

# **12 Barrier assistance measures**

This chapter assesses the Commonwealth Government's fulfilment of its Competition Principles Agreement (CPA) clause 5 obligations in relation to barrier assistance measures used to support the passenger motor vehicle (PMV) and textiles, clothing and footwear (TCF) industries. The Government's obligation to review and, where necessary, reform the protective arrangements offered to industry via anti-dumping and countervailing legislation is also considered.

## **Industry assistance**

Industry assistance was a key element of Australia's trade and industry policies. Successive Australian governments have sought to foster manufacturing, in particular, by erecting tariff barriers and setting import quotas to shield domestic producers from foreign competition. Governments have also used antidumping duties, tax concessions, subsidies, government procurement and public service pricing policies to assist industry. These instruments have shaped the structure of the Australian economy, mainly by protecting and sustaining selected industry sectors. Ad hoc reforms during the late 1960s and early 1970s led to declining government assistance for much of the manufacturing sector, except the PMV and TCF industries.

By the mid-1980s, large parts of Australian manufacturing were widely recognised as not being internationally competitive and of needing restructuring to promote innovation, modernisation and efficiency. In response, successive Commonwealth governments have pursued a gradual reform path to promote a more open and adaptive economy. For most industries, tariff rates are now 5 per cent or lower. Reductions in assistance for the PMV and TCF industries have also been substantial, although tariff rates in these industries remain high relative to elsewhere in the manufacturing sector. Other selective assistance measures provide added protection to these industries.

## **Legislative restrictions on competition**

The principal forms of industry assistance that are a concern under clause 5 are those that restrict competition by creating a barrier to imports. The main

restriction is a tariff, which is a tax on imports that is intended to raise the price of imported goods to levels that make domestic product more competitive. Tariffs enable the assisted local producers to increase sales and/or the prices at which they can sell their goods on the Australian market. While this benefits some domestic producers, it increases the cost of purchasing goods subject to the tariffs (including locally produced substitutes), which distorts production and consumption patterns and restricts the range of products available for domestic users and consumers.

Most tariff rates are now at the general rate of 5 per cent or lower, so the restrictive effect of Australia's general tariff regime is mostly small. In contrast, the tariffs on the PMV and TCF industries — currently around three to five times the general rate — impose a significant restriction on competition.

## Passenger motor vehicles

The PMV industry operates under the Commonwealth Government's post-2000 assistance arrangements, which commenced on 1 January 2001 and will run until 2005. Under these arrangements, the following tariffs apply:

- PMV tariffs frozen at 15 per cent, falling to 10 per cent on 1 January 2005;
- tariffs of 5 per cent on light commercial and four wheel drive vehicles and components; and
- vehicle tariffs on second-hand imports, *plus* a specific tariff of A\$12 000 per vehicle (although concessions are available under the Specialist and Enthusiasts Vehicle Scheme — see volume 2, chapter 2).

Automotive tariff levels also influence the financial assistance delivered to various automotive producers under the Automotive Competitiveness and Investment Scheme (ACIS). The ACIS provides a capped subsidy to the industry, whereby eligible participants receive tradeable import duty credits based on their production, research and development and investment activities. Being tradeable, the duty credits have a dollar value (rather than being expressed as an *ad valorem* tariff).

In addition, the industry benefits from other initiatives, including budgetary assistance measures (eg research and development incentives) and preferential purchasing under the Commonwealth vehicle fleet arrangements.

The Productivity Commission (PC) (2000c) estimated that assistance measures provide the PMV industry with a net subsidy equivalent of at least A\$1 billion a year (excluding assistance provided by State governments). The tariff and ACIS package represents the bulk of assistance to the industry, at around A\$920 million a year (in subsidy equivalent terms).

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## Review and reform activity

The National Competition Council found in the 1999 National Competition Policy (NCP) assessment that the Commonwealth Government had not met its obligations under the CPA clause 5 in relation to review the *Customs Tariff Act 1995 - Automotive Industry Arrangements*. It considered that the Government decisions following the Industry Commission's review of these arrangements in 1997 had insufficient regard for the findings of that review. The Government froze tariff reductions over the period 2000–05 in contrast to the review's findings that an overall net benefit would result from faster and deeper tariff reductions.

