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Submission to

Productivity Commission Review of Australia's General Tariff Arrangements

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EXECUTIVE SUMMARY

The Association believes that the general tariff arrangement interferes with the efficient running of the market place, adding costs in the production process. The Association recommends that the tariff be removed across the board.

While recommending that the tariff be removed, the Association is aware that there may be specific cases where the retention of the tariff is desirable. In such cases the onus of proof should be on the business/industry gaining the benefit to show good reason for the retention of the tariff.

The general tariff, as with all other forms of protection, is an impediment to the operation of free trade and therefore introduces inefficiencies into the market place. Under a situation where producers receive more for a product than would be the case without protection, the use of resources is increased beyond the most efficient point to achieve greater returns. Removing the levels of protection will increase the efficiencies with which scarce resources are used.

The imposition of the GST reinforces the need to remove the general tariff. Maintaining the tariff with the introduction of a GST merely imposes a tax on a tax – an added cost to business – the opposite of new tax reform.

Implementation of microeconomic reform and the removal of the general tariff should be looked at as being complementary. Competition policy will allow domestic producers to become more internationally competitive, standing them in good stead for the future removal of trade barriers.

Australia's involvement in APEC and the Bogor agreement requires the removal of trade barriers by 2010-2020. Removing the general tariff, which is one of the highest within the developed countries, will place the country in a good position to fulfil this agreement and encourage others to do likewise. It will also ensure that by removing tariffs first, Australia can receive the maximum benefits from the trade liberalisation process.

In the case that the general tariff is not completely removed the Association believes all concession arrangements should be retained. Abolishing such arrangements would mean businesses using imports in their production process that have no domestically produced equivalent and or those that re-export goods would be placed at a cost disadvantage.

RECOMMENDATIONS

The NSW Farmers' Association recommends that the general tariff be removed.

The NSW Farmers' Association recommends that the national interest be the objective of Australia's trade and industry policies.

The NSW Farmers' Association recommends that all tariffs on imported agricultural machinery spare parts, chemicals and other farm inputs be removed.

Where the general tariff is not removed, the NSW Farmers' Association recommends that the tariff concession scheme, or similar arrangements, be retained as they relate to imported goods not manufactured in Australia or are subsequently exported in their original or manufactured form.

The NSW Farmers' Association recommends that the Government continue the planned reduction of tariffs in the car and TCF industries.

The NSW Farmers' Association recommends that the ACCC be appointed to ensure that the cost of removing the tariff is not unjustifiably passed on to producers through lower prices.

INTRODUCTION

Australia's agricultural sector is heavily dependent on international trade as both a source of inputs for the production process and income from the sale of commodities. Over 80% of Australia's agricultural produce is exported and in 1998-99 the total value of exports of agricultural products was over $22 billion. The sector also sourced a large percentage of its inputs such as chemicals and machinery parts from overseas. Tariffs and other protection measures therefore have a direct impact on the income farmers receive from the sale of their produce and on the costs they pay for the inputs into the production process.

The NSW Farmers' Association incorporates over 15,000 farming members from a wide range of agricultural enterprises throughout NSW. A large proportion of our members produce goods for the export market and most purchase products from overseas whether they be machinery parts, chemicals or fertiliser. The general tariff agreement therefore has an impact on farmers in general and the NSW Farmers' Association welcomes the opportunity to comment on the Review of Australia's General Tariff Arrangements.

THE SCOPE FOR A POST-2000 REDUCTION IN THE GENERAL TARIFF

The general tariff is an unnecessary additional cost in the production process and does not necessarily provide any real level of protection for industries. At the same time however it is recognised that there may be some specific cases where the assistance provided by the general tariff leads to a net benefit for the community. Such cases may include assisting infant industries to establish and become domestically and internationally competitive.

The NSW Farmers' Association recommends that the general tariff be removed.

