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Date: 4/7/00

Mr Herb Plunkett
Assistant Commissioner
Productivity Commission
PO Box 80
BELCONNEN ACT 2616

Dear Mr Plunkett

The South Australian Government welcomes the opportunity to present its views on the Review of Australia's General Tariff Arrangements, which are outlined below and expanded in the attached paper.

In the South Australian Government's original submission qualified support was given to the removal of the tariffs in question. The Government was prepared to support the changes if:

- Positive welfare effects were demonstrated for South Australia as a result of removing the tariffs.
- Regions and industries negatively impacted by the proposed changes were identified and access to Commonwealth industry adjustment was made available.
- Trade reciprocity in terms of market access from Australia's major trading partners was achieved.

As you are aware, modelling in the draft report indicates that there will be a marginal increase in output as a result of the proposed tariff reduction. However, the modelling also indicates that this benefit will not be distributed across all regions of Australia.

The draft report indicates that South Australia will be impacted negatively in terms of employment and in some regions output from any tariff reduction. This is not an acceptable outcome for the South Australian Government.

The draft report does not adequately provide a discussion on possible industry adjustment measures that could be accessed by the regions or industries negatively impacted by any tariff removal.

The South Australian Government does not agree with the view that unilateral trade liberalisation will increase Australia's standing in forums such as the WTO and APEC. The South Australian Government believes that negotiated market access gains must be demonstrated before further tariff reductions are implemented.

Therefore, the South Australian Government cannot support the immediate reduction (July 2001) of the tariffs under review. The South Australian Government proposes that any tariff reduction should be delayed subject to a demonstration of trade reciprocity in the form of increased market access to Australia's major trading partners.

Please contact Ken Sawers, Manager, Trade Policy and Strategy, Department of Industry and Trade if you have any queries on the South Australian Government's submission on telephone (08) 8303 2008 or fax: (08) 8303 2511.

Yours sincerely

Rob Lucas

Rob Lucas MLC
**TREASURER**
**MINISTER FOR INDUSTRY AND TRADE**

SOUTH AUSTRALIA

# Productivity Commission Inquiry into Australia's General Tariff Arrangements

## The South Australian Government's Response to the Draft Report

June 2000

## South Australian Government's Position

1. The South Australian Government cannot support the immediate removal of the 5% tariffs considering the extremely small national efficiency gains expected.

2. However, the South Australian Government would support a tariff cut to be timed to meet Australia's APEC 2010 commitment, subject to a demonstration of trade reciprocity in the form of increased market access to major trading partners.

3. The South Australian Government does not agree that a unilateral tariff reduction of this nature will increase Australia's trade negotiating position in forums such as the WTO and APEC. Market access gains must be transparent and verifiable before further Australian tariff reductions are considered.

4. All regions within South Australia are expected to see a fall in employment growth due to the tariff removal. This scenario is unacceptable to the South Australian Government.

5. The draft report does not adequately provide a discussion on possible industry assistance measures that could be put in place to compensate the 'losers' of any tariff removal.

6. The South Australian Government continues to support an extended duty drawback scheme analogous to the ACIS scheme operating for the PMV industry.

7. The South Australian Government supports the removal of the 3% duty on goods not produced in Australia under the Tariff Concession Scheme.

## Effects of Removing the Tariffs

In the first submission to the inquiry the South Australian Government gave qualified support for the removal of the tariffs under review. This support was contingent on the Productivity Commission establishing 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 measures.

If the modelling used in the draft report is taken at face value, it is clear that at the national level the Australian economy will benefit only marginally from the proposed changes. The $480 million estimate of national economic gain is not sufficient to warrant the tariff removal.

However, it is also clear that there are significant 'winners' and 'losers' at the regional level with a high proportion of the regional 'losers' being in South Australia. All regions in South Australia will experience negative employment growth as a result of the tariff removal and this outcome is unacceptable to the South Australian Government.

The tariff removal would require movement of labour resources out of the State. All regions are shedding labour due to the tariff removal and there is low probability of re-employment in other regions of the State. The model used by the Commission fails to account for the high existing levels of unemployment in South Australia and persists with the unrealistic assumption of fixed national employment.