In March 2002, the Government referred the post-2005 assistance arrangements for the automotive manufacturing sector to the Productivity Commission (formerly the Industry Commission) for inquiry. The terms of reference for the inquiry did not explicitly require the commission to account for the Government's CPA obligations, but did require it to bear 'in mind the Government's desire ... to improve the overall economic performance of the Australian economy' (PC 2002e, p. v).

The Productivity Commission provided its final report to the Government in August 2002. It noted that assistance provided to the automotive industry in 2005, while historically low, would still be well above that available to most other Australian industries. It found that the industry had adjusted well to previous reductions in assistance and that reduced tariffs had influenced its transition to become a major exporter and innovator. While the inquiry's quantitative modelling of further assistance reductions suggested that adverse shifts in the aggregate price of Australia's exports relative to imports could outweigh the static resource allocation gains, the commission considered that such reductions would provide greater pressure for improvements in workplace productivity and other aspects of the industry's operations, and benefit consumers and businesses through lower prices.

The commission contended that these dynamic benefits provided a strong case for further reductions in assistance. It proposed, therefore, a target tariff of 5 per cent (equivalent to the general rate of assistance). It considered, however, that reducing assistance too quickly after 2005 could impose substantial costs on the community, given the industry's size and linkages with the rest of the economy.

After considering a range of possible transition paths, the commission recommended a package of assistance measures involving a tariff reduction and the continuation of transitional ACIS support to facilitate the adjustment process. It put forward the following three tariff reform options.

1. Reduce the tariff by 1 percentage point a year, commencing in 2006, so as to achieve a rate of 5 per cent in 2010, with no further reductions before 2015.

2. Leave the tariff at 10 per cent until 2010 and then reduce it in one step to 5 per cent, with no further reductions before 2015.
3. Leave the tariff at 10 per cent until 2010 and then reduce it by 1 percentage point a year so as to achieve the rate of 5 per cent in 2015.

While the commission expected the differences in the impact of the three options to be small, it judged that option 2 would provide the best balance between consumer and industry interests.

The commission's three following options for extending ACIS support involved an equivalent funding commitment in *net present value terms*, but with differing time profiles.

- A Up to A\$2 billion in funding allocated equally across two separate capped pools — one for vehicle producers and one for their suppliers — provided over five years, ceasing in 2010.
- B Funding with an equivalent net present value to option A, allocated in the same way, provided over 10 years at a uniform rate, ceasing in 2015.
- C Funding with an equivalent net present value to option A, allocated in the same way, provided over 10 years ceasing in 2015 with funding for the second five-year period set at half that for the first five-year period.

The commission preferred option A, arguing that it would help ensure the adjustment task confronting the industry is manageable. The commission also recommended the retention of the specific tariff on imported second-hand vehicles, despite finding that the tariff was 'effectively a ban on the importation of used vehicles' (particularly since the introduction of the Specialist and Enthusiast Vehicle Scheme — see volume 2, chapter 2) with significant adverse implications for consumers of imported used vehicles (PC 2002e). The commission considered that removing the specific tariff could destabilise an otherwise structured plan for phased reductions in assistance to automotive manufacturing. It recommended reassessing the issue once the transition program for the tariff-ACIS options had concluded.

The Government's announced its response to the commission's inquiry report in December 2002, along with the public release of the report. It accepted the commission's preferred option for tariff reform but, while choosing an approach consistent with the commission's reform proposals for ACIS, did not adopt any of the specific proposals. Instead the Government announced a substantial increase in funding, providing an additional 50 per cent (about A\$4.2 billion) to continue ACIS for 10 years.

The Government introduced into Parliament the ACIS Administration Amendment Bill 2003 and Customs Tariff Amendment (ACIS) Bill 2003 on 25 June 2003. These Bills will enact the 2010 tariff reduction and give effect to the extension of ACIS.

The Productivity Commission is to conduct a further inquiry in 2008, to report on whether changes the legislated tariff reductions need changing, given conditions in the international trade environment.

## **Assessment**

The Council is satisfied that the Commonwealth Government's review of the automotive industry's assistance arrangements was open, independent and rigorous. The Productivity Commission is an independent statutory authority, and its inquiry involved extensive public consultation and objective assessment processes. Its recommendations were well grounded in the available evidence.

