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Extended SIP to take TCF to free trade in 2015

In announcing its support for a further 10-year extension of assistance to the TCF industries, the Government has indicated it will be shifting ground from current SIP arrangements, and inserting certain tests into post-2005 arrangements. These tests are aimed at ensuring on-going taxpayer support is targeted at firms making significant efforts to improve their international competitiveness, rather than just assisting them to 'struggle on' in an ever more difficult market.

As such, access to future SIP benefits is likely to be guided by a new 'additionality' concept. In effect, firms will be encouraged to take steps they would not otherwise have taken in order to improve their international competitiveness. The extent to which firms can build in an 'additionality' theme into their future investment proposals, will therefore increasingly influence successful claims under the new post-2005 SIP Scheme, which will also see eligibility defined by Customs Tariff items, rather than the ANZSIC codes used for the current program.

In all, the Government's decision to extend the SIP is welcome, but at the same time it is clear the environment for the consideration of future grant claims will also change significantly. TCF Services has formed an internal working group, and from early 2004, individual members of that group will be contacting each of our clients to map out what action they need to take to get the best return out of the Government's change of emphasis for post-2005 SIP arrangements.

To begin the process of comprehending these new changes, this issue of *'The TCF Industry Advisor'* maps out the broad parameters of the post-2005 package that has just been laid out by the Government. Further program detail is expected to fall into place in the early months of 2004, as Government seeks feedback regarding its initial proposals from industry, and as legislation is introduced into Federal Parliament (most likely by the Budget session - May 2004). TCF Services' Canberra office will be maintaining a continuous brief on detailed design work regarding the new SIP Scheme, and will report developments in future issues of this Newsletter.

In the meantime, if you have any queries about the post-2005 TCF assistance arrangements, or would like to receive your own individual copy of *'The TCF Industry Advisor'*, please do not hesitate to ring me, or email your queries to: gerry@tcf.net.au.

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The Minister for Industry, Tourism and Resources (ITR), the Hon Ian Macfarlane MP, confirmed 27 November the Australian Government would support a ten-year extension of the current TCF Strategic Investment Program (SIP), and involving new expenditure of up to \$747m over the period 2005-2015.

Extension of the current SIP is to be undertaken via the drafting of a new Act of Parliament, which although being modelled on the current SIP regime, will nevertheless contain extensive changes from those currently applying. The changes are needed to accommodate decisions: to incorporate 'a clear and specific objective' for the extended Scheme; clarify key definitions relating to 'research and development' and 'innovation'; and generally express the new Scheme in more simple and understandable language.

As a precursor to implementing the new SIP Act and related Scheme, the Government has indicated it will first seek Parliament's approval in early-2004 for changes to the Customs Tariff Act, to effect further reductions in TCF tariffs involving:

1 - Holding tariffs at 10% for cotton sheeting, woven fabrics, carpet and footwear; and 7.5% for sleeping bags, table linen and some footwear parts through to 31 December 2009, and then reducing them to 5% on 1 January 2010; and

2 - Holding tariffs for clothing and certain finished textile products at 17.5% through to 1 January 2010, whereupon they will be reduced to 10%. Such tariffs would then stand for a further four years, when they would be further reduced to 5% on 1 January 2015.

Key shift in focus of TCF assistance policy

In the aftermath of Parliament's agreement to advance the above tariff reductions, the Government has similarly acknowledged its willingness to support one 'final' round of transitional budgetary assistance. This last TCF package will take the combined industries through to a point where, by 1 January 2015, tariffs on all TCF products will have been virtually eliminated - as recommended by the Productivity Commission in its final report on the industries' assistance arrangements (see *PC Report No.26, 31/7/2003*).

What has emerged from the Government's consideration of the Commission's recommendations is, therefore, a major change in industry policy. Instead of repeatedly raising new assistance programs designed to achieve little more than staving off structural adjustment, the Government has now accepted the fact that many TCF firms will not survive the forthcoming tariff cuts, irrespective of whatever other support measures are provided to the industry.

As such, the post-2005 program has been designed: to 'strike a balance' between giving the TCF industries adequate time to adjust to future tariff reductions; whilst facilitating a seamless transition from the current growth-oriented assistance regime, to one more focused on addressing the fallout of industry rationalisation; and raising a new Scheme which progressively targets assistance on those firms facing the largest reductions in tariff rates, eg: clothing and certain (household) finished textiles.