**Estimated effects for South Australia**[1]
*Percentage deviations from base values*

| | Gross Regional Product | Employment |
|---|---|---|
| **South Australia** | **0.02** | **-0.07** |
| Adelaide | 0.03 | -0.06 |
| Outer Adelaide | -0.02 | -0.11 |
| Yorke & Lower North | -0.01 | -0.08 |
| Murray Lands | 0.00 | -0.05 |
| South East | -0.11 | -0.31 |
| Eyre | 0.01 | -0.03 |
| Northern | 0.12 | -0.04 |

Of the 75 regions used in the modelling exercise, only four regions in Australia would see a reduction in output below what would have been expected otherwise. Three of the four regions fall within South Australia - Outer Adelaide (-0.02%), Yorke & Lower North (-0.01%) and the South East (-0.11%).

The South Australian Government previously submitted that support for an immediate reduction in the referenced tariffs to zero would be conditional, amongst other things, on industry adjustment programs being provided to disadvantaged industries and regions. The Commission's draft report has not proposed adequate adjustment assistance measures to compensate for the relatively large negative employment growth (compared to national economic gain) and its adverse impact on regional unemployment levels which are already high. Significant funding options for regional areas must be included in the final report. Without significant funding of the adjustment costs in place, the tariff removal should not proceed.

Because the Productivity Commission has chosen to overlook the regional and equity consequences of the tariff removal, the South Australian government <u>cannot</u> support the immediate removal of the tariffs in question.

The South Australian Government believes that South Australia will be unfairly burdened with a large proportion of the industry and labour adjustment costs of this policy decision. The South Australian Government does acknowledge the small benefits to the whole of Australia from this tariff removal and strongly urges the

[1] Source: Productivity Commission 2000. *Review of Australia's General Tariff Arrangements*, Draft Report, Canberra May 2000

Commonwealth to reconsider its position of not redistributing the benefits of free trade to the regions and industries identified as losers from the proposed tariff removal. This includes all regions in South Australia.

## Industry Effects

The South Australian Government is concerned that the draft report does not address the impact of tariff removal on regional industries. While the modelling has identified a very small net aggregate gain in efficiency, there are adverse implications of job losses in regional areas that have not been addressed. The Commission has merely noted that expanded job opportunities exist elsewhere in Australia, particularly Queensland, Western Australia and the Northern Territory. The Commission has overlooked the substantial relocation and retraining costs of such tariff-induced migration from the regional and remote areas of South Australia. Adjustment assistance must be provided to non-metropolitan workers and firms forced to adjust to these tariff changes.

While the Commission has made rudimentary attempts to incorporate adjustment costs into the modelling, the resulting specifications are a still largely at variance with regional issues. The LILLI index procedure allows elements of labour market adjustment costs but substantially ignores the reality of adjustment costs in regional and remote areas. The relocation costs for labour from regional South Australia, for example, are substantially greater than from one urban area to another. The average wages used in the calculations are half the wage levels in capital intensive industries adversely affected by the tariff removal such as soda ash and steel long products. These are low value-added commodities produced in highly capital intensive plants with a skilled labour force. The adjustment costs here include loss of skills, remote location, and the substantial invested capital that may need to be written off with tariff removal.

The submissions by BHP and Penrice Soda Products established that these are export products facing much higher tariff barriers in their markets worldwide. It does not make sense to remove all tariffs on these products, as this would place these world-competitive plants at a competitive disadvantage in the global steel and soda ash markets respectively. Both industries have been users of the anti-dumping provisions and these actions indicate how a relatively small level of tariff protection in world terms on these low value-added commodities can adversely affect the small margins. Further, the additional inventory and distribution costs of imported product to end-users are much higher than for the locally produced product and would justify the continuation of the 5% tariff for these products. In summary, the substantial adjustment costs of tariff removal potentially faced by the steel long products and soda ash industries serve to illustrate the over-simplified approach to regional job losses taken in the draft report and the inadequacies of the modelling approach used to address the adverse implications for job losses in regions.

The South Australian Government suggests that before any tariff reductions are implemented, adequate adjustment assistance for affected regions and industries must be put in place. In addition, trade reciprocity and market access gains must be demonstrated before any further tariff removal. Of all the Productivity Commission options, the fourth option of no change till 2005 is viewed most positively by South Australia, but should only proceed if reciprocity is demonstrated. This issue is discussed in more detail in the following section. A delay will allow for adjustment assistance measures to be successfully introduced to combat the negative impacts of the tariff cuts.