Tariff changes should be made across the board. This will reduce any extra compliance costs involved in distinguishing between exempt and non-exempt items. Any move to reduce the tariff will lead to a reduction in the income attained from the tariff while still maintaining the same administration costs. This will result in the tariff imposing a larger cost on the community.

When to Implement the Change

The Association believes the changes to the general tariff level need to be made as soon as possible but need to take into account other major policy changes. On the domestic front, allowances should be made for the implementation of the New Tax System and any national competition policy arrangements that may specifically effect certain industries. Internationally, Australia's commitments to trade liberalisation also require the reduction of barriers by the year 2010-2020.

The introduction of the GST should encourage Australian's to push for the removal of the general tariff sooner rather than later. Implementing the GST, while the tariff is still in place, will cause the price of goods to increase as the GST is charged on the value of the product plus the tariff. The longer the tariff remains in place the more people will be paying as result of the GST.

The NSW Farmers' Association would like to see the general tariff removed by the year 2005. Setting a date of 2005 will provide enough time to prepare for the removal and allow Australia to receive a competitive edge within its international trading circle. Australian businesses will be able to adjust to competition policy reforms, making them more internationally competitive and allowing them to capture more of the benefits associated with the removal of the tariff.

Setting the time for before the required deadline of 2010-2020 will allow Australia to take advantage of the benefits tariff reform will yield before other countries carry out their required reductions. It will also provide some political leverage going into any trade negotiations that occur after the reduction.

The fact that the benefits from tariff reduction take a long time to eventuate is another reason for implementing the change sooner rather than later. Based on overseas experience, it can take four years or more for tariff reforms to have any beneficial impact and up to 20 years before the full benefits are realised. (Economic Planning Advisory Commission, p. 15)

POLICY OBJECTIVES

From a theoretical point of view, the benefits of removing protection will depend on a number of factors including the relative elasticities of domestic demand and supply and the impact of international measures. It is quite possible that the benefits from the removal of the general tariff level in some particular industries or sectors will be greater than in other industries.

The NSW Farmers' Association recommends that the national interest be the objective of Australia's trade and industry policies.

Improvements in Efficiency

Theoretically, the point of production that maximises efficiency is where the marginal revenue (MR) received from producing an additional unit of output is equal to the marginal cost (MC) of producing that additional unit of output. The principle of equimarginal returns (ie where MR=MC) is the profit maximising position for the producer and also leads to the improvement in technical efficiency.

Interference with the market mechanisms, such as providing support in the form of a general tariff, "creates false market signals leading to resource misallocation and excess production as producers always attempt to maximise returns" (Buse and Bromley p.372). Receiving extra income through the tariff encourages producers to utilise a level of resources beyond the efficient optimum. Removal of the general tariff will improve both the allocative and technical efficiency of the Australian economy.

Australian Industries

The removal of the general tariff arrangement will promote the international competitiveness of industries in Australia. Currently businesses receiving the general tariff are protected from international competition through an inflated price, allowing them to produce more or at a higher cost than their international competitors. Removing the tariff will mean domestic producers are forced to compete directly with international producers on price and may therefore use improved quality and/or matching of product to consumer needs in order to win market share.

The development of sustainable and prosperous industries within Australia will depend largely on the ability of the individuals within the industry to operate effectively. The Association supports the development of new and sustainable industries and therefore recognises that there might be a need for the preservation of the general tariff within certain industries. However, the onus of proof must lie with the particular business or industry to show the retention of the tariff for that particular industry is in the national interest, ie. that the benefits outweigh the total cost. For this reason the Association recommends the review allow businesses or industries the opportunity for further comment following the recommendations by the Commission and prior to the Government making the final decision on the tariff.

