SOUTH AUSTRALIAN GOVERNMENT SUBMISSION TO THE PRODUCTIVITY COMMISSION INQUIRY INTO AUSTRALIA'S GENERAL TARIFF ARRANGEMENTS

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THE POSITION OF THE SOUTH AUSTRALIAN GOVERNMENT

The South Australian Government is concerned with the lack of international market access gains through APEC and WTO processes, particularly in the food and automotive sectors. Any tariff removal should be consistent with a sensible trade liberalisation agenda. The present inquiry is based on APEC commitments to tariff elimination by 2010 which are probably not achievable by Australia and are certainly not achievable by other APEC countries by 2020. APEC trade facilitation is not a substitute for improved market access and further Australian tariff cuts should follow improved market access in East Asia.

However, the South Australian Government also recognises that, in aggregate terms, the removal of the tariffs under review is likely to have efficiency gains for Australian industry. However before any tariff reduction proceeds, the Productivity Commission's draft report must establish a case in terms of welfare effects, including:

- evidence of national economic gain;
- effects of lower tariff revenues on the budget surplus;
- adverse implications of job losses particularly within regions;
- impacts of tax, labour, transport and other microeconomic reform.

In cases where significant adjustment costs are identified, industry adjustment programs must be provided.

Support for the tariff removal is also subject to the extension of import credit schemes to help a wider range of exporters improve their competitiveness and productivity, similar to the automotive scheme ACIS. In a situation of lack of progress in APEC and WTO resulting in only modest improvements in market access, Australia should maintain current levels of border protection, particularly for PMV and TCF sectors. Further liberalisation should then be pursued by way of extended duty drawback schemes. Australia should hold border protection levels and aggressively expand import credit schemes such as ACIS.

The South Australian Government agrees that PMV and TCF industries should be excluded from general tariff reductions.

The 3 percent tax on non-consumer goods imported "duty-free" under the Tariff Concession Scheme should be repealed.

OBJECTIVES

The reduction of the 5 percent general tariffs will aim to:

- Increase overall efficiency of the Australian economy by reducing the static losses of tariff protection. The usual trade policy benefits of across the board tariff cuts will flow through efficiency gains in the Australian economy;
- Assist Australian industries to be more competitive by reducing costs of imported intermediate goods and by improving access to imports, which in turn serves to increase productivity through better access to technology and innovation;
- Lower costs to Australian businesses (including exporters) and consumers on final goods imports.

These broad policy objectives should continue to underpin post-2000 tariff level determination on remaining items in the general tariff. However, tariff reductions will increase efficiency of resource allocation only if there are no other distortions in the economy that cause resources to be misallocated, such as tax policy.

EFFECTS OF THE GENERAL TARIFF REMOVAL

While the benefits of removing the 2,200 general tariffs are likely to be significant, the aggregate welfare effects of the proposed nominal tariff rate reduction are unknown. The Productivity Commission must undertake to provide quantitative estimates of the welfare effects of the tariff removal including impacts on regional areas. It is noted that the reference specifically requires the Productivity Commission to report on the costs and benefits to Australian consumers, industries and their employees. The Commission did not make data available to the South Australian Government to enable such an assessment. It is imperative that the Commission conduct further analysis of the welfare effects, based on economic modelling at the 8-digit level.

In general, the industries affected by this review fall into one of three categories:

- Substantial beneficiaries due to lower input costs;
- Manufacturers of the goods (or close substitutes) that are adversely affected;
- Large industries producing export goods for export markets that are capable of competing with imports.

Many of these tariff items under review are inputs to manufacturing, for which no close substitute is available from an Australian producer. For example, one of the items in the reference is stainless steel, for which no Australian-produced equivalent exists. A manufacturer whose input costs are largely made up of stainless steel will be very favourably affected by access to cheaper inputs. The whitegoods and food industries in South Australia are significant regional users of stainless steel for capital investment purposes, and the competitiveness of these crucial South Australian industries will be enhanced by the tariff removal. Thus the stainless steel import category includes finished products, intermediate goods and investment goods. This is an example of the complexity of the input-output structure for stainless steel imports and serves to illustrate the need for further detailed analysis by the Productivity Commission on the impacts of all 2,200 items under reference.

