protection should be provided to workers engaged in home-based manufacture of TCF products through both legislation and industrial awards, and steps should be taken to ensure that homeworkers whose work is performed for a single customer or business are deemed to be employees for the purpose of legislative and other entitlements.

RESPONSE: TCF Services agrees with this recommendation in principle. There is merit in measures being taken to ensure that homeworkers are not exploited or disadvantaged in the wider workplace. However, caution should be had to ensuring the imposition of onerous regulation does not impede the structural adjustment process. Outworkers are a feature of clothing manufacture in many countries, including Australia. As noted by the Productivity Commission in 2003, “from the perspective of the manufacturer, outworkers can provide flexibility to respond quickly to varying customer needs which can be more difficult to achieve in a factory setting ... some outworkers may benefit from the flexibility in pace and timing of work and being able to combine family responsibilities and paid employment.”

D – Summary and Conclusions

TCF Services believes the rapid onset of the GFC has substantially changed the basis upon which much of the argument advanced by Professor Roy Green in his ‘Building Innovative Capability’ report was based. The global economic downturn is freeing up substantive over-capacity in TCF production areas, and this will impact on investment plans by Australian companies moving forward.

From literally a ‘sellers’ market where the global resources boom was feeding seemingly unending increases in demand, the global outlook for at least the next three to five years is one of immediate economic recession followed by severe structural adjustment as production capacity is cut, and low growth in demand. At the back end of the recovery will emerge new challenges to innovate a new generation of products and services that are energy efficient and environmentally friendly in terms of a cradle to grave acquisition and disposal cycle.

As such, the challenges and priorities facing the local industry today have moved from investment to sheer survival – it’s now all about keeping the industry alive by maintaining the certainty of SIP funds to keep firms sufficiently financial to ward off as best they can the approaching recession, and maintain jobs as opposed to taking a double hit on the loss of sales revenue due to declining demand and the loss of SIP grants.

In such circumstances, TCF Services – drawing on its extensive knowledge of the needs and requirements of a large section of the Australian TCF industries – submits it would be unwise for the Government to cut short the existing SIP program, and replace it with a new program more focused on achieving increased innovation in the TCF sectors alone.

The Clothing sector does not have the luxury of being able to meet the R&D definition of technical risk, so it would be substantially disadvantaged if SIP was taken away - in terms of its sustainment of innovative activities. The clothing sector would also find it more difficult to compete with funding under ICP when compared to the larger textile firms. So if SIP was scrapped altogether, only a small percentage would be likely to successfully qualify for ICP. Accordingly, ICP funding of \$37m would most likely go to the larger companies or major supply chains – perhaps 60 - 80 claimants as opposed to the 360 claimants currently accessing the SIP scheme.

Alternatively, TCF Services believes the SIP Scheme should be retained in its existing form, and run in parallel with the program of tariff reductions, as per the original compact between government, industry and legislators. Should the Government wish to fund a major industry innovation initiative, TCF Services believes this should be undertaken by advancement of the recommendations of Dr Terry Cutler, in terms of new approaches to research and development concessions.

By progressing down this path, TCF firms would benefit from the option of allowing market mechanisms to guide their innovation investments, and choosing which program – SIP or NIS – would provide them the most relevant benefit for their efforts. As argued by Dr Cutler, national economic efficiency would be improved by progressing a major revamp of innovation assistance that would be equally applicable across all industries. TCF Services sees very little benefit – and indeed, the imposition of large costs on industry – in the proposal to terminate the SIP and introduce an entirely new ICP that most likely will only run for five years.

Professor Green's recommendation that the operation of the ICP would be reviewed again in 2014 opens up a dangerous platform for additional pleading for continued assistance by and industry which widely acknowledged that the post-2005 assistance program would be the 'last tranche' of substantive sectoral assistance before the move to generally available assistance measures.

Onset of the GFC is not an excuse to perpetuate indefinite special assistance for the TCF sectors. Accordingly, TCF Services encourages the Government to retain the SIP for its full term, but take early action to develop and resource the National Innovation System, in particular, the new structure of research and development incentives proposed by Dr Terry Cutler.

E – TCF Assistance Options Moving Forward

OPTION 1 (PREFERRED) – Involves a rejection of the Green report recommendations on grounds they have been superseded by the GFC, and a decision to continue the SIP as it stands today for its full term at current funding levels of \$97.5m per year, even if modulation occurs in subsequent years. TCF Services believes this is fiscally responsible, and will avoid major disruptions and cost to industry in having to gear up for a new Scheme. We further believe no single company would be better off under the Green Report package, as compared to where they stand under the current SIP scheme.

OPTION 2 – Keep SIP going for the Clothing sector as per Option 1, scrap the ICP altogether, and allow the industrial/capital intensive sectors to continue to claim SIP for Type 1 grants only. This approach is similar to the existing post-2005 SIP scheme, whereby Technical textiles and non-woven firms could only claim Type 1 grants. In addition, the industrials would be eligible to choose to claim R&D expenditures under the Cutler-recommended R&D concession reforms –

meaning they could cash out their R&D expenditure, and receive up to a 50% refundable tax credit.

OPTION 3 – Keep SIP going for the Clothing and finished textile sectors at \$17.5m funding until the tariff drops to 5%, as is currently legislated to occur in alignment with introduction of the ICP scheme, which would only be accessible by ‘other elements’ of the TCF industries such as Carpet, footwear and textiles. This way, a broader range of companies would likely receive funding for innovation initiatives, thus reducing the risk to the government (and wider economy) of mass corporate failures should investment strategies (and investment returns) be no ultimately realised. Currently, 360 firms receive funding under SIP. Under the proposed ‘dual program’ strategy, well over two-thirds of these firms would likely continue to receive innovation funding assistance. TCF Services considers that if the 5% of sales-based SIP grant is taken away from the Clothing sector, many companies will not survive the approaching recession. This is because, for a majority of firms, profit realised in good economic times is predominantly equivalent to the size of SIP grants as they currently stand. Clothing and finished textiles are the sectors requiring ongoing structural adjustment assistance. If SIP is continued, there is no need for ICP if the Government implements in parallel the Cutler NIS reforms to research and development concessions. If ICP is considered absolutely necessary, it would be more useful for the program to be structured as a business transformation program.