



The Textiles, Clothing & Footwear Industry Advisor

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Free trade agreements changing TCF world

Whilst the Productivity Commission is putting together its draft report on post-2005 TCF assistance options, I thought we would take the opportunity in this newsletter to have a look at how the TCF business environment is changing as a result of Australia's participation in Free Trade Agreements.

Firstly, we look at current problems with free trade to New Zealand under ANZCERTA, followed by some initial reaction to the recent commencement of negotiations with the United States for a comprehensive free trade deal, prospectively from 1 July 2005.

I would also like to extend my thanks to all those clients who gave us time over the last few months to talk about future TCF business opportunities, and responded to our call to develop and lodge a submission to the Productivity Commission.

In our next newsletter, TCF Services will be providing a full analysis of the Commission's draft report and its recommendations.

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Industry suffers whilst politicians pop champagne corks

As Prime Minister Howard flew to New Zealand early in March to celebrate the twentieth anniversary of the Australia-New Zealand Closer Economic Relations and Trade Agreement (ANZCERTA), industry was grumbling about changes in interpretation by NZ Customs of provisions in the original agreement relating to the place of manufacture for clothing.

Spurred on by the declaration of duty free trade between the two nations in 1983, New Zealand quickly emerged as a popular market for Australian fashion/leisure clothing given the relatively high disposable income, a sophisticated market, geographical proximity, and the all important lack of any import duty rate. This latter benefit was only extended on the basis of the export goods meeting the 'rules of origin' which required 50% of the manufactured cost of the goods to be Australian.

Towards the end of 2002, clothing importers began to get questions from NZ Customs regarding who was actually exporting the goods, the manufacturer or simply the owner. As time has passed under CER, many owners of goods are not the manufacturers - given the goods have actually been made in out-sourced premises. Should this change the status of the trade concession?

We think not, but true to form NZ Customs is taking the line that the factory that provides the last element of the manufacturing process should also be the exporter. As a result it has suspended the benefits of the ANZCERTA agreement for such exports and imposed a 19% tariff.

A different line on 'rules of origin' than the 20 year norm

Industry and TCF Services moved quickly to ensure that Prime Minister Howard was aware of the problem before he got to New Zealand, and in a 9 March Press Conference he deferred to NZ Prime Minister, Helen Clark, to explain the situation. According to Clark, "we're looking with some interest from the New Zealand point of view at the reference to, and work of, the Australian Productivity Commission on the rules of origin issue, and

when that Commission has advanced its work, we'll be making a submission to it and looking forward to discussing with Australia how we might modernise and update our relationship in that respect."

Back in Canberra, Clark's comments caught most Industry and Trade Department bureaucrats by surprise with few, including the Productivity Commission itself, aware of the subject 'Rules of Origin' inquiry. Prior to John Howard turning up in Wellington, however, the Commission's boss - Treasurer Peter Costello - had also been in town talking to NZ's Finance Minister on opportunities to take the CER relationship beyond purely trade issues, and into the brave new world of harmonisation of business, regulatory and tax laws. At this time, it is understood the rules of origin issue was also raised.

The end result is likely to emerge in the upcoming 13 May Federal Budget, when the Treasurer is expected to sign-off on a new reference to the Productivity Commission for a nine month inquiry to look into the continuing effectiveness of the 1983 vintage CER 'Rules of Origin' provisions given the swag of complaints from Australian exporters, as well as some written reasoning from NZ Customs as to why they have taken the action to reimpose substantive duties.

Parties get down to haggling on FTA with the United States

The outbreak of hostilities in Iraq has had a subdued effect on prospects for the US-Australia Free Trade Agreement, including opportunities for Australia's textiles, clothing and footwear producers in the more open trade environment that is, potentially, just around the corner in 2005. In the midst of what appears to be a slight-of-hand campaign to steal Australian wheat exports to Iraq, negotiations began in earnest in Canberra last month with both sides promising they would pursue a wide-ranging and comprehensive set of objectives in FTA discussions, which - for industrial goods - means, "the elimination of tariffs and other barriers to trade."