Given the disparate nature of the goods under reference, it is possible that there will be a small number of firms or regions in markets producing such items, or close substitutes, and these firms could be substantially adversely affected by the tariff removal. Adjustment programs are necessary for these firms, and the Commission must identify these industries and affected regions in the draft report.

There are some export industries that value-add on a large scale and are large employers who would consider the tariffs in question to be of little or no value. The Commission must identify these industries as well.

SCHEDULE FOR PMV AND TCF REFORM

The South Australian Government put forward policy recommendations to the 1997 Automotive inquiry which were aimed at facilitating the future growth and development of the automotive industry. The submission supported the continuation of industry assistance through a WTO-compliant export facilitation scheme and urged the Commonwealth to more vigorously pursue greater market access to export markets. Industry adjustment programs should not be in the form of barrier protection or monetary handouts, but rather there must be more programs like the Automotive Competitiveness and Investment Scheme (ACIS) which has had a strong positive effect on investment and export growth.

There has been a lack of market access outcomes for PMV through the multilateral and bilateral mechanisms. The Commonwealth needs to do much more to negotiate access to the heavily protected East Asian car markets. The lack of progress for the car industry under APEC is of particular concern, as the same APEC process is used to justify the current reference and the Commission has raised the possibility of other general tariff reductions under APEC 2010. Furthermore, the fact that APEC has failed to be a viable forum in which to achieve market access presents an even more compelling reason to exclude PMV from future inquiries until there are proven market access outcomes. Based on such poor results from APEC, no further reductions in PMV assistance should be contemplated until significant reciprocity in car tariffs has been achieved.

The Commission must conduct another inquiry if and when further PMV tariff reductions are proposed, and the Commission must base its recommendations on an evaluation of market access gains.

The exclusion of the PMV and TCF sectors from the 5 percent tariff reduction should not affect the scope of the 2,200 items under reference. To verify this, however, the Productivity Commission should provide data on which of the 2,200 items are to be classified as PMV and TCF.

CONCESSION ARRANGEMENTS

In supporting the removal of the tariffs under reference, the South Australian Government recognises that the action may decrease the use of current concession arrangements. The four major tariff concession schemes have assisted firms adversely affected by current tariff levels. The schemes' coverage will decrease if those tariffs are reduced to zero rate. However, rather than eliminate the concession arrangements altogether, there should be a uniform scheme through which firms can apply for tariff concessions. Eliminating tariff concessions would damage the competitiveness of Australian firms by retaining high costs of imported inputs.

There are strong arguments for retaining and strengthening the various tariff concession schemes to cover items still on the tariff schedule. Tariff concessions provide a substantial reduction in the cost of manufacturing inputs and other investment goods not made in Australia. These are significant reductions in the trade-distorting effects of existing tariffs on intermediate goods. Tariff concessions are a non-discriminatory method of industry assistance to exporters and are generally less trade distorting than subsidies and bounties.

There are four general concession schemes through which a firm may apply for tariff relief:

Project By-Laws Scheme

- This policy allows firms to apply for duty free imports of goods that are not available from an Australian manufacturer. Applications are considered on a case-by-case basis and any local suppliers and potential substitutes of Australian origin are taken into consideration. In 1998/99 there were 260 determinations and $13.8 million in duty foregone.
- One key aspect of this scheme, however, is the requirement that applicants have a total capital equipment expenditure greater than A$10 million. This benchmark disadvantages small and medium-sized manufacturers and is therefore a discriminatory policy.

TRADEX and TEXCO Schemes

- TRADEX is an arrangement that will replace the existing Tariff Export Concessions Scheme (TEXCO) in June of this year. The original TEXCO policy offered tariff relief to manufacturers in the form of duty-free imports for goods that would be subsequently processed and then re-exported. In 1998/99 there were 400 users of TEXCO, amounting to $81 million in duty foregone.
- TRADEX, however, is a more inclusive policy that does not mandate the imported good be processed before it is re-exported. It is expected that the new TRADEX scheme will increase the usage of this system and replace claims made via other arrangements, particularly the Manufacture in Bond scheme.

