



Volume 13, Number 07 - 26 November 2004 - ISSN 1034-4837

Global TCF market changes ready to roll

Parliament's return to Canberra on 16 November for three weeks of sittings has seen an early recommencement of the legislative agenda terminated with the calling of the Federal election on 9 October. The poll outcome assures textiles and clothing firms the Howard Government will eventually be in a position to push through its post-2005 Strategic Investment Program (SIP) legislation, along with the post-2010 tariff cuts.

Also on the horizon is commencement of the Australia-United States Free Trade Agreement (AUSFTA) from 1 January 2005, along with a substantive cessation of global TCF import quotas by the United States. This issue of the 'Advisor' looks at the combination each of these influences will have on evolving competitive pressures that will inevitably have to be faced by local firms.

If you would like further information on any of the material below, please do not hesitate to ring me, or email your inquiries to gerry@tcf.net.au.

Gerry Frittmann
Managing Director
TCF Services Pty Ltd

TCF Services Australian Offices

Sydney

Suite 3, Level 2
418A Elizabeth St
Surry Hills NSW 2010
Tel: (02) 8219 4900
Fax: (02) 8219 4999

Melbourne

Unit 1, 250 English St
Essendon Airport Vic 3041
Tel: (03) 9379 0022
Fax: (03) 9379 0991

Canberra

Unit 7, 14 Hartigan St
Garran ACT 2607
Tel: (02) 6260 5944
Fax: (02) 6260 3977

Services & Products

TCF Strategic Investment
Program (SIP)
Automotive Competitiveness
Investment Scheme (ACIS)
Expanded Overseas
Assembly Provisions (EOAP)
Import/Export Compliance
Management
Customs Accredited
Client Program

The re-election of the Howard Government, with working majorities in both the House of Representatives and the Senate, has now laid the groundwork for substantive change in the competitive landscape facing Australia's textiles and clothing industries (TCF) over the next five years, especially once global industry changes are also taken into account.

Legislation effecting the post-2005 Strategic Investment Program (SIP) was re-introduced into the House of Representatives on 17 November, and should pass the Senate over the course of the first half of 2005, assuming the Opposition respects the Coalition's 9 October mandate and drops its objections to the post-2010 tariff cuts initially conjoined by the Howard Government to its SIP bill.

Policy platform material circulated by the Coalition during the course of the recent election campaign affirmed an on-going role for 'sectoral' programs in the TCF and automotive areas, and noted their continuing role in building more competitive firms, capable of succeeding in export markets, as well as at home. Specifically, the Coalition said it had given these industries "generous support and long-term policy certainty (with TCF) offered a second \$747m package of assistance."

At a minimum, the SIP and related bills should pass through the House and Senate over the period February to May 2005, when it is also expected Industry Minister Macfarlane will table details of the administrative 'Scheme' detailing actual entitlements under the Strategic Investment Program. Should Opposition parties, for whatever reason, wish to hold-up passage of the SIP legislation, post-2005 Scheme legislation will join any other bills similarly held-up by the Senate through to 30 June, and will then be passed en-masse after 1 July 2005.

Australia-US Free Trade Agreement (AUSFTA)

Legislation to enable AUSFTA provisions to have domestic effect passed the Parliament in late-August. The key implementing documents were the US Free Trade Agreement

Implementation Bill 2004, and the US Free Trade Agreement Implementation (Customs) Tariff Bill 2004. Australia and the United States were to first have completed an exchange of letters by 31 October attesting to the fact that implementing legislation (in both countries) accurately wrote into domestic law the provisions of the substantive trade agreement.

This exchange of letters was delayed given controversy over Opposition amendments it forced the Government to make to the AUSFTA enabling legislation, most particularly in relation to the patenting and pricing of drugs. The Government has now indicated it will address US concerns by amending Australia's administrative and legal provisions (eg: the Copyright Act), thus paving way for a 1 January 2005 implementation date.

Guided tour of AUSFTA TCF provisions

Provisions in AUSFTA relating most directly to the TCF industries are to be found in Chapter 2 (Market Access for Goods), Chapter 4 (Textiles and Apparel) and Chapter 5 (Rules of Origin) of the substantive trade agreement. In short, they provide for 'staged reductions' in tariffs for most TCF products. The staging process is outlined in Annex 2-B to Chapter 2 of the substantive Agreement. This chapter outlines the impact of the free trade deal across thousands of items of manufactured goods, and is so extensive it defies natural classification. As such, it challenges the drawing together of quick conclusions as to what the most immediate benefits and drawbacks might be.

In regard to general tariff reductions applying across the Agreement, goods produced in America and shipped to Australia will be given a 2% preference over the general tariff rate provided they meet US-style Rules of Origin (RoO) requirements (see *discussion below*). For Australian products shipped to the United States, preferential rates vary on the assumption AUSFTA origin rules are strictly met. Generally, and for Australian exports, if the current tariff to the US is 3% or less, the subject tariff will immediately fall to zero.