Tranche 1 - Changes to current SIP (post-2005)

The Government has confirmed the current TCF-SIP Scheme will run its course through to 30 June 2005, within the existing funding cap of \$678m. Given recent policy announcements in terms of the more liberal interpretation of key Type 2 grant entitlement definitions - whilst reflecting on continual firm closures within the combined TCF&L industries - full program expenditure is now unlikely to exceed \$550m.

Nevertheless, certain legislative changes are likely to be made to the current Scheme in the first half of 2004 - and relating to entitlements in the final two program years (2003/04 and 2004/05) - as a result of the Government's decision to reduce the level of SIP benefits that can be claimed by firms who are already assisted by tariff rates of 5% or less. The sectors principally affected by this decision are Technical Textiles and Leather.

Under the new (post-2005) SIP Scheme, technical textiles are to be afforded reduced access to SIP benefits in the form of only being able to claim Type 1 grants - relating to new capital investment, along with new activities related to brand support (see discussion below). This change is being made on the premise such firms do not need special assistance to remain competitive. Further, there is an assumption such firms can withstand competitive pressure to invest offshore (as all other Australian industries assisted by tariffs of 5% or less are), via accessing Government support for innovation through mainstream programs such as R&D Start or R&D Tax Concessions.

To ameliorate this loss of future SIP benefits, the Government proposes to amend the current TCF-SIP Act next year to remove the 5% value-added cap applying to Type 3 grants. Such an amendment will increase the level of support potentially available for technical textiles and leather firms in the last two years of the current Scheme. Is this a realistic expectation? Basically, to get the best value out of the remaining years of the current SIP, such firms will have to splurge on investments at a time when the mid-term outlook for the Australian dollar will move well over the 75 cents to the US dollar benchmark, thus making domestic/export competitiveness that much harder.

Tranche 2 - New SIP Scheme (2005-2010)

The Government has decided to continue the substance of the current SIP beyond 2005, but in the form of a new Act (and related Scheme) to cover the years out to 2015. The need for new legislation principally comes about from the decision to abolish existing Type 3 (value-added), and Type 4/5 (regional adjustment) grants. The effect of this decision is to de-couple the automatic doubling effect of Type 1 and Type 2 grants in the current Scheme.

In its place, a new five-year (simple English) SIP framework - funded to a cap of \$500m of expenditure - will be raised, and will incorporate only two types of grants. Whilst the subject of negotiations between industry and the Government over January/February 2004, it is envisaged Type 1 grants will continue to apply to capital expenditure, and will be rewarded with a subsidy of 40%. Type 2 grants will similarly apply to non-capital expenditures (as per the current Scheme), and will be rewarded with an innovation subsidy of 80%.

All locally producing TCF firms will be able to participate in the new SIP Scheme, excepting Technical Textiles and Leather, who (as previously noted) will only be able to claim Type 1 grants for new capital investment and a new activity of 'brand support'. In its discussion of the most appropriate way to subsidise investment in market and brand development (p132), the Productivity Commission acknowledged the current SIP Scheme's focus on investment and R&D/innovation could, "make it difficult for clothing firms to access SIP assistance, even when they are ... making considerable efforts to improve their competitiveness through market and brand development, or through 'visual' innovation."

Some further work is therefore expected to be undertaken early in 2004 to 'fine-tune' existing definitions of 'R&D' and 'innovation'. The Productivity Commission (p133) provided some initial guidance on this task with its recommendation to the Government, "there would be merit in giving further consideration to whether: current limits on R&D salaries remain appropriate; collaborative R&D/innovation by groups of firms should be eligible for assistance; and expenditure on process improvement to bring a firm up to industry best practice should be eligible for funding support."

As such, and under the new post-2005 Scheme, the Government intends to re-designate current SIP Scheme Type 2 'brand support' entitlements as Type 1 entitlements, but unlike other Type 1 entitlements, firms will not be required to capitalise expenditures. At the same time, brand support activities (yearly expenditure will be capped to \$3m) will not be required to be linked to an innovative product, but will still only relate to those products sold under a registered Trademark. Over and above production related information technology (IT) for all eligible firms, clothing and finished textile firms will also be able to claim non-production IT up to a cap of \$2m per annum.

Tranche 3 - Curtailed SIP Scheme (2010-2015)

The Government's decision to effect a 'modest redirection' towards those sectors employing most of the TCF workforce and facing the greatest tariff adjustment in the years through to 2010, is to become more pronounced past that time, with its decision to extend the new SIP Scheme for a further five years (to 2015). Entitlements, however, will only be available to clothing and finished textile firms. All other textile entities will fall back to generally available innovation assistance.

