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National Farmers' Federation

Productivity Commission Review of General Tariff Arrangements

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NFF supports the removal of all tariffs on a unilateral basis. The key issue to be considered by the PC is whether the reduction in the cost of capital to all Australian industries and the reduction in prices to consumers and reduced administration and compliance costs as a result of removal of nuisance tariffs outweighs possible reduced opportunities for new producers , and any resource allocation effects.

The issues are not dissimilar to those that arose in 1996 following modification of the Tariff Concession Scheme (TCS) in the run up to the election that year. The original intent of the TCS (introduced in November 1992), was to make concessional entry more readily available without adversely affecting the assistance given to local industry.

The TCS allowed duty free import of goods if there were no local manufacturers (substitute test), or where if a substitutable good exists, the granting of a tariff concession order (TCO) is not likely to cause significant adverse affect to the market for the substitutable good (market test).

With figures available, it is difficult to estimate the net costs or benefits to agriculture of removal of the tariffs. While some business inputs such as tractors and combine harvesters currently attract no duty many other forms of capital inputs do. Also some agricultural producers may benefit from these tariffs on substitutable products.

NFF supported the retention of the TCS. At the time we argued that its retention was a second best solution to removing all existing 5% tariffs. Similarly, in the present situation NFF supports the removal of all 3% tariffs. Once again if tariffs are not to be universally abolished NFF would support the retention of the current TCS.

In an investigation of the TCS the BIE found that the reduction in the cost of capital as a result of the TCS was of order of four per cent. Full removal of all 5% tariffs would result in an even larger reduction. This is not an insignificant benefit to industry.

Whenever the issue of the tariff reductions comes under scrutiny in Australia protected industries resort to scare tactics to maintain their privileges. Nearly 20 years ago, when the car industry's protection was under scrutiny, a major manufacturer put its name to full page advertisements warning of the potential job losses. Around the same time, the same firm complained to the Temporary Assistance Authority into steel that higher tariffs would have a determined effect on their competitiveness. Such behaviour is being repeated now as industry groups argue for a reduction in tariffs on business inputs but want to retain tariffs on the items they produce. Such an approach is patently absurd.

The Industry Commission has identified the benefits to real GDP of Australia continuing to reduce its tariffs, even without similar reductions by our trading partners, at up to $4b a year. While a good part of this would be attributable to TCF and motor vehicle tariffs, the current system of general and nuisance tariffs are also important. While there may be anomalies in world trading arrangements, it will not serve Australia's long term interests to jeopardise such potential improvements in economic performance, by retaining these tariff arrangements.

Tariffs, together with other forms of protection are specific taxes levied on imports which, like all taxes, have the immediate effect of raising the price of imported goods and reducing the amount of those goods purchased, either directly in the case of quotas, or indirectly through higher prices.

The cost of protection falls, in the first instance, on:

- consumers, who are forced to pay higher prices for certain products and therefore have less to spend on other goods and services;
- all Australian industries, which may not only use the high-priced products of the protected industries, but may also compete with protected industries for resources such as labour and capital; and
- exporters, who not only have their costs increased like all other Australian industries, but cannot pass these costs on, because they generally operate in competitive world markets.

By increasing the price, and restricting the supply of imports, protection allows a narrow base of local industries to charge higher prices and provide some additional jobs in protected industries. But the reduction in consumer spending power, lower production and sales by other industries, and lower exports mean fewer jobs in unprotected industries. Maintaining the current tariffs therefore may be superficially appealing since the gains are visible, whereas the costs generally are not.

Tariffs undermine the ability of the farm sector in particular to remain competitive and to contribute to economic growth and rising living standards. Some of their effects include:

- eroding rural export revenue through upward impact on the exchange rate;
- inflating farm costs, through tariffs on farm inputs and the flow-on effects of wage increases which originate in tariff-protected industries;
- jeopardising the development of new rural export markets, especially in developing Asian countries; and
- by diverting scarce labour, capital and management resources to protected industries, they reduce the availability of these resources to other more efficient sectors of the economy such as farming.