If the US tariff is higher than the Australian tariff on an equivalent product, the US tariff will immediately fall to the Australian rate. If the US tariff is lower than the Australian tariff, then there is general provision for the US tariff to be reduced by a further one-tenth of the US rate. For carpets, tariff rates will be reduced to 8% on imported US products when the agreement commences, then 3% on 1 January 2010, and finally to nil on 1 January 2015.

In short, the most likely Australian export beneficiaries will be: certain cotton yarns falling under tariff sub-heading 5205.12/13; certain cotton blend yarns falling under tariff sub-heading 5206.12; certain polyester yarns falling under sub-heading 5509.21/22/53/92; textile fabrics for use in paper-making machines falling to 5911.31/32; certain knitted or crocheted fabrics, mainly for sun protection, of synthetic yarns of different colours falling to 6005.33; and certain blankets made from mohair fibres falling to 6301.2 as a result of a sub-heading change.

Watch out for origin/special rules

The above is true assuming the subject goods meet the Rules of Origin (RoO) that have been embedded in the AUSFTA agreement. In the main, these employ the 'yarn forward' concept which maintains: cotton and man-made fibres spun yarns and knitted fabrics must be produced from fibres grown or formed in one or other of the AUSFTA contracting parties; fabrics produced for export be made-up of yarns wholly formed in one or other of the AUSFTA contracting parties; and apparel for export produced from fabrics entirely formed in one or other of the parties to the Agreement, using yarns wholly formed in one or other of the AUSFTA contracting parties.

Further, any apparel made from fabrics to which the above subject yarns have been incorporated, must also be cut or knit to shape or otherwise assembled in one or other of the AUSFTA contracting parties. AUSFTA also includes provisions effecting a 'de minimis' rule to be applied to textile and clothing products. This rule allows up to 7% by weight of fibre/yarn to fail the 'yarn forward' test. Essentially, they can be imported provided the fibres/yarns are not elastomeric.

Given tariff reductions are progressive, policy analysts are not expecting a flood of US imports into Australia. Similarly, and given the operation of the more rigid (than Australia) RoO, it is not expected there will be a rush of Australian exports to the USA. However, should this not turn out to be the case, AUSFTA also contains 'safeguards' provisions which would enable the contracting governments to act to protect certain of their local industries from destruction.

The specific provision relating to safeguards - Article 4.1(1) - states that action can be effected by "an increase in the rate of customs duty on the good to a level not to exceed the lesser of: (a) the most-favoured-nation (MFN) applied rate of duty in effect at the time the action is taken; and (b) the MFN applied rate of duty in effect on the date of entry into force of this Agreement."

With the benefit of a strong local yarn industry, most US companies are expected to easily meet the 'yarn forward' rule, suggesting that through to 2015 the benefits of the free trade deal will, in the majority, flow to US companies. Products not well established in the US market, such as woollen carpets, do have better prospects assuming marketing campaigns are able to impact on entrenched consumer preferences for synthetic floor coverings.

Calling it a day on global TCF quotas

From January 2005, the United States (and the European Union) look likely to honour their obligations under the 1995 WTO 'Agreement on Textiles and Clothing' (ATC), and terminate their quantitative import restrictions (quotas) on imports of textile and clothing products. The main beneficiaries of this action are expected to be pan-Asian nations (particularly China), and in certain respects, the less developed countries of southern America and Africa.

Import quotas have not generally affected Australian exports to the United States, although local exporters have faced high substantive tariffs. What is of more concern for Australian industry is understanding the likely impact on world trade flows that will accompany a major shift in global TCF sourcing patterns towards China (and most probably, India), and how that will affect the price and availability of products as these two nations adjust shipment patterns after 1 January 2005.

Studies show the United States and the European Union (EU) have been slow to acquit their ATC obligations since 1995. The US, in particular - and through a process referred to as 'back loading' - has first applied quota liberalisation to products that were initially unrestricted, followed by products where quota utilisation was particularly low. So after 10 years of so-called ATC-based liberalisation, quota increases are yet to have the effect of significantly improving market access.

The end result of the above is that the most sensitive (ie: labour-intensive) products, and those with the highest design/technical value-added, have been left to the final stage of quota-free integration post-1 January 2005. Whilst there is no doubt US textile and clothing imports have increased over the period 1995-2002 (the limit of WTO data), and developing countries have gained a larger market share, the real adjustment - in terms of critical import penetration into the United States - is yet to be seen. How will this affect textile and clothing supplies to Australia?

Australia to be squeezed out of China?

This is difficult to predict, and around the world there are conflicting lines of thinking. Firstly, the 40 years of quota restrictions are said to have imposed a major administrative cost on global textiles/clothing trade (aka, an economic 'rent'), which will evaporate once quotas are abolished. Similar to Australia's experience when it scrapped its quotas and slashed tariffs in the early 1990s, the demise of quotas in the US and EU (along with benefits China will accrue from full membership of the WTO), should see exports from pan-Asian countries quickly taking a much higher proportion of total US and European market supplies. With quota 'rents' removed, prices from China and India - at least in the short-term - might fall in the range of 7.5-15% for all exports.

