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TRANSCRIPT OF PROCEEDINGS

PRODUCTIVITY COMMISSION

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

MR J. COSGROVE, Presiding Commissioner
MR M. WOODS, Commissioner

TRANSCRIPT OF PROCEEDINGS

AT SYDNEY ON THURSDAY, 29 JUNE 2000, AT 9.05 AM

Continued from 28/6/00 in Melbourne

MR COSGROVE: Good morning, ladies and gentlemen. This is a resumption in Sydney of the public hearings on the commission's draft report on the review of Australia's tariff arrangements. We began the hearings in Melbourne yesterday. For those of you who don't already know us or can't read the labels, I am John Cosgrove and on my left is my colleague Mike Woods. The purpose of the hearings of course is to allow people to provide comments on the draft report itself and, in particular, to give us reactions to the draft recommendations contained in it.

We always take transcript of these public hearings and, as you can see, that's being done again today to provide a record of the discussions. The transcripts, along with non-confidential submissions that we receive, are public documents and can be obtained in various ways - either from the commission itself or by viewing in public libraries in capital cities. Our staff can help people who wish to obtain copies to do so.

The first participant this morning is the Australian Industry Group, and I'd be grateful if each of you, for the purpose of following our transcript, would identify yourselves and the capacity in which you are giving evidence to us today.

MS RIDOUT: Yes, Heather Ridout, executive director of public policy.

MR PURNELL: Leigh Purnell, executive director, international.

MR McKELLAR: I'm Andrew McKellar, senior adviser industry policy.

PROF QUIGGIN: John Quiggin. I'm a consultant.

MR COSGROVE: Thank you. Who would like to start the ball rolling?

MS RIDOUT: Thank you very much. I'll make some early remarks and then hand over to my colleagues who will make some supporting remarks. We're very pleased to be here today to have the opportunity to respond to your draft report. Can I say we read the report with great interest and I'd say there are no great surprises in it for us, which was rather disappointing. We appreciated the attention the commission gave to our original submissions. We put a lot of effort into those submissions, and we did appreciate that you did address most of the points we made, although as we've indicated in our supplementary submission we don't agree with many of your conclusions in relation to our comments. But we appreciated the attention you gave us.

Today we wish to respond to these conclusions and recommendations but in doing so we would reaffirm our original position which we believe is yet to be effectively refuted. We believe there are still no grounds for pressing unilateral reduction in tariffs from 5 per cent to 3 per cent. As a matter of priority the government should reduce the tariff on business inputs under the TCS system to free, and future tariff reductions should be considered in the context of trade negotiations which deliver reciprocal and proportionate reductions in trade barriers currently imposed by our trading partners.

In responding to the commission's report on our submission, we would make several points: we don't regard this as an insignificant inquiry. As you acknowledge in your report, it covers some 10 per cent of Australia's GDP, so it is an important report and 1 per cent of revenue may not seem a lot but it would go an awfully long way to addressing some of the problems we have in industry in Australia. So there is quite a lot of money and a lot of interest at stake in the inquiry.

We remain unconvinced of the commission's findings on the impact of a reduction in Australia's last remaining 5 per cent tariff. In our view the commission's modelling displays an inherent bias against import-competing manufacturing and, indeed - we would like you to address this - if taken to its logical conclusion, the commission's modelling approach could imply that the best policy is not only to eliminate tariffs but in fact to subsidise imports substantially, which is a farcical result.

Secondly, we'd maintain our view that the 5 per cent general tariff is a valuable, albeit small, buffer for Australian industry against exchange rate volatility and uncertainty, in an environment in which capital markets do not adequately cater for the needs of all sectors. We feel this is an important emerging argument which hasn't been given the theoretical and practical argument that it deserves. Indeed, in our view the commission has not demonstrated that a zero tariff is the optimal result. We maintain our contention that Australia should not concede the remaining tariff without securing in return reciprocal and proportionate action from our trading partners.

We were disappointed that the commission in its report was almost completely silent on the scope for Australian industry to gain from increased market access abroad. This is a major deficiency in the draft report. We were, however, very heartened by the comments by the state and territory trade ministers who said in a press release following their recent meeting:

> In noting the recommendations of the draft Productivity Commission report for the unilateral removal of the remaining general tariff, state and territory ministers urge that any reduction only be undertaken within the framework of ongoing multilateral trade negotiations which provided improved market access.

I understand that is quite contrary to some of the DFAT comments that were made to the commission in the course of these hearings. Moreover, we would contend that it is arguable that Australia has already more than met its commitments in relation to the APEC goal of free and open trade by the year 2010. This issue was of course a trigger for the inquiry.

Finally, I would restate our view - indeed, as the commission has discovered our widely supported view - that the 3 per cent duty on imports under the tariff concession system should be removed where there's no domestic equivalent manufacturer. While we're pleased that the commission has understood the widespread opposition to this tax, we are disappointed that it has not supported the removal of this duty and, in fact, sees its future totally tied up and contingent upon what happens under the general tariff, and we believe there could be some independent action in relation to this.

I'd now like to hand over to my colleagues who will expand on some of these issues. Leigh Purnell will start off on the international, John Quiggin will give you some detailed rebuttal in relation to the modelling, and Andrew McKellar will make some comments on the tariff concession issue. Thank you.

MR COSGROVE: Thank you, Ms Ridout.

MR PURNELL: Before I talk about some of the trade matters, I'd like to put a bit of a motion into the opening comments that Heather Ridout has made. We'd have to say that we've come to this hearing this morning with a fair degree of frustration, because we feel not only the detailed material we put before the commission in the initial hearings haven't been given the weight that they deserve, but as we look at other submissions we feel the way that the draft report has come out tends to put them very much on the periphery rather than have them integrated in a truly detailed way that we think it deserves.

I can only use the word that it seems as though we're really up against a religion on behalf of the Productivity Commission - that you come with a prescribed almost predetermined attitude; that almost regardless of the way that we want to put argument before you, somehow or other this is discounted and we can't seem to convince the commission, regardless of the weight of that. If that's not the correct position by the commission, then hopefully today in some of the argument that we would put, particularly by John Quiggin, we'd like to think that there could be genuine appreciation of that by the commission and perhaps adoption of that. I guess we would like to be convinced that we're not dealing with a religion here, but actually argument that might be able to impress you.

Having said that, I'd like to make three points on the trade issues that have developed since we appeared before you in January. I think they are substantial. The first one is the meeting of the APEC trade ministers in Darwin a few months ago. The trade ministers are the harbingers of the leaders' meeting, and on the best interpretation of that meeting by the trade ministers in Darwin you'd have to say that, while they tried to put a strong construction on the forthcoming APEC leaders' meeting, it's very clear that there is a very low expectation as to how that APEC meeting will be able to proceed in terms of getting real reductions in protection.

It talked about the WTO and the importance of it. There were a lot of meaningful words there, but if you look at the substance of how they developed, what they believe the program will be and the outcome for the leaders' meeting, you'd have to say that we have no expectation that we're going to move that important forum forward in terms of reductions in protection. As we've said before, Australia has everything to lose and nothing to gain from the world maintaining its protectionist position. Our view is one that we have unilaterally reduced our tariff barriers enormously, that we are now down to this last remaining five percentage points, and we don't see the rest of the world - whether it be within WTO forums or APEC, which is the trigger for this inquiry - we don't see that movement happening.