Some \$100m has roughly been budgeted for the 2010-2015 curtailed SIP Scheme, with subsidy rates to be developed after an internal program review (around 2007/08), in order for their declaration in an appropriate time period in the run-up to 2010. Such a review is not intended to accommodate any issues outside of internal SIP administration review, as the Government has specifically ruled out undertaking any further reviews of TCF assistance. Formal notification has been given that 'sector specific assistance will cease after that provided under the post-2005 package'.

Firms in the clothing and finished textiles sectors will also benefit from a separate Supply Chain Efficiency (SCE) program, to support major capital investment which strengthens linkages between the clothing and finished textiles sector. This \$20m program will run from 2010/11 to 2014/15, but will only be open to companies not already receiving assistance through SIP. The SCE program is, therefore, a 'last chance' initiative, and is expected to herald the rise of the 80/20 TCF company - reliant 80% on imported products, and 20% on niche/just-in-time local manufacture. Grants for SCE will be administered on a competitive basis, and will be open to

clothing and finished textiles companies, and related suppliers. Consistent with the post-2005 policy shift, SCE projects will need to demonstrate that the investment would substantially enhance the competitiveness of local clothing and finished textile manufacturing.

New Programs to parallel SIP Extension - SME grants

Running parallel to the new (and curtailed) SIP Scheme over 2005-2015, is to be a \$25m competitive grants scheme specifically focused on small enterprises unable to access SIP benefits. The Productivity Commissions observed in its report, "a recurring theme in submissions was that transitional support should be more accessible to small firms." The Government's decision to extend SIP-related support to small firms therefore acknowledges the difficulties many of these enterprises have in meeting the \$200,000 (and successive) expenditure thresholds under the current Scheme.

In its final report, the Commission told the Government (p129), "the in-principle case for not discriminating against small firms is self evident. The entrepreneurial and innovative skills apparent in many small TCF firms suggest that there is good growth potential in this part of the sector. Indeed, given the financing difficulties that small firms often face, transitional budgetary support might induce more new activity to improve international competitiveness than support provided to larger, established firms." This accolade has turned out to be convincing from the Government's view.

Having said that, the Commission provided little guidance to the Government in terms of the structure of the new Small Firms Grant Scheme, other than the funding would need to come out of the \$600m allocated to both the new (and curtailed) SIP Schemes. Issues relating to the need to define the meaning of 'small firms', along with definition of the 'scope of activities' to be assisted are still to be worked out by the ITR Department (in consultation with industry) over the next few months. It is expected, however, the evaluation of grant applications will be undertaken by a small panel of 'experts', contracted to evaluate grant applications on behalf of the Government.

Import credits scheme for clothing and household textiles

Manufacturers will also be afforded a \$50m Import Credits Scheme (ICS) from 2005-2015, to grow their product ranges through integration with international sources. Because of the competitive pressure of imports under successively falling tariffs, Australian firms - due to their higher cost structures - will have little choice but to concentrate domestic/export production on branded or otherwise differentiated product. The balance of more standardised products, across the middle to lower cost ranges, will ultimately end up being fully imported.

To assist in this internationalisation process, the new 10 year ICS will provide some moderate support (ie: assistance is capped at \$5m per annum) to clothing and finished textile firms to make the shift to higher value added products, as the utilisation of credits will be limited to those enterprises alone (eg: the Government has ruled out 'transferability' of credits, meaning they can only be used against entries of finished clothing and textiles). Import credits will be earned against yearly increments in local production or value added, as compared against a rolling three-year average, using 2002/03 as the base year.

The Government has also agreed to a further five-year extension (to 2010) of the **Expanded Overseas Assembly Provisions (EOAP)** scheme, which provides a duty concession for the Australian textile or leather content used in the offshore manufacture of finished garment or footwear products imported into Australia. Some \$27m of duty has already been foregone under EOAP extension to 2010, with a further \$6m a year expected to be foregone in the extension to 2010.

All these programs will be supplemented by a \$50m (10-year) structural adjustment program to assist TCF workers displaced as a result of firms closing down local factories in the shift of production offshore. Such funds are not intended for industry assistance purposes, but will be specifically targeted for case-by-case support to assist workers affected by large plant closures.

The Textiles, Clothing & Footwear Industry Advisor (C) 2003 [Co-Operative Ventures (Australia) Pty Ltd] brings you the latest facts, analysis and contacts regarding Australia's TCF industries and related Government assistance and support programs.

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