Manufacture in Bond Scheme

- The Manufacture in Bond Scheme (MiB) allows its users to import goods to be stored in a warehouse duty-free. The goods must be subsequently exported in their original form. Changes have been made to improve this system, whereby users no longer have to pay Customs Service any cost-recovery charges. With the implementation of the TRADEX Scheme, the MiB scheme is likely to diminish in coverage.

Tariff Concession Scheme

- The Tariff Concession Scheme (TCS) encompasses other goods that are not produced in Australia. The scheme is widely used by smaller firms and for items such as those under review. In 1998/99 the scheme delivered $79 million in duty forgone and assistance to importers.
- Consumer goods under this scheme are imported duty-free, but any non-consumer good that qualifies attracts a 3 percent duty even if exempted from a 5 per cent tariff line. This 3 percent revenue tax was designed to help the budget deficit at the time. With the Government now operating under a budget surplus, the 3 percent tax is unnecessary. The administrative costs of applying for tariff concession under TCS often outweigh the benefit of a 2 percent reduction in tax from a 5 percent tariff. The 3 percent tax hurts firms' competitiveness by unnecessarily adding to input costs and should be removed.

Clearly these concession schemes can be extended and streamlined to make them more accessible to Australian industry. By minimising the complex administrative process that a firm must endure to apply for and receive an import tariff concession, the streamlined scheme would become a more attractive option through which to reduce input costs and to provide WTO-compliant assistance to exporters. Furthermore, if the eligibility criteria are progressively extended and relaxed small and medium-sized firms will also have the opportunity to capitalise on lower input costs. A synchronised and streamlined system of extended duty drawbacks would achieve numerous efficiency gains throughout the Australian economy given the size of the remaining tariffs in Australia. Tariff revenues were some $4.5 billion for 1997/98 according to the Australian Customs Service website. The ABS tariff data estimate $3.95 billion in total tariff revenue for 1998/99. Admittedly, of course, an expanded tariff concession scheme would be likely to have a negative impact on the current budget surplus.

Additionally, there are two schemes designed to assist the PMV and TCF industries:

Textiles, Clothing, and Footwear (TCF) Import Credit Scheme

- This program was designed to assist TCF manufacturers as tariffs are phased out to zero in 2010. The import credits earned by TCF exporters are calculated as a percentage of Australian value-added production, multiplied by an export phasing component that decreased throughout the scope of the program. This program finishes in June 2000.

- Tariffs on TCF goods are frozen until 2005. When the Import Credit Scheme closes in June, assistance measures will focus on investment and innovation for the TCF industries to become more competitive. After the Import Credit Scheme finishes no tariff concession scheme will be in place for TCF.

Automotive Competitiveness and Investment Scheme (ACIS)

- ACIS is the replacement scheme for the two previous arrangements in the PMV sector, the Duty Free Allowance Scheme (DFA) and the Export Facilitation Scheme (EFS), which are scheduled to finish on 31 December 2000. The DFA allowed manufacturers to import components duty-free up to 15 percent of the value of the PMV and was worth $223 million in revenue foregone in 1998.
- The new ACIS program extends from 1 January 2001 to 31 December 2005 and issues import duty credits based on the type of automotive manufacturing. Motor vehicle producers will be able to claim import duty credit of up to 25 percent of the value of production and 10 percent of new investment in plant and machinery. The producers of automotive components, machine tools, and services will be able to claim duty credit up to 25 percent of new investment in plant and machinery and 45 percent of investment in research and development.
- Benefits of the ACIS program will be capped at a total of $2 billion over the five years that it is scheduled to be in effect. They will be distributed on a quarterly basis.
- The entire program is designed to be WTO-compliant and to reward innovation and investment as well as production.

The ACIS scheme can serve as a model for inexpensive, WTO-compliant assistance to firms. By readjusting the current concession schemes, such as Project By-Laws and TCS, to be more inclusive and explicit, small and medium-sized firms could have access to cheaper inputs. Such extended duty drawback measures offer Australia a method of assisting firms within the current structure of global trading regulations.