The Council accepts that using the existing ACIS arrangements to facilitate the transition to a lower tariff environment is consistent with promoting the long term public interest. It considers that the commission's review established a robust case that the remaining restrictions — the temporary retention of higher tariff rates and transitional assistance for the automotive industry over the short to medium term — are in the public interest.

While the Government has provided more generous transitional assistance under budget funding for ACIS, it introduced a package of Bills to Parliament to implement reforms consistent with all of the commission's recommendations. Nevertheless, the Commonwealth has not met its CPA clause 5 obligations to review and reform the automotive industry's assistance arrangements as the Bill to implement the proposed reforms has not been passed by Parliament.

## **Textiles, clothing and footwear**

The current assistance arrangements for the TCF industries comprise:

- the Textiles, Clothing and Footwear (Strategic Investment Program) Scheme (SIP), which provides grants for eligible investment in new and second-hand plant and equipment, research and development, production and ancillary activities related to restructuring<sup>1</sup>;
- a commitment to hold tariffs for TCF products at 2001 levels until 2005. From January 2005 the tariff:

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<sup>1</sup> Funding is capped at A\$678 million for the life of the program, with assistance to individual companies in any one year capped at 5 per cent of the company's annual sales.

- for clothing & finished textiles will fall from 25 per cent to 17.5 per cent;
- for cotton sheeting and fabrics, carpet, and footwear will fall from 15 per cent to 10 per cent;
- for sleeping bags, table linen and footwear parts will fall from 10 per cent to 7.5 per cent; and
- the Expanded Overseas Assembly Provision Scheme, specific TCF policy by-laws and market access initiatives.

The lower tariff rates to commence in 2005 will continue the reductions in sectoral assistance that commenced during the 1980s. Nonetheless, even after these 2005 tariff reductions, the TCF sector will continue to receive tariff assistance above that afforded to general manufacturing activity.

## **Review and reform activity**

In its 2002 NCP assessment, the Council found that the Commonwealth Government had not met its clause 5 obligations in relation to TCF assistance arrangements because the Government's decisions following the Industry Commission's 1997 review of the *Customs Tariff Act 1995 — Textiles Clothing and Footwear Arrangements* had insufficient regard for the findings of that review. The Government froze the tariff reductions over the period 2000–2005, despite the review's finding that an overall net benefit would result from faster and deeper tariff reductions. While the Council accepted that this decision may help support investment and employment in the TCF industry, the Government's decision was not consistent with the CPA objective of maximising the net benefit to the whole community.

The Government asked the Productivity Commission to evaluate current assistance arrangements for the TCF industry to provide policy options for post-2005 assistance and to report on related matters that will affect the sector's long-term viability. The commission commenced the inquiry on 19 November 2002 and provided a final report to the Government on 31 July 2003. As with the automotive inquiry, the terms of reference for the inquiry did not explicitly require the commission to take account of the Government's CPA obligations, but did require it to have 'regard to the Government's desire... to improve the overall economic performance of the Australian economy' (PC 2002a, p. 6).

The commission released a position paper on 16 April 2003 setting out its preliminary views on the industry and post-2005 TCF assistance arrangements. It considered that while the tariff pause and SIP arrangements have helped many TCF companies, the current arrangements are expensive and have the following deficiencies.

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- The costs to consumers are high. Even following the legislated tariff reduction in 2005, the impost would still be about A\$750 million a year. In addition, the SIP makes available an average of A\$140 million a year to TCF companies (PC 2003b).
  - As a percentage of value added, assistance to TCF production is five times that to manufacturing as a whole.
  - The high level of support may be reducing the pressure on some companies to restructure their activities, and elements of the SIP appear to detract from its capacity to encourage improved competitiveness in the sector.

Given these costs and deficiencies, the commission considered that it would be inappropriate to roll over the assistance arrangements after 2005 without amendment. The commission also found that the sector's economic contribution to Australia, while significant could not justify continuing special assistance.

It noted that the lower assistance and the smaller size of the sector mean that the *net* cost of special assistance to the community is also lower. Quantitative modelling for the commission's inquiry supported the view that removing special support for TCF production would provide little measurable 'allocative efficiency' gain. The commission considered, nevertheless, that assistance reductions after 2005 would reinforce the competitive pressures on companies to improve their productivity, quality and delivery performance, to innovate, and to look for new markets. The reductions would also be consistent with Australia's international commitments and broader trade policy interests.