As I think we may have said in our appearance before you in January, when you look at some of the countries - and I cite the trade minister Rafida Aziz, the Malaysian trade minister; her interpretation of free trade is at least a minimum of 10 percentage points on tariff. That's what she said to me personally and publicly. That's the first point.

The second one is that in the last week we've seen the dispute between Australia and the US on the Howe Leather case, and the government made no bones about the fact that there was a claim by the US that Howe Leather would pay compensation of $20 million. It came down to $7 million as part of a package arrangement, whereby the government gave commitment to reduce from 5 to free on 30 product lines; granted that they were part of the nuisance tariff listing that we're looking at, but nonetheless it very much was part of a negotiating coin. To us, that absolutely underlines the very point that we're making: if in fact we determine unilaterally to just give away tariff reductions, apart from what we consider to be the costs of those reductions, but in an international or a multinational trading arrangement, if we just forgo any ability to have trading coin, we think that's a folly on behalf of the Australian government to be doing that.

Finally, we had since our meeting a meeting between all of the ASEAN business leaders, and Australian and New Zealand business leaders, in Kuala Lumpur at the end of April-May. Clearly you know that there is a task force that's been set up to look at an AFTA-CER link - and Tim Fischer is the Australian representative on that - and there are studies being done to look at the benefits of an AFTA-CER link. But when we put to the ASEAN business leaders that the CER side is very strongly in favour of an AFTA-CER link, the strong response from the ASEAN business leaders is, "Well, what's in it for us? Why do we need to have you guys part of the AFTA? You already have virtually open markets. There is nothing in it for us."

There was some citing of auto or TCF but, broadly speaking when they looked across the whole range of our tariffs, even at 5 per cent, they felt that they could pretty much march into our markets, so they were going to be handing advantage over to us if there was an AFTA-CER link, and already they had pretty much open access to our markets. So again, within that context at critical times with the AFTA coming into place at 2002, why would we want to unilaterally remove that last five percentage point, again underlining - apart from what we consider to be the detrimental impact of such a reduction. They are the three points that I'd like to make in the opening comments.

MR COSGROVE: Thanks, Leigh.

PROF QUIGGIN: I'll be focusing primarily on the modelling. First I'd like to say that I'm gratified that the modelling of the commission confirms key arguments that were put forward in our previous submission; first for example the figure of 1.1 in the supplement to the draft report shows as argued by the AIG that the allocative efficiency benefits of removing tariffs are very small indeed, significantly smaller than the terms of trade effects and, therefore, on a standard optimal tariff argument, that the optimal tariff is non-zero and is probably at least 5 per cent.

Secondly, although we're not entirely in agreement with the way the commission has approached modelling adjustment effects, nonetheless that modelling is there and again confirms the view that, even if you wanted to downplay the terms of trade effects - as the commission said, it's modelling results aren't reliable in that respect - the adjustment effects again clearly outweigh the allocative efficiency gains. The commission's report, the validity of the recommendations, really turns crucially on the issue of the supposed efficiency gains, and we can see that very clearly from table 1.1. It shows the submissions using a standard economic model, which clearly indicate a welfare reduction, and then using a non-standard model incorporating these dynamic efficiency effects which shows the productivity growth.

Certainly in terms of the process that's been mentioned, I think it's pretty unfortunate that, although the commission covers itself by including those results in the supplement, they're not mentioned in any way in the draft report, that I can detect. So we're in a position where really the arguments on which the commission has relied, and its predecessor bodies, for 30 years to justify tariff reductions, the standard neo-classical trade theory model, come out with the wrong answer in terms of the policy recommendations, and that model is suddenly forgotten about in the draft report. It's not that they're discussed one way or the other, as they are to some extent in the supplement; it's not even mentioned.

Certainly I think the kind of concerns we have about process are heightened by the fact that the government isn't even given the option of following the policy implications of the model which the commission itself has been one of the most vigorous defenders of for a very long time.

I now want to turn to the substance of the question about how strong is the basis for relying on these dynamic efficiency effects and, in particular, the assumption that they have the positive sign assumed by the commission. Again the draft report pretty much admits that they're difficult to measure but pretty much expresses no doubt whatsoever about the existence and sign of those effects. In the supplement, coming to C, we have a slightly qualified statement, still fairly strong:

> There is a growing body of empirical evidence suggesting that more liberal trade policies and trade openness are associated with faster growth -

a few references, and Campbell 1998 is one attempt to provide theoretical justification for those effects. That's the first hint that maybe this isn't an established proposition accepted by all economists. If we look at Campbell's paper - the title I think is a pretty fair summary of the flavour of that paper; it's entitled Can We Believe in Cold Showers? published in 1998 - so certainly Campbell's work and Vowsden's, on which it's based, very clearly makes the correct point made in the AIG submission that there is in fact no theoretical consensus behind this.

If you look at the commission's own publications or publications by commission staff, when they're subject to external refereeing as a condition of publication, we read:

> The debate on the impact of trade liberalisation on productivity is unresolved. Here we provide a brief overview. The theoretical literature does not yield an unambiguous prediction of the direction of change. The onus, therefore, rests on empirical studies to establish any effects. Empirical studies, in turn, have failed to show an unambiguous association between trade policy and growth.

That's from Chand 1999. I think that's a pretty accurate summary of the situation - that we have a theoretical literature which is very much ambiguous both on the growth effects and even more so on the welfare effect; that is, a lot of these cold shower effects, if they do exist, are largely due to unmeasured increases in labour input, in labour effort, so there's a serious question over it, even if the GDP figures go the right way, whether there's an associated welfare effect of any relevance. But even the effect on GDP, as the work of Campbell and Vowsden shows, is quite ambiguous.

Again, if we look at the empirical literature, although that's not hinted at in either the report or the draft supplement, there are quite a few studies going the wrong way as far as that's concerned, are particularly micro-level firm studies. So we're really relying very heavily on a single empirical study undertaken by the commission staff to justify a position which doesn't have a firm theoretical basis and isn't generally established, although the results go in both ways in the empirical literature, and this study suffers from one glaring problem which has been pointed to in a number of cases where radical reform policies of various kinds, from a variety of theoretical perspectives, have been pointed to as improving productivity; namely that there's a selection bias effect.

If we have a policy which leads to the contraction of a sector or the relative contraction of a sector and the closure of some firms, the departure of some labour, it's reasonable to expect that the weakest firms will have a greater propensity to leave and so we'll see a spurious increase in productivity just caused by their selection effects. A very standard example of that is the British manufacturing sector following the contractionary policies of the Thatcher government. It showed very great improvements in productivity, but when the expansion came the productivity growth didn't prove to lay the basis of any sort of manufacturing revival in Britain.

All that happened is that the weakest firms have been driven out of the industry. Certainly any productivity effect that existed was substantially overstated.