Australian Businesses and Consumers

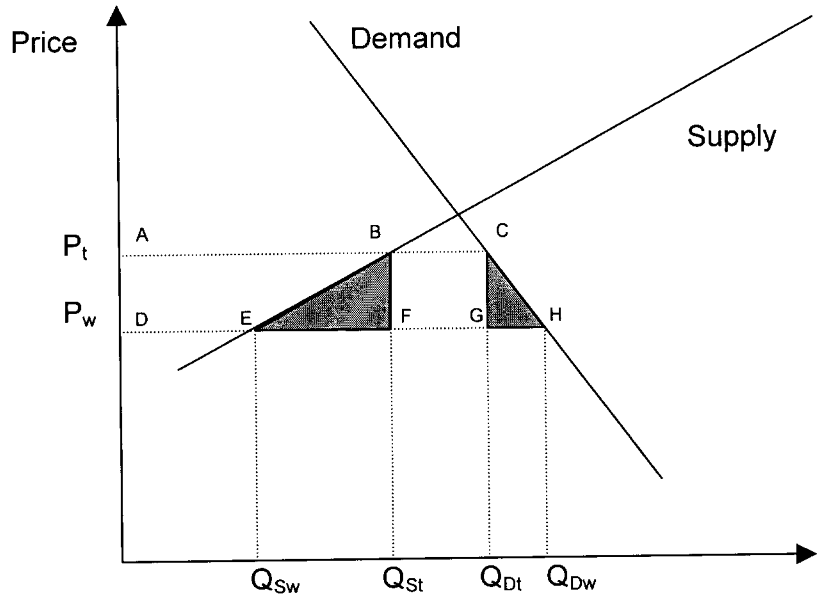
Removing the general tariff and improving the international competitiveness of Australian industries should lead to an improvement in the quality and pricing of products provided by Australian industries. Removing the tariff will allow importers to sell the products closer to the world price. This in turn will force domestic producers to either reduce the price to retain market share or differentiate their product in terms of its attributes or quality. Promoting higher quality products and lower prices to the Australian population.

The Environment

Generally it is believed that trade can lead inter alia to improvements in economic activity and increased GDP. This in turn will cause incomes to rise and promote a broadening of environmental awareness at both the government and producer level. Increased incomes will cause consumers to increase their expectation of quality, both of the natural environment and of products. Increased incomes also provide the means to afford the cost of environmental action and awareness.

EFFECTS OF REMOVING THE GENERAL TARIFF

Classic equilibrium analysis allows the benefits of removing the general tariff to be illustrated. The following diagram shows the domestic demand and supply curves for an import competing industry such as a machinery manufacturer. It is assumed that demand is relatively price inelastic as the industry produces a necessary component for the production process of many other industries. Supply is assumed to be slightly more elastic because of the competitive nature of the industry.



Removing the tariff will result in the domestic price dropping from the tariff included price, P_t, back to the world price, P_w. In this case producers will face a cost because of lower prices and sales, represented by the area ABDE. Consumers will receive a gain of area ACHD because of lower prices, and the government will lose the area BCGF in revenue from the tariff. The end result is that by removing or reducing the tariff there is a net gain of areas BFE and CHG (highlighted). Although this is a simplistic model it helps to demonstrate that there are potential net gains for the community through the reduction or removal of tariffs.

Although the general tariff only stands at 5 per cent and some may describe it as a small tariff, depending on other factors in the economy and the type of business a small tariff does not necessarily mean that benefits to be obtained from removing the tariff are insignificant.

A paper by the Economic Planning Advisory Committee showed from modeling results that a one percentage point cut in tariffs on average resulted in an increase in GDP of around 2.0 to 2.3 per cent, based on the average OECD experience. With a large number of tariff lines with a rate of 5 per cent or less - in 1996, 85 per cent of all tariff lines had a rate of 5 per cent or less (WTO p.199), it can be expected that the removal of the general tariff will result in a greater than one per cent drop in average tariff levels. It can therefore be expected that the increase in GDP will be equal to or greater than 2 per cent.

