

## Government yet to 'bite' on PC position paper

In the aftermath of the Productivity Commission's release of its draft Position Paper on Post-2005 assistance, there has been remarkably little debate on the substance of the report, outside of its more controversial recommendations on Tariff reductions.

Recognising the industries are in for some serious adjustment over the next five to ten years, the Commission has made a generous case for continuation of the Strategic Investment Program (SIP). Elements within the Government, however, appear to be not so welcoming in terms of the sorts of financial numbers the PC has floated to support SIP extension.

Hearings on the Position Paper start in Melbourne on 3 June, followed by Geelong (5 June) and Sydney (12 June). As a prelude to the hearings, this newsletter outlines some of the issues governing debate over the forms of extension to the SIP Scheme that are being proposed.

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## Another SIP will not save the TCF&L industries post-2005

Underpinning the whole of the Productivity Commission's (PC) paper is a view that whilst the outlook for some firms and parts of the TCF sector is quite positive (and particularly if identified weaknesses can be addressed), in other areas of the combined industries future prospects are said to be "very limited" - and this was prior to the major appreciation of the Australian dollar!

Such observations present the Government with a serious dilemma in terms of continuing current assistance arrangements. In effect, it does not want to throw good money after bad, whilst at the same time the Commission has put a strong social argument to continue assistance as long as possible, as a means to managing orderly adjustment and/or firm exit. In essence, the PC says without extended assistance, too many firms might go broke, too quickly, and therefore, create embarrassing politics for Canberra.

The PC starts out scaring the reader with its observations that large elements of TCF already have 'serious competitive disadvantage in producing standardised clothing and footwear items', whilst any short-term improvements are almost immediately likely to be matched by continual improvements in alternative sources of supply from overseas. As the paper says, "there is now little if any productivity difference between Australian and efficient Chinese suppliers."

According to the Commission, there is "generally poor profitability among firms still producing standardised TCF commodities (and) many participants acknowledged that such activity will continue to migrate offshore, almost regardless of the assistance regime. This in turn will place pressure on firms further upstream who supply these more vulnerable sectors, for example, textile and leather suppliers servicing local clothing and footwear manufacturers."

## Australia's future TCF already diverging from its past

Seeking to offset these competitive realities through high tariffs, says the PC, "would be neither effective nor in Australia's interests. The future of an internationally competitive Australian TCF sector lies mainly in the manufacture of differentiated, higher value-added products, and in the provision of bundled products and services."

Based on the assessment that 'current activity is unlikely to be viable in the medium to longer-term', the policy imperative put by the PC to the Government turns away from the usual 'economic development' mantra (ie: growth/new entry), and toward the more critical need for Government to take action "to reduce the risk of disruption as firms leave the sector."

Such conclusions, the Commission says, "has important implications for the timing and choice of future assistance reductions." One is left with the conclusion that if the PC thought it could get away with 'throwing in the towel' on the whole industry, then it might like to do that. However, one flickering flame - the TCF Strategic Investment Program (or SIP) - is holding it back.

## Old statistics not supportive of good decision-making

Given PC industry analyses are based on out-dated statistics (ie: 2000/01 vintage), and the SIP has been in operation for just under three years, the PC is left admitting "it is difficult to gauge how well the overall package is performing. Because investment and innovation take time to plan and implement, there is likely to be a lag before the package's effects on sectoral outcomes become apparent." In short, the PC does not want to kill off TCF assistance if there is some hope that elements might just flourish - especially innovative technical textiles and highly functional manufactured products.

Hesitant to run a sword through the industry just on perceptions of its paltry investment performance and quirky industrial relations record, the next best tool in the Commission's armoury is to advise the Government to advance Tariff reductions, and then push for the whole approach to post-2005 TCF assistance options to be framed with the aim of addressing the quantum of looming 'adjustment issues'.

After all, the PC readily admits its quantitative modelling of industry data suggests little will be gained from further Tariff cuts alone. In PC-speak, removing special support for TCF firms "would provide little measurable 'allocative efficiency' gain."