I think there are further difficulties in relying on this study in relation to the way in which it's been used in the commission's modelling. A lot of these were raised at the session when the modelling results were discussed. So what's being assumed here is that the process depends on nominal rates of protection - the modelling in fact used effective rates - and that it has, unlike the welfare effects which, as was argued in the AIG submission and as a standard proposition have a quadratic property so that as the tariff gets close to zero the welfare effects of reducing it also become close to zero - it's been assumed here that the effects are linear. It's also assumed that there are no offsetting effects from the industries which gain in terms of effective protection, and that's addressed of course by the alternative modelling which in fact produces the opposite result.

So we have the situation where the modelling is interpreted to mean we have a linear improvement in productivity when tariffs are reduced and, as was pointed out at the open session but not taken up by the commission in its modelling response, if we had this linear effect, we could expect it to carry on in the linear fashion at least some distance past zero, so that we would expect these cold shower effects to be even colder with negative effective rates of assistance so we suggest that this kind of result, if it was at all correct, would imply an optimal policy of an input subsidy. We don't think that makes sense as a policy recommendation. We're putting it in as a reality check to show in our view how heavily the commission is relying on the assumed efficiency effects to generate results which aren't supported by theory or empirical evidence.

So what you need, I think, if you're going to justify this, is to take this single piece of research, with no statement on what the time path is, as showing that these cold shower effects have a linear effect down to the point of a zero nominal tariff and then immediately disappear the moment that the tariff reaches zero. Now, I must say, as far as my colleague's comments go, that sounds like religion to me.

MR COSGROVE: Thanks, John.

MS RIDOUT: Andrew?

MR McKELLAR: A couple of brief comments going to the issue of the tariff concession system. Some of these have already been flagged in the earlier comments. We are certainly disappointed that the commission has not considered a specific option in those that it has identified to restore the full effect of the tariff concession system and remove the 3 per cent impost that was imposed on business inputs in 1996.

MR COSGROVE: To only do that? In other words, to leave the general tariff in place?

MR McKELLAR: Correct.

MR COSGROVE: I see.

MR McKELLAR: Sorry, I'm referring to the options that you identify on page 12 of the overview there. One of those options doesn't include the actual restoration of the full impact of the tariff concession system.

MR WOODS: You have no problem with our views on the issue, I take it.

MR McKELLAR: Sorry?

MR WOODS: You're not arguing with our views on that issue as such? It's just the treatment of it in the option?

MR McKELLAR: We think it should be put forward as an option for consideration by government.

MR WOODS: In its own right?

MS RIDOUT: It's own right.

MR McKELLAR: Its own right.

MR WOODS: But you're not arguing against our position on the issue in itself?

MR COSGROVE: On the TCS.

MR PURNELL: No, we're not.

MR McKELLAR: Per se, no.

MR WOODS: You're not, thank you.

MR McKELLAR: As I was saying, our original submission identified the restoration of the full impact of the tariff concession system. The removal of the 3 per cent duty on business inputs has been the first priority, in terms of future reform. It's worth noting that the overwhelming majority of submissions received by the commission in the preparation of the draft report identified that 3 per cent impost as a very significant irritant. So I think the evidence that the commission has received really points to that as being, first and foremost, a very significant issue that does need to be considered in its own right. We think there is the scope there to look at that issue in isolation from the rest of the 5 per cent general tariff.

Of course, the decision, when it was imposed in 1996, to institute that 3 per cent impost on business inputs was, essentially, a revenue-raising measure. At the time, the industry minister, in private consultations with industry groups, acknowledged that it was bad policy. It was bad policy and it remains bad policy, and we think that it does need to be reversed as a matter of priority. Of course, the split between business inputs and consumer goods was an entirely arbitrary one; one that was reached as a compromise in the interests of getting that legislation through the parliament, in the interests of securing the revenue that the government was seeking at the time to help in restoring the budgetary position.

That imperative has been long since addressed, and we would argue that the rationale for maintaining a policy which has such an adverse impact clearly, from the submissions that you've received, should be overturned. I think, on that point, there is very much a need for the commission to consider the presentation of practical options for government to respond to having, in the past working in government, worked on the responses to at least five or six commission reports. I think often the difficulty that was perceived is that the commission would present options or recommendations which, from a public policy point of view, were too black or white. There needs to be, I guess, practically focused options that are put to government, and we would argue, certainly, that an option which suggested potential removal of that 3 per cent impost without, at this stage, making any finding on the general 5 per cent tariff should be considered.

It is not an ideological question; it's one of pragmatic consideration, and notwithstanding the questions over APEC's effectiveness we've signified in our supplementary submission that we remain committed to the intent of the APEC 2010 objective. It's a question of how one achieves it. As my colleague has already said, we're well on the way to having done that, if not having already arguably achieved it. So it's a question of really how we get there.

Just a very brief comment on the nuisance tariff review issue; it doesn't get a great deal of coverage in the draft report. I guess it is seen as an issue that is already finalised, to a large extent. In its origins, the nuisance tariff review was conceived, I guess, as an initial starting point, from some minister's point of view anyway, to addressing the problems that were being encountered as a result of that 1996 tariff concession decision. Of course, since then there have been a number of sectoral initiatives including the removal of IT tariffs; the removal of medical and scientific equipment tariffs; some removal of tariffs as a result of the packaging and labelling report and so on. Some of those responses, I guess, have gone some way towards addressing, in steps, some of the problems, but by no means all of them.

The nuisance tariff review was conceived as a way of further progressing that, although it obviously does have some great shortcomings in the potential anomalies that it creates. Certainly, the point that Leigh Purnell made before in relation to the tariffs that have been reviewed, or indicated will be removed as a part of the Howe Leather settlement I think, were ones which were identified through that nuisance tariff review process. That is an absolutely fundamental and critical point that we would urge the commission to take on board. If your draft recommendations had already been accepted, then the government would not have had the flexibility to reach the agreement that we did with the United States to settle that dispute.

I think that is a clear indication that the commission needs to consider, or the implications of its draft recommendation, that that would limit our flexibility in such international trade negotiations. The result that would have come out of that dispute settlement would not have been as easy to reach and, potentially, a clear instance where a successful Australian exporter could have been penalised as a result of a decision to restrict our flexibility for largely ideological reasons and not for practical public policy considerations.

MR WOODS: Can I just clarify a point? I mean John will pursue further questioning, but I was trying to judge from your presentation on the nuisance tariff review whether the outcome of the 268 items that were finally announced as moving to zero was a sufficient outcome of that process or not a sufficient outcome. In the nuisance tariffs when finally they announced 268 tariff items - - -

MR PURNELL: I'm sorry, I don't quite understand your question.

MR WOODS: Well, I'm trying to understand the evidence that we've just received, about the outcome of the previous nuisance tariff review.

MR McKELLAR: I think the tariff, if I can just say - I think the ones that were identified in that initial response were all ones that we had consulted with our membership on. We didn't have particular concerns that the removal of those tariffs would in any way adversely affect Australian manufacturers. Similarly, the additional ones which were removed as part of the Howe Leather settlement, and were also ones which we had identified, did not present significant problems for Australian manufacturers. So in the context of that review process there was a consultation to identify which tariffs, on that nuisance tariff list, could be removed without presenting difficulties for Australian manufacture. I think that was a sensible way to go about it.