For the agricultural sector it is believed that the removal of the general tariff on many products will lead to a reduction in costs for producers. The actual cost of the general tariff on farming businesses is difficult to quantify due to the interactive nature of the tariff. Because of the goods that it is applied to, the general tariff can indirectly impact on the cost of the final good purchased for use on the farm. For example there are a number of metallic goods to which the tariff applies that would be used in the production or repair of machinery and/or the construction of buildings and other fixtures on a farm.

The general tariff imposes a cost on many farm inputs including chemicals for pesticides and herbicides, materials for fencing and other construction and numerous machinery parts. All these contribute costs to the production process and in the case of machinery the final good that is purchased is often made up of a number of individual components each with a tariff imposed on them. This compounding of additional cost can lead to a significant proportion of the final cost of the good consisting of unnecessary tariffs.

The NSW Farmers' Association recommends that all tariffs on imported agricultural machinery spare parts, chemicals and other farm inputs be removed.

Microeconomic Reform

Microeconomic reform and trade liberalisation are two policies designed to achieve the same outcome. Both lead to improved efficiency and resource allocation across regions and continents. Reaping the benefits of trade liberalisation requires reform of the domestic market, particularly those in the supply chain, to encourage competition, promoting internationally competitive products. It is important to ensure that the export product does not hit the market burdened with added costs imposed by domestic distortion. It is therefore necessary to maintain domestic reform as it will allow a greater collection of benefits given reform in the international market.

However, it may be necessary to make some form of recognition of the possible impacts of reforms. In the recent Inquiry by the Productivity Commission it was stated in relation to microeconomic reform that, "the direct costs of some reforms to date have tended to show up more in country areas than in cities" (PC p.283). While the effects of NCP are a separate issue from the general tariff review, consideration must be given to the combined impacts and effectiveness of policy implementation.

Floating Exchange Rate

Substantial trade liberalisation needs, in general, to be associated with depreciation of the exchange rate if unemployment and a deterioration in the balance of trade are to be avoided (Corden p.148). Conducting liberalisation at the same time as a devaluation in the exchange rate will allow domestically produced goods to remain as attractive as imported goods, ameliorating some of the negative effects of reducing tariffs.

The GST

It can be shown that under a consumption tax the cost of a 5 per cent tariff is considerably larger than if there is no consumption tax (Snape p.151). This is because the tariff increases the price of the product on which the GST is imposed. Reducing the tariff under a consumption tax arrangement will appear to yield larger benefits. In reality maintaining the tariff with the introduction of a GST merely imposes a tax on a tax – an added cost to business – the opposite of new tax reform.

The introduction of the GST will have a neutral effect for the majority of importers, as it is refundable to businesses. However, we would expect a short-term benefit to exporters as the burden of other taxes is removed. This would last only as long as it takes the floating exchange rate to adjust to reflect this change in terms of trade. The GST is a tax, just as a tariff is a tax. In the spirit of tax reform the introduction of the GST provides an excellent opportunity to remove the tariff.

TRADE ASPECTS

Australia's general tariff level of 5 per cent remains higher than the general tariff level of most other developed countries (Snape p.147). The significance of Australia's general tariff rate in comparison to other developed countries may mean it could be used as a bargaining tool in trade negotiations.

Reciprocity

The argument that further tariff reductions should not be granted until other countries reduce their barriers is often voiced by those not in favour or hesitant about tariff reduction. The fact remains however that to receive the maximum benefits from trade liberalisation there is a need to be the first country to remove impeding trade barriers. Once other countries remove their trade barriers the market is brought back to a level playing field where the benefits of receiving or paying, higher or lower prices respectively are negated.

Australia should therefore where possible use the removal of the general tariff as a bargaining tool to remove other trade restrictions (probably of similar size and nature to the general tariff) but not to the extent that it loses sight of the benefits to be gained from unilateral reform. The removal of the general tariff should be used to indicate that Australia is continuing its trade obligations under the WTO and APEC and that other countries should be encouraged to do likewise.