The commission considered that the decade after 2005 should be the last period of preferment for TCF production in Australia, meaning the target tariff rate should fall to the general rate of 5 per cent. After assessing various paths for reducing tariffs across the sector to 5 per cent, the commission proposed the following four options for consideration.

1. Maintain all TCF tariffs at 2005 rates until 2010, then reduce them to 5 per cent and maintain that rate to 2015.
2. Reduce all 2005 TCF tariffs in even annual steps to achieve 5 per cent in 2010, then maintain to 2015.
3. 'Tops down' to 5 per cent in 2010, then maintain that rate to 2015 — that is, reduce higher tariffs before lower tariffs.
4. Follow option 1, but reduce tariffs on apparel and certain finished textiles to 10 per cent in 2010, then to 5 per cent in 2015 (PC 2003b, p. 84).

The commission thought that the effects of options 1, 2 and 3 on company behaviour might not be greatly different. Under option 4 (the commission's preferred option), however, producers of apparel and certain finished textiles would receive an extra five years to adjust to the larger tariff reduction necessary to achieve the 5 per cent target rate. This option would thus delay

the benefits to consumers and user industries from lower tariffs, but lengthen the transitional period for those parts of the sector facing the largest reductions in assistance.

In presenting reform options, the commission noted that domestic TCF sector's adjustment to changing global realities is far from complete. It proposed, therefore, that a successor to the SIP (which is due to end in 2005) provide transitional assistance to support the tariff reductions. To give the sector time to adjust to future tariff changes, yet signal that its special assistance needs to end no later than 2015, the commission proposed the following approach.

- Following expiry of the current SIP in mid-2005, a new transitional support program would operate for eight years.
- Total funding for an initial four-year period would be set at A\$560 million, equivalent to notional annual funding under the current SIP (in nominal terms).
- Funding for the subsequent four-year period would be halved to A\$280 million.
- Transitional support would then terminate.

The commission also outlined options for tackling some deficiencies in the SIP. To avoid unnecessary disruption, however, the commission considered that other arrangements should remain, noting that tariff reductions would render assistance such as the overseas assembly provisions redundant over time.

The final inquiry report was completed on 31 July 2003 and forwarded to the Commonwealth Government for its consideration and release within twenty-five Parliamentary sitting days of receipt of the report.

## **Assessment**

The Council is satisfied that the Commonwealth Government's review of the TCF sector's assistance arrangements was open, independent and rigorous. The Productivity Commission is an independent statutory authority, and its inquiry processes involve extensive public consultation and objective assessment processes. Its draft findings were well grounded in the available evidence.

The Council accepts that using the existing SIP arrangements to facilitate the transition to a lower tariff environment is consistent with promoting the long-term public interest. It considers that the commission's review indicates that the restrictions — the temporary retention of higher tariff rates and transitional assistance for the TCF sector over the short to medium term — can be in the public interest. Nevertheless, the Government has not met its



clause 5 obligations to review and reform the TCF sector's industry assistance arrangements because it had not completed the review and reform process. While industry assistance is a significant issue, assistance arrangements for the TCF sector are already in place until 2005. If the Government were to adopt a package similar to that proposed by the Productivity Commission, then some delay in review and reform would thus be unlikely to impose a significant cost on the community.

## **Antidumping and countervailing measures**

'Dumping' occurs when a foreign supplier exports goods at a price below the 'normal value' (which is usually the price in the supplier's home market). Under World Trade Organization rules, a country can apply antidumping measures if dumped imports cause, or threaten to cause, material injury to a competing domestic industry. In addition, the World Trade Organization Agreement on Subsidies and Countervailing Measures (1995) allows members to apply countervailing duties where exports benefiting from certain forms of subsidy cause or threaten to cause material injury or serious prejudice to a domestic industry.

Like tariffs and other measures that raise the price of imports, antidumping and countervailing measures may restrict competition, protect a domestic industry and impose higher costs on domestic consumers. Relative to its share of world trade, Australia tends to be a frequent user of antidumping measures. Consequently, these measures have the potential to impose a significant cost on the economy.