## Transitional support for a slow death, or protracted TCF re-birth?

Considering for a moment that the flask may be half full - and that there are good reasons to extend the SIP to provide an environment where new and emergent TCF firms might be encouraged to grasp the twin tools of innovation and rapid technology infusion, the Commission has concluded, "cessation of transitional support immediately after the current SIP expires in mid-2005, could be counter productive."

So, with the success or otherwise of the SIP to date not able to be measured, and having recommended quite substantive reductions in TCF tariffs after 2010 (to achieve a maximum of 5% by 2015), the PC considers, "given the magnitude of the adjustment task still confronting the sector, early cessation (of the SIP) in combination with further tariff reductions could risk sacrificing some activity that otherwise had reasonable prospects of becoming viable under more accommodating transitional arrangements."

From the community's point of view, the Commission considers, "an investment to reduce that risk would be worthwhile." The Position Paper accordingly proposes a successor to the SIP - not an exact successor, mind you - as the Commission sees 1 July 2005 as a valuable opportunity to take-up some of the 'lessons learned' from the first three years of current SIP implementation.

It has, therefore, proposed an extended (to 2013), but time-limited (two rounds of four years) Scheme that would:

- Reward incremental/new activity rather than continue to subsidise activity that would have been undertaken by firms - as natural responses to market changes - without support;
- Give firms flexibility to judge what spending will best promote their future competitiveness (including, where appropriate) reducing dependence on TCF manufacturing activity;
- Provide support (only) to firms likely to survive and prosper as a result of that support;
- Provide a sufficient level of support to make a difference to firm behaviour;
- Take account of the extent of the Tariff reductions facing firms in different parts of the sector;
- Discontinue current discrimination against small firms, which meet assistance criteria;
- Promote certainty and transparency through improved Scheme administration;

- Keep administrative and compliance costs low, while minimising the risk of exploitation and abuse (called 'gaming' by the PC);
- Maintaining Scheme integrity in a way that minimises the risk of complaints to the WTO.

## Structure of a 'polished-up' post- 2005 SIP

According to the Commission, "striking the right balance between giving the sector time to adjust to future Tariff changes and signalling that its special assistance treatment will end no later than 2015, is also important. This suggests that, like tariffs, transitional support should be progressively reduced.

The model chosen by the PC is - following the expiry of the current SIP in mid-2005 - to commence a new transitional support mechanism that will operate in two tranches, for a total of eight years out to 2013. Total funding for the first four years would be similar to the current SIP (around \$560m), whilst in the second tranche (2009-2013) funding would be halved to \$280m. Transitional support would then terminate in 2013.

In proposing a dual-tranche extension, the PC has urged the Government to address some common deficiencies in the SIP, the introduction of which could be commenced prior to 2005. Under what is called 'Option A', the Commission canvasses the following changes which, it says, entail "the least disturbance to the current framework."

Such changes are:

- Further clarifying the meaning of 'innovation';
- Enabling AusIndustry to provide advance 'binding rulings' on the eligibility of expenditure for funding support, prior to certain investments occurring;
- Relaxing some registration-related auditing requirements to reduce compliance costs;
- Paying successful claims more promptly;
- Somewhat reducing the \$200,000 eligibility threshold;
- Providing generalised funding support for expenditure on state-of-the-art second hand equipment (subject to fraud and prevention measures); and
- Making early stage processing eligible for funding support.

The Commission quite reasonably argues, that "as well as improving on the operation of the current SIP, this approach would take advantage of the case history and decision-making precedents accumulated prior to 2005." In essence, such modest improvements could be brought forward in 2005, meaning that if the Government adopted 'Option A' as policy, industry would be provided with a good five years of reasonably certain Scheme administration.

## Tightening-up the SIP in the years past 2009

Addressing merely the 'common deficiencies' means the Government would miss the opportunity to address some other deficiencies in the current SIP, which are more reflective of where current Government industry policy is moving for all assistance Schemes.