We conducted a consultation process. We provided feedback to the government on that. The way in which that has been resolved to date has been satisfactory from our point of view. I think that that matter is probably largely concluded now, but I think drawing on the settlement from the Howe Leather dispute it points to the fact that we have been able to come up with some practical measures there, which have worked to the advantage of all parties concerned. But it was important to have that flexibility there to do that, and I think the danger in the commission's draft report is that you would remove that flexibility if those draft recommendations were accepted, and that would have been counter to Australia's national interest and, in particular, counter to the interests of Australian exporters like Howe Leather and to other manufacturing firms and industries generally.

MR WOODS: So if the outcome had been 298 rather than 268 in the first instance, and not had those other 30, you're arguing that there would not have been another way of resolving the Howe Leather dispute, but that we should have kept 30 up our sleeve in case something like Howe Leather came along.

MR McKELLAR: No, the fact of the matter is that the government did have that scope there to do that, and in future - - -

MR WOODS: Deliberately or - I mean if you pressed a bit more and if there was another Howe Leather resolution, if pressed more, would we find a few more?

MR McKELLAR: This is the question as to what do you get in return? In this context we've got a settlement on that case in return. We don't have any problem with the tariffs that have been given up, but our submission makes the point that it should be contingent upon reciprocal and proportionate action. The Howe Leather settlement meets those sorts of criteria. The commission's draft recommendations do not.

MR WOODS: If I can take it just one more step in that: that would suggest that maybe if there was another issue that needed resolution that we would find some more. But in the meantime, Australian business should be prepared to cope with the consequences of having some items where that applies, but should do so just in anticipation that there may be another resolution.

MR PURNELL: No, let's be clear about a couple of things: firstly, where there are nuisance tariff issues we would say, categorically, that the duty should be removed as soon and as promptly as possible.

MR WOODS: Good, absolutely.

MR PURNELL: We're not into some sort of playing games on that issue.

MR WOODS: Okay, excellent.

MR PURNELL: The 3 per cent fits exactly into that category. So the faster that those duties can be removed the better. The point we're making in the Howe Leather is, given a timing issue, we did have a negotiating coin relating to some tariff reduction, and we played it and it was to the benefit. But we're not saying to the government, "Put imposts on industry at some stage where there is no known local manufacturer," in case in 12 months' time or something another Howe Leather - we're not saying that at all.

MR WOODS: So we're agreeing?

MR PURNELL: Yes, we agree on that point of principle.

MR COSGROVE: If I may take this point one step further: would AIG's position be that a general tariff of 5 per cent should be used as a bargaining chip to alleviate the problems of an individual manufacturing company such as Howe Leather?

MR PURNELL: No. Our view is that we have a 5 per cent general tariff rate which - what we have done is we've gone through and, through the process of consultation with government, tried to identify nuisance tariffs. It has been an exhaustive process. Therefore, the 5 per cent general tariff that is remaining under review, there are known local manufacturers. Therefore, our whole argument says that that should remain for all of the reasons that we've given. If we then get into a process of the reduction of that 5 per cent our position is - we're talking about APEC - there is a time frame, 2010, for developed economies.

We see no reason on earth why the Australian government should be moving earlier than that. We've put reason and argument why we believe there's going to be a lot of lagging happening anyway on the 2010 time frame. So within that process that's it. We don't believe that in some future case we sort of line up a few companies somewhere and say, "Well, the 5 per cent actually is useful to you, but we'll trade that off where it is being used by a local manufacturer, for some other case." That's not our position.

MR COSGROVE: No, but you're recommending to us, and we agree with you, that the so-called nuisance tariffs should be removed.

MR PURNELL: Yes.

MR COSGROVE: They serve no purpose. That the 3 per cent TCS duty should be removed.

MR PURNELL: Yes.

MR COSGROVE: It's discriminatory and inefficient.

MR PURNELL: Yes.

MR COSGROVE: Which means that with those items taken away, all that the government would have to deal with a future Howe Leather case is to reduce someone's 5 per cent tariff.

MR PURNELL: Firstly, we would like to think that now as we, in practical, real-life terms, move forward we won't have Howe Leather things. The government has changed its policies to make it absolutely squeaky clean on WTO-type issues. So we would like to think that the government has changed its policies: the auto, the TCF policies have now been altered. So I don't think we're going forward with that. I think, in practical terms it's not there, so I think we come back - the point was to show an example where we did have some negotiating coin, and the way timing was we were able to use the nuisance tariffs; now we're looking at the 5 per cent, we're talking about an APEC time frame and the arguments stand.

MS RIDOUT: I think, too, the comments that were made in the media by the minister for trade, Mark Vaile:

> In some of the circumstances that we end up in, in terms of some decisions within the WTO, it's very handy from time to time to have more cards to play with rather than less.

That was made very much in the context - - -

MR COSGROVE: Yes, we're aware of that.

MS RIDOUT: I also put to the commission the comments made by Ambassador Thorley in Washington, just this week, about the WTO and the need to have a look at their arrangements across sectors, and the inconsistency of some of those arrangements. I thought that was a most encouraging sign from our ambassador, injecting some realism into this whole area. Having just returned from the States I saw a great lack of will to really initiate the next round amongst the people I spoke with. I saw a lukewarm view about APEC, and I came back with the view of why would I put my members interests in jeopardy for something that is really not top of the pops over there.

MR COSGROVE: Okay. Well, perhaps I should say in a general way that we do appreciate the seriousness with which your organisation has approached this inquiry, and we are grateful for the considerable documentation and views that you've put to us at the hearings as well. It's not our intention to dismiss that lightly, I can assure you. There was mention of a religious approach. I mean, it's not the practice of the Productivity Commission and its staff to gather on Friday mornings and, you know, bow in front of a free-trade idol. We do think, with reason, that there's what you might call a prima facie case, based on longstanding thought by people expert in these fields, that that's ordinarily a likely good solution for a country, but it may not always be.

I can assure you we went into this inquiry rather uncertain as to whether that would be the case. We've not yet completed the inquiry and we will be looking very carefully at all of this additional material that you've provided to us. I can't tell you right now what our final report will say, but we won't fail to address, where we think it appropriate, the further submission that you're making to us today. So I don't want to leave you with any impression that, you know, we've been light-handed about all of this.

I think, as John said, there is very little disagreement between us, in terms of the benefits, with perhaps one qualification, and it's an important one. It's the point that John, as we would expect, alighted upon: that we have included in our modelling estimates a view that lower assistance does induce a once-for-all improvement in efficiency in those industries previously receiving the assistance. Now, I think we have, in the report itself - I'd need to look again at the modelling supplement, John, and I will, but I think we've mentioned in the report itself that if one looks more widely at research done in this field, ie not just that conducted in Australia, one does see some other studies which indicate such an effect. You'll find them in chapter 3 - I think Frankel and Romer in the United States have done some work. There has also been some work done by Sebastian Edwards in that direction, and I think one other piece that I can't remember.

But let's assume that, you know, that work is faulty in some way. What convinces me that there is such an effect is that manufacturers tell me that there is such an effect. We will try, if we've not done so adequately in the draft report itself, to provide some further information of that kind. But it has been a common theme through any of the inquiries of this type with which I've been associated during my time at the commission. Now, as we've said in the report, it may not always be easy to measure, but I don't think we should get hung up with measurement problems when people on the ground are saying to you, "Yes, we had to clean up our act. We had to change our work practices so that we could still maintain some profitability in a more competitive environment. Yes, we had to look at how we managed the show. Yes, we had to run the plant more productively."