Reductions in Australia's tariffs and other forms of export assistance have produced a more open and internationalised economy. This has enabled cheaper imports to contribute to increased production, and has established an entrenched export culture among most industry sectors.

International trade involves an exchange of exports for imports. That is, it provides an opportunity for exchanging goods Australia is able to produce relatively cheaply for goods that it does not produce as efficiently.

By specialising in the production of goods at relatively low cost (and exchanging these for goods which would otherwise be produced in Australia at relatively high cost) national income and welfare will be increased.

A more open economy provides benefits to consumers and industry by allowing them to purchase the best goods wherever they are made. It also provides other advantages, since, by competing with the world's best, Australian firms stay at the leading edge of product development and are therefore able to succeed in local and world markets.

On the other hand, protection not only has a direct adverse impact on those who are already exporting, but can also discourage the development of new industries and new export and growth opportunities. There is reduced incentive to be innovative and to seek new markets overseas if an industry is sheltered from the realities of the market place by protection.

As mentioned above protection can also encourage over investment in the protected sectors of the economy.

Protection and Employment

In the final analysis most arguments in favour of protection come down to the employment consequences of removing protection. It generally argued that we need to protect our manufacturing industries to prevent "cheap imports" taking Australian jobs.

Those who favour free trade are accused of sacrificing jobs for Australians for the sake of economic efficiency. This can sometimes be a difficult claim to counter. In many cases protectionists can point to the possible immediate loss of jobs if protection is removed whereas proponents of free trade must discuss the longer time lags involved in adjustment.

Indeed, claims of such job losses are an almost daily occurrence in most major newspapers, whenever reduced protection is discussed.

This is one of the most transparently false arguments in favour of tariffs and protection. Experience in Australia's manufacturing industry and in protected industries elsewhere in the world shows that job losses are greatest in the *protected* industries, because they become increasingly uncompetitive compared with leading edge business in the same industry in other countries.

The simplest way to assess these claims is to look at employment trends in the period since 1973, when tariff reductions seriously commenced in Australia. Undoubtedly, if the protectionists were confronted with the extent of tariff reductions from 1973 to 1997, back in 1973 they would have predicted dire consequences for the economy and the almost certain total demise of the manufacturing sector. History, however, provides a different picture.

Over the period in question manufacturing employment fell from 1.4 million to 1.1 million **BUT** total employment increased from 5.6 million to 8.1 million. So, while employment in manufacturing did decline, this was swamped by increased employment opportunities in other sectors of the economy.

And even this reduction in manufacturing employment needs to be considered in the context of two related issues. First, that nearly all developed economies became increasingly service orientated over this period. As average incomes and living standards improve, consumers spend more of their income on services rather than goods, thereby resulting in a decline in the relative importance of manufacturing.

Second, while employment in manufacturing has declined, total production has increased. This suggests that the anticipated increase in productivity and efficiency as a result of tariff reductions has indeed occurred.

Proponents of maintaining these tariffs are also likely to use the so-called "bargaining chip" argument – don't reduce tariffs unilaterally – rather, save them for multilateral negotiations where they can be traded-off against concessions from our negotiating partners. This fallacious argument is based on the misconception that trade is a win-lose negotiating game played out during a round of trade talks. Negotiators want to get as much access to other markets while making as few concessions as possible. That is, they treat imports as bad and access to the local market as something to be given away only reluctantly. This is a fundamental misconception. As discussed above, trade is a win-win situation.

The tariff reduction measures announced in the late 1980s and the early 1990s placed Australia in the forefront of tariff reduction and meant that we could take part in international debates from a position of strength, so far as the adjustment is concerned.

Only by a continuing commitment to trade liberalisation can the Government ensure that Australian industry and farmers can take advantage of the long term trend towards globalisation. Australia must continue to reduce and eventually eliminate all import barriers if we are to compete effectively with other countries.