## Market Access and Trade Negotiation Positions

In the South Australian Government's first submission to this inquiry, concern was expressed with the lack of international market access gains realised through APEC and WTO processes. The South Australian Government insists that any tariff removal should be consistent with a sensible trade liberalisation agenda.

A sensible agenda would involve gradual trade liberalisation measures that are reciprocated by Australia's trading partners. The reciprocal trade liberalisation measures offered to Australia by our trading partners should be both transparent and verifiable. Australia should not offer further tariff reductions until reciprocity has been clearly established and demonstrated to the Australian community. It is illogical to further reduce protective tariffs when few of our major trading partners have done so or to the same extent over the past decade.

The South Australian Government does not share the views in the draft report expressed by DFAT and the Australian APEC Study Centre that a unilateral decision to reduce tariffs will elevate Australia's position in future APEC and WTO negotiations. Substantial tariff reductions implemented by Australia over the past decade have not won identifiable market access gains. Indeed, to make any negotiating position at all, Australia has had to team with major groupings such as the Cairns Group. There is a lack of evidence that the large tariff reductions in the late 1980's did count at the negotiating table. Australia's bargaining power as a small country in the international trading system is so absolutely circumscribed, that even major unilateral tariff reductions over many years have not demonstrably improved the Australian negotiating position. It is probable that Australia would have achieved similar WTO outcomes with many of the old tariffs still in place because our bound tariffs are larger than our applied rates. As a negotiating position, Australia would have been better advised to hold onto its trumps. As a small country in multilateral trade negotiations, Australia does not have the status to influence trade negotiations by unilateral tariff removal. In the context of current WTO negotiations on agriculture and services, the small general tariff reduction would be of little utility and this should be monitored in a transparent and verifiable manner. If the proposed tariff removal is withheld, there may be some element of leverage in future negotiations.

It is concluded that the proposed tariff reductions will provide little practical utility in trade liberalisation negotiations. The South Australian Government believes that negotiated market access gains must be demonstrated in a transparent and verifiable manner before further tariff reductions are implemented.

## Extended Duty Drawback System

The South Australian Government strongly supports the introduction of an extended duty drawback scheme analogous to the ACIS scheme operating for PMV. This reform of the existing disjointed tariff concession schemes has not been addressed by the draft report.

The South Australian Government urges the retention of the various duty remission schemes. In the past there has been ad hoc implementation of fairly limited drawback schemes with numerous compliance conditions. It is recommended that the Commonwealth adopt a more general approach with less eligibility criteria and spread access to duty drawback across more sectors. The TRADEX scheme is a useful development and should be expanded. The trend towards more general extended duty drawback schemes has been apparent 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 firms to a uniform type of tariff concession with much lower administrative and compliance costs to firms and government.

The South Australian Government believes that this type of arrangement should be extended beyond the automotive industry to general manufacturing industries. The harmonisation of existing by-law and concession schemes can provide worthwhile elements of trade liberalisation with minimal distortions and assist the competitiveness of manufacturing industries during the adjustment process by lowering the cost of imported components. Extended duty drawback schemes would assist firms to adjust to rapid changes in the international market place in exchange rates and relative prices. By facilitating access to technology and components at world market prices, extended duty drawback removes the rigidities in the adjustment process caused by Australia's $4 billion tariff wall. This results in greater flexibility in both timing and magnitude of responses to international or external shocks as well as reducing the deadweight losses of protection.

## 3% Duty Under the TCS

The South Australian Government agrees with the Productivity Commission's analysis that there would be efficiency gains from removing the 3% duty on goods not produced in Australia under the Tariff Concession Scheme and supports the abolition of this duty.

The 3% duty acts as a tax on business inputs, which reduces the international competitiveness of local manufacturers. An illustration of this is stainless steel, which currently attracts the 3% duty since domestic production ceased in 1997 with the closure of BHP's stainless steel operations.

The wine industry in South Australia is a significant user of stainless steel and the 3% duty adds extra costs to the industry at a time when it faces serious challenges from other international wine producing regions. The removal of this duty would reduce input costs and help the wine industry increase its export competitiveness to meet changes in international market conditions.

The 3% duty was originally introduced as a fiscal measure to improve the Commonwealth's budget position in 1996. On the basis of the current budget surplus, there is no reason for this duty to remain. It does not make policy sense for the Commonwealth to continue to rely on measures such as the 3% duty to generate fiscal surpluses.