CHAMBER OF COMMERCE AND INDUSTRY
WESTERN AUSTRALIA

26 June 2000

The Assistant Commissioner
Review of General Tariff Arrangements
Productivity Commission
PO Box 80
BELCONNEN ACT 2616

Dear Sir

SUBMISSION ON THE DRAFT REPORT ON THE *REVIEW OF AUSTRALIA'S GENERAL TARIFF ARRANGEMENTS*

The Chamber of Commerce and Industry of Western Australia (CCI) would like to express its support for the major finding of the Productivity Commission in its draft report on the Review of Australia's General Tariff Arrangements, that the remaining general tariffs on goods should be reduced to free by July 2001.

Further, CCI believes that the there is no persuasive evidence that a later tariff reduction beyond July 2001 would reap any significant benefits that would outweigh the costs arising from further delay in the removal of the remaining general tariffs.

CCI's submission in response to the Commission's draft report, which explores in greater detail the issues for and against the removal of general tariffs by July 2001, is attached herewith.

May I congratulate the Commission on its draft recommendations on general tariffs and I look forward to the Commission's final report as it becomes available later in 2000.

Yours faithfully,

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CHAMBER OF COMMERCE AND INDUSTRY
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REVIEW OF GENERAL TARIFF ARRANGEMENTS

A response to the Productivity Commission's draft report on the Review of Australia's General Tariff Arrangements

June 2000

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1 INTRODUCTION AND SUMMARY

This submission details the response of the Chamber of Commerce and Industry of WA (CCIWA) to the draft report of the Productivity Commission on the Review of Australia's General Tariff Arrangements. It concentrates on the need to remove the remaining general tariffs within the shortest, most practical timeframe.

CCIWA supports the major finding of the Productivity Commission, that the remaining general tariffs on goods should be further reduced to free by July 2001.

The arguments presented in the draft report for the early removal of general tariffs are persuasive – it would enable the earliest practical realisation of overall community benefits and further allow for the abolition of the associated tariff concession arrangements.

There is no persuasive evidence that a later tariff reduction beyond July 2001 would reap any benefits that would outweigh the costs arising from further delay in the removal of the remaining general tariffs.

Removal of general tariff rates at the earliest possible opportunity will increase national economic welfare and efficiency – both allocative and administrative.

Opposition to further immediate tariff cuts falls broadly into three categories.

Firstly, some submissions focussed narrowly on the interests of affected industries and groups who believe they would lose out from the process.

These groups' interests should be taken into account, but they must be weighed against the wider, more diffuse interests of those who would gain from tariff cuts. The Commission should recommend actions which deliver the best outcome for the whole economy, not just certain sectors, interests or regions within it.

Secondly, some submissions accept that Australians are net winners from domestic tariff cuts, but argue that it is more important for Australia to use its remaining trade barriers as leverage to secure reciprocal trade liberalisation in bilateral and multilateral trade negotiations.

CCIWA believes that Australians have much to gain from tariff cuts overseas, but also believes that it is unrealistic to expect a small trading nation with relatively low residual tariffs to be able to exercise any significant leverage by offering to reduce its tariffs.

Australian trade representatives should continue to pursue cuts in our trading partners' tariff barriers. But to forego the certain benefits of unilateral tariff cuts now in the hope of uncertain benefits from reciprocal cuts in future would seem an unnecessary gamble, and foolish if it is based on an inflated expectation of our bargaining clout.

A third position argued that tariff cuts may proceed in future but should not go ahead now, rather, they should coincide with the staggered and extended schedule of tariff reductions for passenger motor vehicles and textiles, clothing and footwear sectors in 2005.

Such arguments have some merit in highly protected industries undergoing substantial structural change. But adjustment to the removal of a 5 per cent tariff should hardly be traumatic, taking place as it does against a background of taxation changes and exchange rate swings whose effects on prices and competitiveness swamp the impact of small tariff changes.

Just as CCIWA would not want to exaggerate the positive but relatively modest benefits of removal of small tariffs, so it is sceptical of the claims of major adjustment costs and loss of competitiveness arising from removal of those tariffs. However, if these tariffs are not removed, their costs will continue to be borne by user industries, exporters and consumers of the goods subject to these tariffs. While the removal of tariffs is less important to industry policy now than when tariffs were high and disparate, tariffs still do national economic welfare more harm than good. They should not be tolerated on the basis that they are not very harmful.

In conclusion, CCIWA endorses the draft key recommendations, namely:

- General tariff rates on goods under review should be reduced to free sooner rather than later, preferably on 1 July 2001.
- Concessional arrangements related to the goods under review should be abolished on 1 July 2001.

2 THE CASE FOR REMOVING GENERAL TARIFFS BY JULY 2001

CCIWA supports the removal of the general tariffs under review (*Option 1: Free in the near future – say July 2001*) and the associated concessional arrangements sooner rather than later by 1 July 2001 as the application of tariffs generally reduces economic welfare and efficiency.

2.1 Welfare Effects

Tariffs entail transfers between different economic groups – notably, from consumers to producers and government. Remaining tariffs are low, so these transfers are less substantial than they once were, but production and consumption are still being affected by artificial price signals. There is a net welfare loss.

2.2 Allocative Efficiency[1]

Tariffs raise the price of imported goods. This allows domestic industries to charge higher prices in the Australian market for their produce without being uncompetitive relative to imports. The immediate effects are threefold: higher domestic prices for imports and their substitutes, additional government revenues, and a disincentive for protected industries to export, as the domestic price is artificially higher than the world price.