Now, I don't think we can ignore those statements of what a reduction in assistance does to the efficiency of the firms who are now, as we say, experiencing a colder shower. This is something that you may not agree with and it's an element that we will, as I say, be trying to provide some further information on in the final report, but I think the essence of the difference of view which has emerged between us up to the time of the draft report really relates to perceptions of adjustment cost, and we have tried to provide some figuring there ourselves in two ways, which we think suggest that they will be relatively small. You have given us your results of a survey of your members which we indicated in rather brief terms in the draft report that we hadn't found very persuasive.

It might be helpful, I think, if I indicate some of the reasons why we took that view. They relate to the methodology of the survey in part but also to the presentation of the results and the interpretation of the results. I won't here today go into all the detail but first on methodology, I think it would have been helpful to your members in responding had the cover note leading the survey indicated that preferential rates of duty, for example those lower rates that are given to some developing countries, would have already reduced the level of assistance seemingly provided by 5 per cent tariff.

In many cases it turns out of course to be less than five, and we know from, I think, generally agreed calculations that the current effective rate of assistance to manufacturing, excluding passenger motor vehicles and TCF, is three, not five. So there is not a full 5 per cent there always. Likewise it didn't mention, as far as we could see, that manufacturers, or at least some of them, would benefit from reductions in their input costs if the 5 per cent tariff was removed. We've noticed that the tariffs at which we are looking relate, to a quite considerable degree, to capital goods - you know, the kind typically used by the manufacturing sector. There are not as many consumption items in the remaining 5 per cent general tariff as there are capital goods.

On results I think you can't avoid noting that more than 87 per cent of those surveyed did one or other of these things: fail to respond at all, indicated that they thought there would be benefits from tariff reductions, indicated that they expected no change from the tariff reductions or indicated they did not know what the effects would be. So what we're left with is less than 13 per cent who expected adverse impacts. Now, that seems hardly indicative of what one might call substantial adjustment costs for the manufacturing sector.

I think it would have been useful had there been some attempt made to examine the reasons for the non-response; you know, what was driving that. The actual reporting of the results for aggregates such as employment and investment ignored the increase side of the ledger, and again it would have been good, I think, to have prepared a weighted average of the expected rises and falls in the text, whereas at present I think the impression given tends to exaggerate the likely adverse effects.

There were also some counterintuitive results, it seems to us. Table 2.3, which I think is in submission 63 - I won't go to the complete detail here but it suggests that a reduction in the 5 per cent tariff to zero can produce price changes of more than 6 per cent. I fail to understand how that could happen. It also suggests that a reduction of the 5 per cent tariff to zero in the sectors we're looking at, that is non-passenger motor vehicles and non-TCF, could somehow produce dramatically adverse effects for the TCF and transport industries. This is a feature of table 2.4.

Finally, in this area we've seen - if you look at manufacturing's experience since the mid-1980s - no declines even during the recession of the early 90s in output and employment of the order predicted by those results reported in your survey which suggest declines of something in the order of 14 or 15 per cent. We have never seen such a decline in recent history so we wonder how the removal of the 5 per cent tariff could have such a dramatic effect, not recently seen.

Some other points - and I'm not going to have time, I'm afraid, to address all of those that you have mentioned to us this morning - but as I said earlier, we will certainly look at each of them in our further work as we finalise the inquiry. The Howe Leather case, as you mentioned, Leigh, I think is, one would hope, a one-off event. What we had there really was a requirement to do something as a result of either a policy or an administrative oversight. If we'd been on the ball in this country we should have realised that the assistance being provided to the TCF sector and the passenger motor vehicle sector as well - although perhaps so in the latter case - were vulnerable to WTO action. In other words, the circumstances are rather exceptional, but we discussed that a little bit earlier.

The additional option, which Heather I think flagged in her opening remarks and Andrew then picked up, of leaving in place the 5 per cent general tariff and removing the 3 per cent TCF duty, is something that we looked at a bit on the run, I must admit, in the draft report preparation, and we will come back to it and it may emerge as an option. The modelling supplement, as John probably has seen, does have some figuring on which you can assess its effects, and again subject to further consideration of the points that John has provided in commentary on our modelling, what it suggested at the draft report stage was a small net benefit again but not quite as big a benefit as the options we have preferred in the draft report. But you're not the only people who have raised this suggestion that it should be an option.

MS RIDOUT: I imagine we're not.
MR COSGROVE: No. There have been at least two others or maybe three.

MS RIDOUT: Yes, it's a common view.
MR COSGROVE: And we will be looking at that quite seriously, I can assure you. Then finally, I think on the modelling itself, as a result of that workshop, John, where several people suggested to us that we really should be working with a dynamic approach, and as you remember the paper presented for consideration of the workshop was based on the traditional, as you say, comparative statics modelling. Well, when our experts, (indistinct) and Co sat back and thought about that, they agreed, yes, we should move to a dynamic approach.

This is certainly fresh work. It's possible that we haven't got it all right the first time. We've done a serious job of work though, I can assure you. What that did was to change certain aspects of the modelling in ways which you might not have been able to catch up with, and if our supplement was deficient in that respect, then I apologise, but let me just mention a few points. You have suggested that the modelling approach has some bias in it, in particular that it tends to produce results which favour capital-intensive industries. I don't think that's quite so surprising and it's certainly not a kind of an artificial result produced by the modelling. When you think there are several important export industries which are capital intensive in our country, and we all know that tariffs are a tax on exporting industries, then tariff reductions will favour those export industries which happen to be capital intensive. The mining industry is a good example.

Is it biased against import-competing industries? Well, again I have doubts. There are some, I must admit not many, but there are some parts of the manufacturing sector which the modelling indicates will gain from the removal of tariffs. Although, as we've said, on average or in total, manufacturing is expected to experience a slight decline.

MS RIDOUT: That's right.
MR COSGROVE: John also referred to the tax in his notes in your further submission, to the tax treatment of foreign investment, and this again, following comments at the workshop, which of course we again take seriously, was changed from a pre-tax to a post-tax presentation in the draft report version of the modelling. I'm sure that's mentioned in the supplement. We've talked about the induced productivity effect. The import subsidy logic I think could be a bit of a hangover

from the comparative statics approach, although I would need to consult my expert advisers on that.

But we certainly would agree with you that it would be a nonsensical thing to do, essentially for two reasons. The first is you would have a really big loss of revenue to replace and that would seem to be a problem, and secondly I would have thought that you would only want to apply the cold-shower effect up to the point where these so-called EX inefficiencies - I hate this economist jargon - had been eliminated. So they are some, what I hope are helpful points, that might assist you to understand how the modelling has moved between the workshop and the draft report. Now, Mike, have I said anything along the way - - -

MR WOODS: No, I think that's fairly comprehensive. There is one additional comment in your submission about the inadequacy of existing capital markets and, John, in your comments you made reference that that was an area that was worthy of some further exploration. Having just recently received your comments we tested that yesterday with Kaal Australia in the aluminium sector, to just get some initial sounding on it. Certainly from their point of view they felt that the range of products in the capital markets more than adequately met their needs. They are not the largest world player but they are significant from the Australian perspective, and that's a sample of one, but it's just that they were there in front of us yesterday, and having only just recently received your supplementary submission - - -

MR McKELLAR: Just on that point I think that's far from a typical business that we would be looking at. I mean, our membership boasts - - -

MR WOODS: Yes. As I say, we had one, so we asked them on it, but what I was going to ask, having mentioned that in passing, if you were able to elaborate on that - - -

MR McKELLAR: They are hardly a small Australian manufacturer in the Australian context.