Trade Minister, Mark Vaile, issued an up-beat press release saying the conclusion of an FTA with the United States presented "a unique opportunity to advance the interests of Australia's exporters, and offers significant benefits to the nation in terms of economic growth and employment.' He added a high standard FTA with the world's major trading power "will also add momentum to the objectives we are pushing through the World Trade Organisation (WTO) aimed at strengthening the multilateral trading system and advancing the cause of global trade liberalisation."

It was just as well Vaile was pushing the positive line, for back in Washington, US textile manufacturers were telling the Trade Representative's (USTR) office they saw little in the agreement for them in terms of increased exports to Australia. At the same time they feared the FTA would open up the back door for the trans-shipment and smuggling of products from China that sought to undermine US labelling and 'rules of origin' requirements.

Impact of the US abolishing quotas post-2005

What both sides are not explaining is that the cutting of a bilateral FTA between Australia and the United States - prospectively set down for implementation from 1 July 2005 - will coincide with the expiry of time for the elimination of quantitative import restrictions (ie: quotas) on all imports of TCF products into the US that was agreed in previous WTO rounds. At that time, there is expected to be some major upheaval within world TCF markets, as China moves to concentrate the vast bulk of its production into the US, irrespective of most of this trade still facing a substantive tariff.

This trade diversion effect is forecast to have a major impact on the availability of goods for small volume markets such as Australia. So as China shifts to serving a more open US market, importers will find it more difficult to acquire small relative volumes of product destined for Australia, or will be shifted back in time - in terms of supply priority - to the end of the queue. The people most affected by this in Australia will be retailers, who might not be able to secure desirable volumes at the times most appropriate for opportune selling.

Should the trade diversion effect become acute, local manufacturers of clothing and related accessories might find the retailers 'come-a-knocking' at their doors for local product, and for many in the industry who have suffered the harsh business practices of retailers in the past, it might be a time to settle some old scores whilst locking in some long-term concrete understandings in regard to future rounds of local sourcing.

This is not the only good news from the advent of a FTA with the United States. As a niche supplier at duty free rates into one of the world's largest and most sophisticated markets, many Aussie companies are currently re-crunching their numbers with a view that the design, manufacture and export of more sophisticated TCF products becomes substantially more viable for local enterprises after 1 July 2005 under an FTA.

Many see the most immediate opportunity to be in the area of design, sampling and supply of the first season's shipments of new and innovative product, which would subsequently be turned over to Chinese or other foreign suppliers once volume-oriented repeat orders kicked-in. This is one good reason why the Government should extend the Strategic Investment Program (SIP) for a further period of time - to ensure Australian TCF manufacturers can gear up to advance 'the unique opportunity' trumpeted by Trade Minister Vaile.

Charting where TCF sits in the 21st century

The Australian Bureau of Statistics has just released its latest survey of Australian Manufacturing industry (Catalogue 8225.0) which contains a number of insights into how the TCF industries have fared over the last ten years. As at June 2001, TCF and Leather manufacturers employed 57,000 people, a decrease of 9.6% from the previous year. In 200/01, these manufacturers generated \$9.1 billion in sales and service income (down 2%), and \$0.1b in pre-tax profits (down 57%). In terms of total manufacturing in Australia (which is measured by the Australia-New Zealand Standard Industrial Classification, or ANZSIC), the ABS comments "this industry is relatively small."

According to the ABS, the TCF&L industry balance sheet shows that the net worth of the industry decreased by \$0.3b (down 16%) during 2000/01. The industry experienced a decrease in the value of assets (down 2%), while the value of liabilities rose by 6%. Capital expenditure on tangible assets increased by 15% to \$0.3b. The ABS says the largest component of capital expenditure was outlays on plant, machinery and equipment (including motor vehicles), which amounted to \$0.2b - or 79% of total capital outlays, including tangibles.

For 2000/01 the industry profit margin was 1.5% (ie: \$15 of pre-tax profits per \$1000 of operating income), a decrease on the 1999/2000 result, and the lowest of all the ANZSIC manufacturing sub-divisions. Pre-tax profits were nevertheless recorded in 2000/01 by 66% of TCF&L manufactureres (66% in small, and 65% in both medium and large businesses).