IMPLICATIONS FOR EXTENDED DUTY DRAWBACK

Duty drawback is the term used to describe duty remission schemes where exporting firms can earn credits for concessional imports. In contrast with duty remission programs that require the inputs to be subsequently exported, an extended duty drawback scheme has no requirement that concessional imports be incorporated into exports. The credit holders can use the imports as they wish and even sell their credits to third parties. Notwithstanding the 1986 GATT ruling attempting to link imports into the production of export goods, any WTO compliance issues would be addressed as for the current ACIS scheme.

The EFS, which operates until December 2000 in the automotive industry, is an example of a current extended duty drawback scheme. In 1998 the EFS was worth

$280 million in duty foregone and the DFA scheme was worth $233 million. The replacement scheme (ACIS) is a more generalised extended duty drawback scheme that has less restrictive eligibility and operating criteria. Generally these types of schemes constitute concessional trade liberalisation measures that can significantly lessen the burden of tariffs. Reductions in effective protection can then be achieved with some final good tariffs still in place. By successively relaxing the eligibility criteria, the extended duty drawback schemes can progressively provide more uniform assistance to more firms throughout the economy.

If the existing Australian concession schemes could be synchronised and extended to a more generalised concept of extended duty drawback, then additional assistance could be given to Australian firms within WTO rules. With total tariff revenues at $4.5 billion annum, a more generalised duty drawback scheme therefore has considerable scope for both increased export industry assistance and concessional trade liberalisation. Experience over the last decade with the automotive scheme would tend to indicate that considerable trade expansion could be achieved by way of this second-best policy instrument of concessional trade liberalisation.

The usual argument against duty drawback schemes is that they potentially confer an export subsidy to the user of the scheme. However, it is likely that the net subsidy rate implicit in these measures would be quite low, depending on their uniformity and generalised eligibility criteria. Their potential to subsidise low cost exports is limited, and the tradeable credits ensure that distortions in resource allocation are minimised. Exporters are assisted by across the board access to cheaper imported goods. The stimulation to flows of concessional imports leads to more widespread and across the board reductions in tariff protection by this second-best policy. Extended duty drawback schemes can lead to considerable trade liberalisation gains and expanded trade flows while maintaining final goods protection (particularly in PMV and TCF).

In general Australia has implemented fairly limited drawback schemes with numerous compliance conditions. It is recommended that Australia use a more general approach, with less eligibility criteria, and spreads access to duty drawback across more sectors. The trend towards more general extended duty drawback schemes has been apparent in Australia over the last decade, but progress needs to be accelerated and a more uniform approach to tariff concession arrangements adopted. This would result in more widespread access by exporting firms to a uniform type of export assistance with much lower administrative and compliance costs to firms and governments.

COSTS OF TARIFF CONCESSIONS

The administrative and compliance costs of tariff concession arrangements are generally small compared to the benefits they confer. The Australian Customs Service estimate the 1998-99 full costs of operation of the TCS scheme at $2.25 million and the value of assistance granted to industry at $79 million. This would make it one of the most cost-effective industry assistance schemes operated by the Commonwealth. The TRADEX scheme, operated by AusIndustry within the Department of Industry, Science and Resources (DISR), appears to be even more cost effective. More detailed

cost-benefit studies of these arrangements are required, but several trends are apparent.

Administrative costs to firms with these extended duty drawback schemes should decrease further as a result of developments in electronic lodgement of import clearance documents. Freight forwarding companies on behalf of importing clients can access the concession arrangements at no extra cost over existing arrangements for electronic clearance of import goods. Furthermore, Commonwealth compliance costs are lowered by better access to electronic clearance of export documentation. Such electronic export clearance data form the basis of the import concession credits in the same way as sales tax is rebated against ECN numbers. Ultimately the extended duty drawback schemes could be integrated into the GST rebating procedures for importers and exporters.

Freight forwarders are nevertheless very insistent on the need for synchronisation and simplification of the existing patchwork of tariff concession schemes. Schemes such as TRADEX and ACIS are preferred to existing methods on the grounds of lower compliance and administrative costs.