MR WOODS: No.

MR McKELLAR: If you look at the availability of products to manufacturers at the smaller and medium size end of the market, it is very difficult to envisage that a lot of those sort of companies do have access to those sort of capital market products.
MR COSGROVE: Why do you say that, Andrew? I could obtain forward cover on a foreign exchange.

MR McKELLAR: Theoretically you could.
MR COSGROVE: Why couldn't a small business?

MR McKELLAR: Do they employ them or not?
MR COSGROVE: Well, that's a choice.

PROF QUIGGIN: I think a large part of the difficulty is that the forward cover transaction is designed - like, they're available to everybody but are designed for exporters, so it is quite as much more technical expertise in particular to construct the kind of insurance against the effects of exchange fluctuation for an import competing firm that does prefer them, which is covering - you know, if you were covering exports to a specific market, that is you have four doors into the United States denominating US dollars, it's a very straightforward matter to hedge that against a US dollar transaction.
MR COSGROVE: But equally if I have - - -

PROF QUIGGIN: If you are facing unknown competition from variable - I mean, I don't say, for example, that General Motors in respect of their domestic manufacturing operations wouldn't have the financial expertise and capacity to address the kind of - and construct out of the range of markets designed, as I say, primarily for the purpose of hedging exports, that you could construct alternative securities with sufficient financial expertise that would have hedging effects. But I think we're moving into an area where there aren't off-the-shelf products that are available in the way that exporters can hedge their exports.
MR COSGROVE: But they might have a forward foreign exchange liability.

PROF QUIGGIN: The point is that these importing community industries aren't facing forward liabilities that be hedged. They're facing the possibility that their adverse exchange rate movements will make them the most competitive which is a far more - - -
MR COSGROVE: But they can remove the risk of volatility.

PROF QUIGGIN: They can remove the risk if they can quantify the risk - that is, if they can - - -
MR COSGROVE: I mean, that's a matter of judgment on their part.

PROF QUIGGIN: Well, I mean - - -
MR COSGROVE: They might not make as much profit as they would otherwise do.

MS RIDOUT: Are they meant to be manufacturers or financiers?

MR WOODS: That's a separate question.

MS RIDOUT: Well, it's a very important question.

MR WOODS: I understand that. But the thrust of the evidence to us was that the capital markets are inadequate in some way.

MS RIDOUT: I think it's more - - -

MR WOODS: That's what I'm trying to understand, whether it's their understanding and use of it - - -

MS RIDOUT: That was in anticipation of our response to that which we're quite aware of, but the general issue remains that there is exchange rate volatility and the fact that you in some circumstances can counter it through the market and there may be inadequate products there - we can have an argument about that - but the issue that we're really getting at is the one John is highlighting: is that companies can't always anticipate it, and it's a fact of life. I'd make one other comment, John, about what you said about our survey. I could say, well, when you speak to manufacturers and they tell you that the cold-shower effects have been good for them, that's more than hearsay compared to what I think was a reasonable attempt to get a view from our members about the tariff issue. Now, 13 per cent may not seem like a big response rate but it's not a bad response rate to surveys, and you'd know that as well as I would. I would also say that a lot of companies - 21 per cent of them - actually supported the tariff reduction because they knew it would be good for them. There was a lot of honesty in that survey and I was quite pleased.

We have done surveys on GST price effects which can have some very funny and inconsistent figures attached to them, but the point still remains that there are powerful adjustment issues anticipated out there in industry. I would also say that when those companies tell you the tariffs have been good for them, I don't think they really appreciate that most of the research says that the tariff effect wasn't great on them in the early 90s because the exchange rate was very propitious for them, and I would alert you to the Reserve Bank literature of the period which says that that was a much more important issue. If our members were competing with the 70 plus dollar and a 5 per cent tariff, I tell you, the adjustment impacts on industry through the 90s would have been quite substantial.

MR COSGROVE: Yes, I agree.

MS RIDOUT: And I think it's one of the great challenges going forward that needs to be understood by the commission, and that's one of the reasons we are trying to put forward on this exchange rate issue. We can attach a capital market debate to it but it is an important issue going forward in a floating exchange rate regime that we need to understand. That's really what I wanted to put.

MR PURNELL: John, you did say, "Let's not get hung up on measurement" and then you went on to in fact use that to criticise our survey and so on, and as Heather said, we'd match what our companies say to us every day in the material and the survey that you may have had in input to you any day. I guess we'd match what our companies say are practical real life benefits or non-benefits.

MR COSGROVE: Yes. You may be right, Leigh, but the problem may have been, to a large extent, in the way the results were reported, but as I said at the end, it just seems highly unlikely, I would say to put it mildly, that a policy change of this order could induce the suggested large decline in an employer - - -

MS RIDOUT: I tell you, John, it's an educated audience. They have been dealing in the tariff issue now for almost 10 years and many of them were around when the first tariff reduction occurred in 1975, so they're not an uneducated audience when it comes to tariffs. We had a big debate within our membership about tariff reform and we nearly changed our name to the Metal Trade Importers Association at the time because there was a real balance of views about getting the right balance between a low tariff and protecting local manufacturing. We always err on the side of local manufacturing because that's in Australia's interest and the industry's interest, but we understand there's a trade-off and so do our members. But they're firmly of the view on this occasion that in the majority of opinion the 5 per cent or the 3 per cent - and they understand that issue too - is a minimal level.

PROF QUIGGIN: Could I respond to a few points?
MR COSGROVE: Yes, John.

PROF QUIGGIN: First, I guess, I certainly endorse the point about anecdotal evidence, and I would say in terms of these ex-efficiency effects, I talk to lots of people in rural and mining industries and none of them tell me that thanks to the marvellous increases in effective rates of assistance they've received over the past 25 years that they're taking life easy. I guess I find these ex-efficiency arguments very difficult to get around but certainly you said it's up to the point where ex-efficiency benefits are exhausted. Well, what's that? There's certainly no reason at all why it should be when the policy most preferred by the Productivity Commission is reached, which is the effective assumption that has been made.

I would suggest in all probability that anybody who was relying on some notion that the government would rescue them from trouble has either wised up or exited the industry some years previously, and the likelihood that another 5 per cent is going to produce something that a move, for example, to negative 5 per cent wouldn't produce - at which point I think you start getting cold feet about the argument - is very dubious.

Looking more generally at this kind of argument, I would make the point that it has a lot of policy implications which, if you maintain, I would certainly be glad to follow up with you. For example, looking at taxes on energy use, we could anticipate, and it has been argued on many occasions, that those taxes would lead over and above their price effects. They will lead to induced improvements in efficiency which will more than pay for themselves so that we can, for example, tax energy, meet our contractual obligations and, by the magic of induced efficiency effects, not even experience any contraction in the output of the industries that are being taxed.