Performance measures for the industry over the period 1995/96 to 2000/01 have mostly declined, with profit margin falling from 4.3% to 1.3%, return on assets falling from 7.1% to 2.2%, long-term debt-to-equity worsening from 49% to 95%, and the Current Ratio moving from 1.4 to 1.5. TCF&L production fell substantially - down 18.1% to \$2,562m in 2001/02, compared with the previous year - and taking the longer-term view, has been shrinking over the last twenty years at an average annual rate of -2%.

TCF needs a better argument than this to secure SIP extension

To complete the tale of woe, the Australian market for TCF&L manufactured goods is said by the ABS to "have fallen by 9.1% in 2001/02 compared with the previous year - on the basis of market estimates of \$9.3b of income from sales, which is made up of \$2.7b of exports and \$7.4b of imports, yielding a total Australian market for TCF&L products of \$14.0b for 2001/02, with an estimated (and high) level of import penetration." In short, 53% of the Australian market is currently being satisfied by overseas products.

For those TCF&L companies engaged in active export, the ABS reported firm's achieving higher averages per person employed for sales and service income (\$220,000 for direct exporters compared to \$114,000 for non-exporters), and in regard to industry value-

added per person employed, direct TCF&L exporters achieved \$55,000 compared to \$38,000 for non-exporters. So that was the good news!

Big guys no longer dominating the TCF&L sectors

One other theory shattered by the ABS is the myth that large enterprises are the heart and soul of the TCF&L industries and, as reflected in early SIP policy, they should therefore be the focus of the bulk of assistance being provided by Government for driving new capital investment and expenditures on innovative product development and process improvement.

According to the ABS statistics, the contribution of small, medium and large enterprises to the total TCF&L manufacturing industries has changed, and is much more even than first thought. Small enterprises (employing less than 20 people) are now said to contribute 34.2% of total employment and 24.8% of industry value added (IVA), whilst medium enterprises contribute 29.1% of employment, and 30.1% of IVA.

Large TCF&L companies (those employing more than 100 persons) were said in 200/01 to have contributed 36.7% of total industry employment and 45.1% of IVA. Looking at this another way - and reflective of the industry re-structuring that has occurred over the last five years at the big end of town - TCF&L enterprises in Australia employing less than 100 persons now contribute 63.3% of total employment and 54.9% of industry value added.

IR problems show TCF not that much different from motor vehicles

One sleeper expected to be picked-up by the Productivity Commission in terms of arguments supporting any extension of the SIP is industrial relations, and the extent to which poor IR management contributes to the industry's ability to achieve ongoing competitive sustainability. Whilst the ABS logged industrial disputes as generally decreasing in the year ended June 2002, it noted that in the ranks of the highest number of working days lost per thousand employees in manufacturing, the TCF&L industries came in second (248 days) after wood and paper product manufacturing.

Across manufacturing as a whole, the main causes of recorded disputes was said by the ABS to be managerial policy and physical working conditions. Exposing perhaps an 'achilles heel' for the TCF&L industries in calling for on-going post-2005 assistance, the statistics point to a significant increase in working days lost for the textiles, clothing, footwear and leather manufacturing industries, which were up 363.7% on the previous year.

TCF Services now 'the source' for the latest textiles intelligence

TCF Services has secured a non-exclusive licence to become the principal Australian agents for the UK-based publisher of 'Technical Textile Markets', 'Performance Apparel Markets' and 'Textile Outlook International' - world renowned publications which maintain an intimate link into emerging technologies and business strategies for TCF firms with a view to mastering long-term sustainability and export orientation.

TCF Services will be establishing a library in Sydney of each of these publications over the last few years, and is negotiating a licence to produce sample extracts of articles that particularly relate to our clients and other interested parties. Respective client managers will be fully briefed on the range of information contained in each of these publications, and will be in a position to provide guidance in regard to subscription details.

Each of the three publications is supported by a website: www.textilesintelligence.com.

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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