Consumers pay more for imports, and for their domestically produced substitutes, so real incomes are reduced. Exporters have to export more to purchase the same volume of imports, so real GDP adjusted for the terms of trade falls further still.

As employees seek to maintain the real value of their wages in the face of higher prices, nominal earnings rise. This adds to wage costs for all employers. Industry must also pay more for imported inputs and those from protected domestic producers, so material input costs rise.

The effects spread the costs throughout the economy to businesses and consumers. The biggest losers are exporters, who cannot pass on higher labour and input costs as higher prices in world markets.

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[1] Allocative efficiency is the extent to which the economy's finite resources are deployed in such a way as to derive maximum economic benefits. An important condition is that prices reflect underlying costs.

2.3 Administrative Efficiency[1]

The imposition of tariffs also imposes administrative and compliance costs, shared between taxpayers, importers and exporters. Indeed, the relatively high administration costs associated with relatively modest benefits under preferential and concessional tariff arrangements which modify the application of general rates mean that the net benefits are small, and many businesses do not even bother to apply for concessions.

With progressively less revenue being raised from a tariff base, and the tariff itself getting no less complex, administrative efficiency is low and declining steadily.

3 THE CASE AGAINST REMOVING GENERAL TARIFFS BY 1 JULY 2001

The concessional tariff rate under the Tariff Concession Scheme of 3 per cent, applied to business inputs where there is no local domestic production to protect, is distortionary, complex and delivers negligible benefits to the economy.

Maintenance of the higher general tariff rate of 5 per cent, at least for some time, attracted more supporters. The options, and their proponents' arguments, are examined below.

3.1 Deferring Implementation

Option 2: Free following a longer period of notice – say, January 2003

and

Option 3: Phased down, with a reduction to 2.5 per cent on 1 July 2001 and set Free on 1 January 2003

Proponents of these options argue that deferred or phased implementation will give affected industries and their employees time to plan for the future and undergo adjustment consequences, as well as contributing to government revenues for longer. However:

- Adjustment consequences from the removal of general tariffs are swamped by wider changes taking place in the economy (exchange rate swings, tax reform, technological change etc).
- The present level of general tariffs has existed since 1996 and Australia's APEC commitments are well know. Affected industries have had ample time to adjust to changed tariff arrangements.
- The contribution of general tariffs to government revenue is small relative to total government revenue (0.7 per cent of government revenue in 1999-00).

Option 4: Free on 1 January 2005 to coincide with the scheduled reduction in PMV/TCF tariffs.

Some submissions went further, arguing that removal of general tariffs should be delayed to coincide with the scheduled reduction in passenger motor vehicle and textile clothing and footwear tariffs in 2005. This is the least favoured option proposed in the draft report.

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[1] Administrative efficiency is administrative cost relative to revenue raised.

Proponents argued that this would avoid a temporary period of reduced assistance for producers reliant on inputs from these sectors, allow more time to plan for the government revenue consequences.

While the temporary period of reduced assistance for producers reliant on inputs from highly protected sectors may be avoided, the resulting benefits to the small proportion of businesses affected by the general tariff are far outweighed to the costs of such a long deferral for the economy as a whole. Indeed, this argument reinforces the compounding complexities which arise as a result of tariff protection, with more and more sectors demanding protection and assistance to offset the effects of protection on their suppliers or competitors. It would be far better to abolish all tariffs as soon as possible.

In other respects, the disadvantages of option 4 are similar, but greater, than options 2 and 3.

3.2 Reciprocal or Unilateral Reductions?

In this as in previous Productivity Commission reviews of tariffs, some submissions have argued that Australia's remaining trade barriers should be used as leverage to gain preferential access to specific markets or as bargaining counters in international trade negotiations.

Certainly Australia gains when its trading partners reduce their trade barriers. But it also gains through unilateral reductions in tariff barriers.

For reciprocity to be a beneficial tactic, two conditions must hold:

1. Firstly, the realisable gains from other countries' reductions in tariff barriers must be so much greater than the benefits of unilateral reductions that it is worth forgoing the immediate benefits of unilateral tariff cuts; and

2. Secondly, Australia's trading partners must have enough to gain from reductions in Australia's tariffs that they can be induced to cut their own tariff barriers if we offer to cut ours. This in turn requires that we have a large market or potential market for their exports, and/or tariffs which are high enough to make a significant difference to their exporters' competitiveness.

It is plausible that Australia might have even more to gain from reciprocal than unilateral tariff cuts. But it is highly unlikely that removal of a 5 per cent general tariff in a small economy is a sufficient incentive to induce changes in our trading partners' tariff policies.

Indeed, a no less plausible argument suggests that Australia has more chance of influencing its trading partners' tariffs by acting unilaterally than through reciprocity.

Some countries may find the demonstration effect of a country which can point to the success of its own trade liberalisation to be more persuasive than the highly limited benefits which Australia can offer in reciprocal negotiations. At the very least, Australia's credibility will be enhanced if it is seen to practice what it preaches when pushing for trade liberalisation in international trade rounds.

In the final analysis, however, whether there is any benefit from setting a moral lead is a secondary issue.

Most important is that deferring the unilateral removal of general tariffs with an unrealistic objective of first securing reciprocal trade liberalisation simply defers the associated benefits from this process and only allows the costs to Australia's economic welfare and efficiency to continue.