So I think there are a lot of arguments which I think raise the point that this is an argument that needs to be handled with great care and to rely implicitly on it, without even mentioning the alternative, more orthodox view in your draft report, I think is a mistake. I wanted to briefly mention your anecdotal evidence also suffers from the same selection bias point that I raised previously; that is, how many people have you talked to who have gone out of business as a result of those tariff improvements? Did they say, "Well, this made us much more efficient but not quite enough," or did they say, "This came as a real shock at a time when we're under pressure from the bank and maybe we could have made it but we went under."

MR COSGROVE: It is undoubted that policy changes of this kind are going to wipe out some businesses.

PROF QUIGGIN: I'm merely making the point. By looking at the people who survive you get a biased sample; you get the sample of people who experienced improvements. If you have a bunch of people who experience random changes in productivity following the tariff, you will get a sample of people who have got good improvements, not bad ones, and your anecdotal evidence will be biased in that way, just as the - - -

MR COSGROVE: That's a perfectly fair point, John. We are aware of a further study - the author's name is not in my head - but it tried to remove the selection bias and looked specifically at the experience of the surviving companies and, again, appeared to contain evidence suggesting improvements in productivity.

MS RIDOUT: The point I was making - and I looked at this literature - was that they couldn't be considered in isolation. We have had this debate many, many times around our council tables, not just once. We have probably had it a hundred times with 130 very big and small companies. There are, as you would know, so many issues operating, including the exchange rate at any one period, that's going to affect how they cope and meet changes and I think on balance most of the literature would support that position.

PROF QUIGGIN: I want to briefly explain my position on capital intensity. I did miss that footnote about the change in tax treatment so I will withdraw that point. My general point is the headline figure is GDP, not household consumption or not - the relevant welfare measure in a dynamic model is present value of consumption.

MR COSGROVE: Yes.

PROF QUIGGIN: But the headline figure in the reporting - so I mean it's obvious - - -

MR COSGROVE: No, the headline figure in our report is the gains to household consumption. I mean, we may report at the table, duty-free first - - -

PROF QUIGGIN: I mean, the GDP figure comes first and tends to get most of the attention, and the GDP figure is biased because a change towards a more capital-intensive industry mix, financed either by reduction to domestic consumption or by the input of foreign capital, will raise GDP more than if at all it raises welfare.

MR COSGROVE: Yes, but we have tried to account fully and I hope properly for the fact that the foreigners earn the income and take it away on the capital which they have financed.

PROF QUIGGIN: I guess it's more a question of I think the commission isn't going far enough - in particular in real GDP at the top of its tables - to make the point that - well, for example, looking at table 1.1, which is the crucial exhibit, table 1.1 states, in welfare times, "If you don't buy the efficiency effects, you come to the conclusion that this is a policy reducing option." I think it's fair to say if somebody had managed to discover the existence of the supplement, had ploughed through at this point and wasn't a trained economist, would read that table as saying, "Without the efficiency effects, the benefits are still positive but not as great."

MR COSGROVE: Okay, we will try to address that, fine. There was one other point which I didn't respond to specifically and it was yours, about why haven't we included more on the issue of opening up access to overseas markets. Yes, I think that's a fair comment on the draft report and, again, it's an area we are doing more work on and I hope you will see a more satisfactory treatment in the final report when it's released.

MR WOODS: On that area though, your pessimism regarding WTO, we will look at it, but that hasn't been shared by other witnesses to us who see some evidence of sort of a new round being possible late 2001. I don't know if you have got any further updates yourself to that - - -

MR PURNELL: No, but the only other point I would make to that is WTO is one thing but this whole commission inquiry is triggered by an APEC commitment and that is another forum and that is a world in which we have to look at commitments as well. I know they - - -

MR WOODS: I understand that totally but you had a certain pessimism running through on WTOs that I - - -

MR PURNELL: Yes.

MS RIDOUT: But in relation to our original submissions on the next round, we put in an expected time-line for any benefits that might flow from that round and they were pitched out many, many number of years.

MR WOODS: I fully agree with that point.

MS RIDOUT: So even if they do get serious - the Europeans and the US - some time next year about it, and that remains an "if" and there's presidential elections and a whole host of issues happening over there - - -

MR WOODS: Yes, I understand all that.

MS RIDOUT: I think you're still looking at an awfully long time down the track before we start to get any real benefits for this economy from that round.

MR WOODS: I understand the time-frames, yes.

MS RIDOUT: In terms of your options, I think it's important.

MR WOODS: Yes. It was just a response to a particular phrase in - - -

MR COSGROVE: Also, of course, we have never wanted to give the impression, and I hope we haven't, that we don't see additional gains coming to Australia from multilateral trade equalisation.

MS RIDOUT: Yes.

MR COSGROVE: It's quite clear there is a hierarchy of gains. You know, if nobody does nothing, nobody gains. If a country moves unilaterally, it may gain, it may not, and you people think we would not in this case. If everybody moves then everybody gains and that's about the only thing that's clear.

MS RIDOUT: Yes.

MR COSGROVE: I'm afraid I know our next participant is waiting to appear and unfortunately we do have a bit of a timetable to stick to. Thank you very much again for your time.

MS RIDOUT: Thanks very much for the courtesy and the attention you have given us.

MR COSGROVE: Not at all. It's the least we can do and we hope we can satisfy you a little better in the final report.

MS RIDOUT: We're really looking forward to the final report.

MR COSGROVE: Our next participant is Sandra Nori, the New South Wales Minister for Small Business and Tourism also, if I understand correctly.

MS NORI: But the trade is within the small business, yes.

MR COSGROVE: Minister, for the purposes of our transcript of the hearings, would you and your colleagues please identify yourselves voice-wise and indicate the capacity in which you're giving evidence to us today.

MS NORI: Yes. I'm Sandra Nori, the Minister for Small Business and Tourism in New South Wales, and I'm accompanied by my colleague, Loftus Harris.

MR HARRIS: I'm Loftus Harris. I'm the director-general of the Department of State and Regional Development of New South Wales.

MR TREANOR: I'm Allen Treanor. I'm the senior manager of policy in the Department of State and Regional Development.

MR COSGROVE: Thank you. I should begin by thanking you for the earlier submission that you provided to the inquiry, minister. Would you like to speak to that or is there anything else that you would like to say to us?

MS NORI: Thank you for the opportunity of being here today and thank you for having rearranged the schedule because we have an unscheduled sitting of the state parliament today, so thank you for that, I appreciate it, and the cooperative way that we have been able to work with you. I'm not going to say a lot that's different to what I already put in the original submission, with the great assistance of the department, but I do want to make some comments on your own draft and I guess what I would really like you to understand; that my coming here today, particularly on a parliamentary sitting day - there's a message in that. It is about saying how strongly I/we feel about this issue. I have raised it in the parliament on a number of occasions and so on, so I want you to understand the passion with which I feel of the case that I'm to put to you.