Compliance costs of this form of industry assistance are much lower than other forms of Government assistance where case by case applications must be made, often at great expense in preparation by the applicant relative to the amount of assistance available. The case by case compliance costs are much larger for direct assistance measures, and so many State and Federal Government agencies have either severely downgraded or terminated direct industry grants and subsidy measures. Traditional direct assistance measures like grants and subsidies are in sharp decline, partially due to escalating costs to applicants. Import concession liberalisation measures provide much lower administrative and compliance costs than alternative direct assistance measures.

The broad implications of the proposed tariff removal for current industry competitiveness schemes would be to highlight the need for synchronisation of the existing piecemeal policy approach to the current tariff concession schemes. The various duty schemes should be restructured to ensure consistency across industries and across agencies. It may well be feasible to phase out the old TCS and MiB schemes operated by Customs and to extend and expand the TRADEX scheme to cover the tariff items dealt with by TCS and MiB. The Project By-Law arrangements also seem somewhat anomalous in their operation and may be simplified and systematised by incorporation in an extended duty drawback scheme. The duty concession can then be determined and processed electronically at the point of import rather than on a case by case basis with numerous discretionary rules such as the $10 million lower limit.

Drawing these schemes together and operating them under one agency, such as AusIndustry and DISR, would substantially reduce administrative and compliance costs of these forms of assistance. Consideration should also be given to operating the extended duty drawback schemes in tandem with the GST drawback arrangements for exporters. This would produce further administrative and compliance cost savings to industry users of tariff concessions and to agencies providing the industry assistance.

The South Australian Government's view is that there is no general tariff rate at which these concession schemes should be discontinued. Rather, the schemes should be synchronised and extended to all exporters, regardless of the tariff rate. The TRADEX scheme administered by DISR has been recently revamped and its scope broadened to non-manufacturing industries and the volume of assistance to industry doubled. The South Australian Government supports the DISR initiative on the TRADEX scheme but would like to see it extended much further.

TRADE ASPECTS

Though the potential for domestic economic gains has prompted the South Australian Government to support the removal of these tariffs, there are concerns over what this essentially unilateral action indicates about the Commonwealth's trade liberalisation agenda. A sensible agenda would enact gradual liberalisation measures that are reciprocated in kind by our trading partners. It is therefore illogical for Australia to further reduce protective tariffs when none of our trading partners are doing the same.

This is particularly true of our 2010 APEC commitments. The South Australian Government urges the Commonwealth not to act on APEC commitments if such reciprocity is not achieved. The Government acknowledges that the current reference has been prompted by the Commonwealth's commitment under APEC to review Australia's general tariffs by the year 2000, and that APEC is of increased importance to Australia given the failure to launch the WTO Millennium Round in December. However, the South Australian Government questions the viability of APEC given the lack of market access gains from its inception. The APEC goal of eliminating all tariffs in Australia and other developed countries by 2010 is an insurmountable task, particularly for Japan and the US. The 2020 tariff elimination goal for developing country members is even more unlikely to be reciprocated.

With respect to negotiating power, the tariff reductions have very little practical utility as negotiable concession items in a WTO context. The bound rates for negotiation are well in excess of the actual tariff rates applied by Australia; therefore the negotiations on the bound rate levels will likely have no consequence for domestic policy tariff cuts. There would be no loss in bargaining power. To this extent, the proposed tariff reductions should not be conditional on any future WTO multilateral trade liberalisation. Australia's negotiating power is preserved through the bound rate mechanism. As the proposal deals with tariffs at a uniform and restricted coverage, the state of multilateral and regional trade negotiations should have no affect on the decision to implement this largely domestic policy. It is unlikely that the general tariff removal is a significant point of leverage for the Australian negotiating position in WTO. South Australia's position on further reductions in border protection is that there must be demonstrated reciprocity in market access before further tariff reductions are considered.