Trade Developments

Australia has re-committed to the Bogor Declarartion of free trade and investment by the years 2010-2020. Under these arrangements Australia is committed to removing all protection measures including the general tariff. This definite date for the removal of protection may mean that the negotiating power coming out of removing the general tariff becomes somewhat limited as other APEC nations remove trade barriers.

CONCESSION ARRANGEMENTS

Removing the general tariff will reduce the need for many of the concession arrangements. However, those arrangements such as the manufacture in bond scheme and the TRADEX scheme are expected to continue as they apply to other tariffs and not just general tariffs.

In the event where the general tariff is not completely removed but reduced, the Association believes schemes such as the Tariff Concession Scheme should continue to operate as they apply to imported goods not manufactured in Australia or are subsequently exported in their original or manufactured form. In reducing the tariff level there should be no reduction in the concession provided, that is the concession should remain at 2 per cent. So if the tariff was to be reduced to 2 per cent or less the concession would mean no tariff is paid on those imports which would fall under the concession scheme.

Where the general tariff is not removed, the NSW Farmers' Association recommends that the tariff concession scheme, or similar arrangements, be retained as they relate to imported goods not manufactured in Australia or are subsequently exported in their original or manufactured form.

SCHEDULE FOR PMV AND TCF TARIFF REFORM

While not within the scope of this review the Association would like to take the opportunity to encourage the Government to continue on its path to removing the tariffs in both the PMV and TCF industries. A format that required tariffs to be removed/reduced sooner would be preferred by the Association.

Tariffs in both these industries represent a significant cost to farmers both directly and indirectly. The decision in 1998 to freeze tariffs means that cars will cost $2,100 more this year than necessary. Tariff barriers along the wool pipeline increase the retail price of a finished wool product by up to 50%, reducing the demand for textiles and therefore reducing the demand for Australian wool.

The NSW Farmers' Association recommends that the Government continue the planned reduction of tariffs in the car and TCF industries.

The Association believes that the protection and assistance reform should be refocused to ensure that the same principles apply universally to all industries and those with the highest levels of protection should have that protection reduced the fastest. The benefits that can be obtained from the removal of the higher tariffs are much larger than those obtained from the removal of smaller tariffs.

The removal of the general tariff and the subsequent increase in assistance for the PMV and TCF sectors will increase the distortion imposed by the higher TCF and PMV tariffs. The potential removal of welfare benefits could be larger than expected due to the nature of many of the products subject to the general tariff and their involvement in the production process. This distortion on welfare gains should encourage Government to continue reducing tariffs in the TCF and PMV sectors to allow the full benefits of trade liberalisation to be realised.

THE GENERAL TARIFF AND AUSTRALIAN PRODUCERS

Many of the agricultural products listed under the eight digit general tariff arrangement have an equivalent Australian producer. These processors would produce a significant proportion of the product sold in Australia and would receive benefits from the tariff being in place. Almost all the listed items, however, are either processed, preserved or prepared foods, such as frozen beans, prepared or preserved citrus and dried pears. The general tariff is therefore providing support to the Australian processor and not necessarily to the Australian producer.

The degree to which the benefits of the tariff are passed from the processor to the producer through higher prices is debatable. Many growers would argue that the benefits are not passed on and therefore the tariff not warranted.

However, removing the tariff may result in processors attempting to pass on the cost of removing the tariff to producers by paying them a lower price for their produce. The Association recommends to prevent such actions the Australian Competition and Consumer Commission (ACCC) or a similar body be appointed to monitor the pricing arrangements between producers and processors. Such a body would ensure that where there was no benefit passed to the producer as a result of the tariff, there is no cost imposed on the producer as a result of removing the tariff.

The NSW Farmers' Association recommends that the ACCC be appointed to ensure that the cost of removing the tariff is not unjustifiably passed on to producers through lower prices.

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