### **Review and reform activity**

Antidumping policy and administration have undergone important changes over the past decade. In 1988, following a review by Professor Gruen, the Commonwealth Government introduced changes, including setting sunset periods for antidumping actions and establishing the Anti-Dumping Authority. The impact of these measures was to reduce the scope to assist local industry.

Following the Willett Review (*Review of Anti-dumping and Countervailing Administration*, 1996), the legislation on antidumping and countervailing measures was amended and new arrangements became effective on 24 July 1998. Antidumping and countervailing measures continue to be subject to a five-year sunset clause, but administrative arrangements were streamlined. The most significant changes were:

- the shortening of the antidumping and countervailing investigation to a single stage (155 days) conducted by the Australian Customs Service; and
- the abolition of the Anti-Dumping Authority.

The streamlined administrative process for antidumping action in Australia may encourage Australian industry to pursue such actions more often. The new appeal process — which consists of a review of existing information with no further investigation — compared with the previous system — under which companies could call for and obtain information that was independent of the Australian Customs Service’s investigation — could also result in more appeal outcomes that favour the retention of duties. That said, the number of new antidumping and countervailing cases *initiated* in Australia has been stable and relatively low over recent years (aside from a rise in 1997-98) compared with the early 1990s (PC 2002f). Antidumping and countervailing activity in Australia tends to fluctuate with the business cycle, however, with requests from industry for anti-dumping measures increasing in periods of economic downfall. The impact of the reforms may not be properly judged, therefore, for some time.

The Government was to examine the impact and effectiveness of the new system as part of its review of antidumping and countervailing regulation under the CPA — a review that was scheduled to commence in 1997-98. The Government postponed the review to allow full implementation of the new administrative arrangements. There may be a case for antidumping duties where predatory pricing or artificially low prices (such as where the purpose is to obtain hard currency) could damage long-term domestic interests or affect company viability. Overzealous application of antidumping duties, however, would deny Australians access to more affordable business inputs and consumer goods. The Government must evaluate these aspects of Australia’s antidumping system to ensure that the system is working in the public interest.

## Assessment

The Commonwealth Government has not made progress towards completing its review and reform of the competition restrictions contained in the *Anti-dumping Authority Act 1998*<sup>2</sup>, the *Customs Act 1901* (part XVB), and the *Customs Tariff (Anti-dumping) Act 1975*. Despite the new administrative arrangements for antidumping having operated for over four years, the Commonwealth has not announced the timing or manner of its review of legislation on antidumping and countervailing measures. As a result, it has not met its CPA clause 5 obligations to review and reform antidumping legislation.

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<sup>2</sup> It should be noted that the Anti-dumping Authority Act was repealed in December 1998.

**Table 12.1:** Commonwealth Government review and reform of legislation providing barrier assistance

<i>Legislation</i>	<i>Key restrictions</i>	<i>Review activity</i>	<i>Reform activity</i>	<i>Assessment</i>
<i>Anti-dumping Authority Act 1998, Customs Act 1901 (part XVB), and Customs Tariff (Anti-dumping) Act 1975</i>	Barrier to competition from low priced or discounted imports	Review has not commenced. The Government has not finalised the timing or manner of the review of legislation on antidumping and countervailing measures.	Reference to Anti-dumping Authority Act (which was repealed in December 1998) has been deleted following changes to the administrative arrangements for investigation of antidumping and countervailing measures.	Review and reform incomplete
<i>Customs Tariff Act 1995 – Automotive Industry Arrangements</i>	Barrier to competition from imports	Productivity Commission review of <i>automotive assistance</i> post 2005 was completed in 2002. A further Productivity Commission inquiry is scheduled for 2008.	Tariffs are to be reduced from 15 per cent to 10 per cent in 2005, then to 5 per cent on 1 January 2015. ACIS will be extended to 2015 as a transitional support measure.	Review and reform incomplete
<i>Customs Tariff Act 1995 – Textiles Clothing and Footwear</i>	Barrier to competition from imports	Productivity Commission's inquiry into <i>textile, clothing and footwear assistance arrangements</i> post 2005 commenced in November 2002. It released its preliminary views in April 2003 and reported its findings to the Commonwealth Government on 31 July 2003.	Tariffs are to be reduced from 15 per cent to 10 per cent in 2005.	Review and reform incomplete