While the South Australian Government recognises the Commonwealth's efforts to achieve market access in multilateral negotiations, the outcomes have been disappointing nonetheless. Protection levels in food and automotive markets in the

APEC regions are still unacceptably high. The steel industry still faces high tariffs in their international markets and further reductions should be delayed until other APEC steel producers have lowered their trade barriers. Such tariff barriers affect critical industries in South Australia, and upcoming APEC meetings will be important opportunities to reverse these trends. The Commonwealth is in the position to reinvigorate the APEC trade liberalisation and facilitation processes, presently stagnant. The Commonwealth must produce the necessary market access, and if they cannot then they must provide further adjustment programs to adversely affected industries, such as automotive and steel, through the Department of Industry Science and Resources.

SCOPE FOR A POST-2000 REDUCTION IN THE GENERAL TARIFF

The South Australian Government supports a further inquiry into any subsequent consideration of reducing general tariffs other than the 2,200 items included in the current reference. In particular, the Commission would need to produce detailed assessments of any impacts in the context of a full inquiry process. The issues that must be considered by any future Commission Inquiry on post-2000 general tariff changes include:

- evidence of national economic gain;
- the effects of lower tariff revenues on the budget surplus;
- adverse implications of job losses particularly within regions;
- the impact of tax, labour, transport and other microeconomic reform;
- the failure of APEC and other trade negotiations to deliver improved market access.

The need for further reductions in the general tariff rate would be obviated by the adoption of extended duty drawback schemes, which would have a similar effect to lowering the general tariff rate across the board. Concessional trade liberalisation would be easier and simpler to administer than picking out a small group of heterogeneous products in the general tariff lines every few years and going through a full Commission Inquiry process to achieve piecemeal trade liberalisation. The scope for post-2000 tariff reductions would then be determined by the eligibility criteria for extended duty drawback and the schemes and could be progressively extended to firms throughout the economy.

Tariff changes to the general tariff rate, if they are the preferred policy alternative to a more comprehensive tariff concession scheme, should be across the board but must contain exemptions for the PMV and TCF sectors as in the current reference.

Exemptions for PMV and TCF sectors are justified on the grounds that these are regionally important industries and have been subject to significant industry adjustment pressures in recent years. Accordingly, PMV and TCF sectors should be handled in separate Commission inquiries on future general tariff reductions. The

South Australian Government made representations to the 1997 automotive inquiry for higher levels of assistance than allowed under the current PMV arrangements, and this policy recommendation for increased adjustment programs continues. Their exemption is required to make up for the inadequate market access gains via APEC and WTO.

Finally, Australia's APEC commitment to open and free trade and investment by 2010 would likely justify further post-2000 general tariff reductions. However, another Commission inquiry must occur regarding any further general tariff reductions, based on an evaluation of market access gains. No further general tariff reductions should be contemplated until the APEC 2000 commitments have produced the required market access outcomes.

If a decision were to be made to proceed with further tariff reform, there would be a limited selection of trade policy instruments available. Therefore concessional trade liberalisation, such as provided under ACIS, may offer an acceptable alternative route to tariff reform. Trade expansion could then occur through an extended duty drawback scheme that does not damage Australia's negotiating position in APEC and WTO.

CONCLUSION

In conclusion, the South Australian Government recommends the following actions be taken:

- The 2,200 tariffs under review should not be reduced until the Productivity Commission has established a case on economic welfare and trade reciprocity grounds.
- Eliminate the 3 percent tax on non-consumer goods under the Tariff Concession Scheme, as it is unnecessary and harmful to Australian business.
- Eliminate the $10 million capital expenditure benchmark that is required to qualify for consideration under the Project By-Laws Scheme. The benchmark unnecessarily discriminates against and harms small and medium-sized firms, who are subsequently forced to pay higher input costs than large firms for the same product.
- Continue the policy of excluding the PMV and TCF industries from post-2000 general tariff reviews. PMV and TCF schemes should be reviewed prior to 2004.
- Synchronise and extend duty drawback schemes to better assist Australian industry in producing high-quality competitive goods. The duty drawback schemes are not only cost-effective, they are compliant with WTO regulations and do not encourage industries to be completely dependent on the government for protection from imports.