Whether to be applied immediately post-2005, or possibly held-back for application post-2009, the Commission flags to the Government that the current review provides a real opportunity to:

- Impose a regime where grant payments are tied to incremental outcomes, thus motivating the Scheme to induce real improvements in industry competitiveness;
- Broaden SIP eligibility to a wider range of investment activities considered likely as leading to improvements in competitiveness;
- Take the razor to AusIndustry 'red tape' and significantly cut compliance costs;
- Reduce auditing costs for smaller firms, whilst introducing more stringent auditing regimes for large firms to ensure investments do lead to longer-term competitiveness, thus reducing the risk of gaming or abuse; and
- Improving the transparency of decision-making processes to reduce the extent the Scheme is prone to disputation.

Whilst encouraging industry to consider the benefits of opening-up the current SIP, the Commission also warns that 'making support more widely available would spread overall funding more thinly' - possibly raising the need to invoke 'modulation'. However, no analysis is provided to back up such an assertion. In fact, little analysis of the current SIP is provided in

## Things could get worse if you don't like Option A

the Position Paper, with the Commission preferring to rely on the conclusions of a Departmental review of the SIP in 2002, which itself is somewhat dated in terms of the current realities of SIP administrative practice following Ministerial changes made in August 2002.

**M**oving beyond what is clearly a sensible framework for polishing-up the current SIP and extending it beyond 2005, the Commission also floats two other alternatives.

Option B involves re-basing assistance around a 'value-added' bounty - an old chestnut of the Commission's - and a return to some of the discredited subsidy Schemes of the 1970/80s. Although admittedly simpler to administer than the current SIP, the PC itself admits such approaches have 'systemic shortcomings', not the least being the challenge of defining and measuring incremental value-added.

The Commission's third approach, Option C, involves a wholesale change to the way the Scheme would operate, and involves another return to the past whereby 'Boards' or 'Panels of Experts' would be appointed by the Government to dole out money to industry on the basis of pre-determined criteria and the passage of high-cost submissions through multiple levels of political Government.

Option C proposes to essentially take TCF industry assistance administration back to the days of the TCF Development Authority (TCFDA), when essentially money was provided to companies to make major advancements in long-term competitiveness and sustainability. What the Commission does not say, is that many of the firms who received such grants have since moved offshore, or quickly closed down! So much for the wisdom of 'experts'.

Acknowledging such, the PC admits that "getting the right balance between reliance on pre-determined selection criteria and the provision of discretion to the selection panel would not be easy." Further, it judges the effort and cost of preparing claims under a competitive bidding approach "could conceivably be higher than under a rules-based Scheme," such as the SIP.

At the same time, the PC considers the other key advantage of a competitive bidding scheme - bringing the decision on funding eligibility forward - could be partially replicated within the existing SIP framework by taking-up the 'Option A' suggestion to provide for 'binding rulings' on whether proposed expenditures will qualify for funding support. Teasing out the three 'options' is, in essence, what the Commission's up-coming hearings are all about.

## Let's not change anything else - things are all too fragile!

**M**oving on to other parts of the post-2000 TCF assistance package currently in play, the Commission has looked at the case for making further changes post-2005, and has concluded there is not "a strong case for either abolishing for changing the Overseas Assembly Provisions (OAPs) or the TCF Policy By-laws."

The PC considers that, for most firms, these assistance elements "are minor parts of the assistance package and they will become even less relevant as TCF tariffs decline post-2005, and beyond. Making changes in the interim could increase uncertainty as new arrangements were bedded down, and divert attention from the main game."

Irrespective of this position, the Commission nevertheless found there was merit in arguments by TCF (and other) importers for greater opportunity to be given for applications to secure exemptions from the Excluded Goods Schedule (EGS) of the Tariff Concession System - a mechanism steeped in much history and complexity (in terms of achieving changes).

According to the Commission, "a wide range of TCF products are covered by this schedule, meaning that concessional entry for some 'specialist' items is not available, even when there appear to be no locally produced close substitutes."

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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