Alternatively, the huge redirection of Chinese and Indian textile and clothing production from global markets towards the US and the EU after the end of import quotas, is anticipated to absorb much of these two countries' production, leaving smaller importers such as Australia unable to access satisfactory supplies - in terms of both the quantity of goods demanded and their delivery timeliness. If the anticipated scarcity of textile and clothing supplies does actually develop over 2005, natural market reactions will ensure that prices to Australia will increase.

The volume increases being talked about for the US/EU are not insignificant. In Australia's case, and between 1995 and 2002, textiles penetration by China rose to 35.3% (from 19.3%) of total imports, and for clothing, China's share rose to 70.4% (from 54.3%). The WTO is predicting China will now increase its US textiles market share by 50%, with Bangladesh and Sri Lanka benefiting by a similar percentage. Those losing market share will be African countries (ie: those which previously enjoyed preferential access), as well as a number of Latin American countries.

US to lose half its clothing market to imports

In the case of clothing, the impact is much more dramatic. The WTO's modelling indicates that China and India combined will take 65% of the export market. China, in effect, triples its market share, whilst India's market share is quadrupled. All other countries lose market share, especially Turkey, Central European and North African countries, Mexico and Pacific micro-States such as Fiji.

So far the economic modelling has looked at production and price effects in static terms. More dynamic considerations such as technology, improved logistics, and the influence of ethnic/cultural links on garment sourcing have not been explored. Australia is geographically situated at relative distance from all other significant textile and clothing exporters, except China, which accordingly enjoys a 'less time to market' advantage. So perhaps it can hold local market presence?

More recent French (2004) research suggests other Asian countries (eg: India, Indonesia and Vietnam) are rapidly catching up with China in terms of favourable unit labour costs, as rapid growth within China itself drives up overall manufacturing costs. Perhaps their exports will fill the perceived supply gap? The French study also asserts Chinese industry is weak in design and fashion capabilities, and therefore, has limited ability to capture 'rapidly reactive' production scaled against the constant fashion shifts now commonly experienced in advanced western markets.

Again, and despite production short-falls in China and a rise in prices, traders might continue to source textile and clothing product from China because the above-mentioned costs and difficulties will not outweigh the added costs/disruption/uncertainty arising from a forced shift to alternative suppliers from other countries to which the subject importer is not familiar, or does not have an ethnic/cultural relationship. Assuming continual modernisation of China's textiles and clothing industries, supply difficulties can be anticipated to wane over time as new capacity comes on tap.

Similarly, and assuming higher tempo Chinese and Indian exports do actually wipe out traditional suppliers to these markets - on the basis their historical market share was only assured by preferential arrangements not enjoyed by pan-Asian suppliers (eg: Mexico under NAFTA, South American off-shore processing zones, etc) - what will happen to the production they previously supplied to the US and Canada? Realistically, it could be anticipated that suppliers potentially squeezed out of the US and EU by China and India would quickly look to other countries, including Australia, to ship their goods. In such a competitive market, it may just be that eager traders will first slash prices as a means to re-establishing export business lost in their former preferential markets to shipments hitting the US without substantive restriction from 2005.

Watch out for catches in shipping dates

Those Australian exporters to the US and the EU of garments made in China or other Asian countries that are currently subject to quota will need to critically watch their shipment dates in order to benefit from immediate ATC trade liberalisation from 1 January 2005. Customs officials in both countries have warned that it is the date that the goods are exported from the country subject to quota that determines whether the goods will be free of quota restrictions on arrival.

In short, Chinese origin garments imported into the US or EU in 2005 will still be subject to quota and require the appropriate export licenses if the garments were exported from China in 2004. If the goods have been exported from China to Australia in 2004, and are subsequently re-exported to the US or EU in 2005, the goods will still be subject to quota in these two destinations as they were first exported from China (the quota restricted country) in 2004.

To be sure, only goods that are actually exported from China in 2005 will be free of quota restrictions. TCF Services is continuing to assist firms looking to obtain the required export licences for quota during this transition period. Please call Paul Angel in our Sydney office (02/8219-4900) if you need further information.

The Textiles, Clothing & Footwear Industry Advisor © 2004 [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.

The Newsletter is published on a regular basis for clients of **TCF SERVICES PTY LTD** [ABN 88 053 245 926], PO Box 141, Surry Hills NSW 2010. Tel: +61 2 8219-4900/Fax: +61 2 8219-4999. Web: www.tcf.net.au
Correspondence should be addressed to the Editor.

Reproduction in whole or in part is not permitted without permission in writing from the publishers.

Disclaimer - Before relying on the information contained in this newsletter, users should independently verify its currency, completeness and relevance for their own purposes, and should obtain any proper professional advice. In particular, users should seek more detailed independent professional advice before making any investment/business decisions based on the content of this Newsletter.