I guess you would expect me to say that I'm somewhat disappointed with your interim report because I don't agree with it so naturally I would be disappointed. I'm not here to talk about economic modelling. I'm not going to revisit my sort of year 2 economics at Sydney University or anything like that. I guess I am here - yes, clearly I am a politician - but that does mean I do get out and about a lot, I have a lot of contacts and a lot of networks and I do pick up a lot from people that aren't going to make it here to your doorstep and make a submission and can I say that - and I draw your attention to something that you may not have been aware of - and that is that less than two weeks ago we had the national ministerial council of trade ministers. The only territory that wasn't there was Kate Carnel from the ACT. Mark Vaile obviously chaired the meeting.

The discussion around that table - I don't think it's a state secret - was how do we win the hearts and minds of the Australian population on the benefits of trade, globalisation - indeed, free trade - and there wasn't a person around that room who was anti-free trade, including myself, however we were not happy with the direction that we presumed the federal government was taking because of a fairly narrow terms of reference to your good selves and, of course, by then we had the benefit of your interim report which did recommend the abolition of the last 5 per cent of tariffs on general manufacturers.

A discussion went around the table and I moved - and I think the AIG has probably given you the words - okay, so you've got them. But basically what we moved was that the last five per cent of tariffs should not be removed unless and until, in the context of international trade negotiations, to use it as a bargaining chip to get our trading partners to reduce their tariffs. In an ironic way, it was precisely because everyone around the room understood the benefits of free trade and globalisation, but why wouldn't we? We're paid to know and we work with it, we're familiar with it so, okay, our level of knowledge and interest is greater than perhaps the average citizen, but we felt there is a real gap between those of us for whom it's quasi-second nature to be familiar with it and the rest of the population.

I know that you good gentlemen are economists and you're with the productivity commission and it's your job to look at the economic modelling, but I would suggest to you respectfully that it's part of your job, in advising the federal government, to point out that there is this discrepancy between those who understand the economic model, those who understand the benefits and the rest of the community. Because the reality is that if you can't carry a community with you then it's not going to - you know, it's all very well to get the economic modelling right but if you can't implement it because of other factors, whether they be right or wrong - so I would respectfully submit to you that I think that your final report ought to point this particular issue out to the federal government so that they have the benefit of that information when they make their final deliberation.

The other part of the discussion that went around the room was that, "Yes, we all know that we did the hard yards in the eighties when we basically slashed tariffs from 35 per cent down to 5 in a staged process and, yes, overall the benefits have accrued across the nation," but as we know, the benefits accrue in a diluted form across the whole country. There are still some regional economies - and South Australia would argue that they themselves are a regional economy as a state - that they suffered badly.

So clearly, in the public's mind - it's not an unreal perception. It's not just a case of confusing rowdy with perception - it's a very real issue for some communities. They did not get the benefit of the jobs that replaced the jobs that went and that has to be recognised. So that was the context of the federal state and territory ministers and in a sense ironically our position was that because free trade and globalisation is important to us because we do produce so much more than we can possibly consume and because therefore we desperately need access to markets, that that precisely put greater pressure on us to actually - and you may find this on it -

to keep that last five per cent as that bargaining chip because there's a fair bit of anger in the community, clearly the unions and amongst the ministers and groups like AIG and so on, but if this last 5 per cent goes we will have - I think AIG actually has a particular case that it could bring to you but it's not clear to me whether the individual case is willing to be named, so that makes it a little harder.

But I have no doubt that it's correct and I have no doubt that it would only be one of many. Ironically, this particular company would have to virtually go out of business. They would be put out of business by a competitor who has a country whose tariffs are so high that they can't export into them, so that is really a double whammy there. That's a bit of, I suppose - I won't say "gratuitous" but I think that's trying to paint the landscape for you. It's not something that quite fits in with your little economic models, I know, but I just think we have to take cognisance of that.

We saw what happened at Davos, we saw what happened at WTO. The reality is, we're living in a world that is increasingly becoming a bit suspicious about globalisation and the WTO. I have no doubt that many of the organisations that protested in Seattle were genuine. I also have no doubt that many are seizing onto it as the great new protest agenda for all sorts of other reasons. But they are realities that have to be faced by governments in trying to determine what's right for their economy.

Okay, I'll go back to the script. Look, as a government we are very conscious of the fact that New South Wales, being the largest economy, the most diverse state economy in this country, that if this 5 per cent goes it's probably going to have its largest - or it's going to have a very significant impact here on our state. And that's my job. I get paid by the New South Wales taxpayer, so I'm here to worry about New South Wales.

I guess the point I want to make is that I have advice from AIG that if we actually cut these 5 per cent of tariffs, that might result in savings and efficiencies that spin out to be about $3 per person in Australia per year. Now, I don't know if it's $3 or if it's $2.99 or if it's $4.50, but it strikes me that at that rate, in that ballpark, is the pain worth that small amount of gain? I pose that to you and I'll let you tell me whether it's $2.99 or 3.50. So I ask you to think about that in the context of what I said. Is the pain worth the gain?

Okay. I know that DFAT and all the hard-core economic advisers and academics who believe in free trade and globalisation would argue that we must lead by example. I accept that there's some validity in that. I do have to point out: I think we did lead by example in the 80s, very much. We reduced our tariff barriers unilaterally, so we have done our good Samaritan act - and I don't want to sound too cynical, because I actually do accept that the reduction in those tariffs did yield enormous productivity gains. It restructured our economy. There was pain, but it's put us in a position where we are able to compete globally and overall it was the right thing, but at the same time I'd like to acknowledge those people who suffered.

It's not easy for the person upon whose shoulders the pain falls. Usually it's in the form of losing their business or drastically reducing it and, of course, further down the track, jobs going. I can't personally sleep that well if I think that we've done something to cause people to lose their jobs. If governments can't provide jobs for people then what's the point? And if the economy can't provide a job then we're really letting people down. So I can't take the fact that, "Oh yeah, there might just be a few more job losses, a few more small businesses going out of business, but we'll get $3.20 gain across the economy." I don't feel that comfortable with that. I would like to see a lot of gain. If we're going to do it, there has to be a lot of gain.

It seems to me that if reducing our tariffs by 30 per cent didn't induce our trading partners to reciprocate, not even necessarily with some sense of proportionality, then why will the last 5 per cent have that impact? In my view, clearly it won't. That's my humble opinion as a politician, but let me tell you, negotiating and cutting deals is something that we pollies know and understand.

It seems to me - and this is the whole thrust of what we did at the National Ministerial Council meeting - was argue that 5 per cent is not a lot to bargain with, but it's better than nothing. And I can bore you. I can give you all the stats that my department and my staff have dragged up and I can show you that we have the lowest tariffs in the world but, more importantly, we have a very transparent economy. We do not try to introduce tariff barriers by the back door through non-tariff barriers, whereas our dear friends, our trading partners, do.

Now, what mechanism have we got to get them to reduce their tariffs? Leading by example hasn't worked. I suggest it's time to get tactical, I suggest it's time to be strategic, and that's why I'm arguing the last 5 per cent should stay on: because for the little gain, we then lose the one last tool, tactic, card up our sleeve to try and get them to reduce theirs. And of course, as I said, it's imperative - imperative for a country like Australia, incredibly imperative for a state like New South Wales - to get our small businesses, especially, to export.

If I can just divert for a moment, we have a whole suite of programs to assist small business and, yes, we look after the mums and the dads and the retailers and so on - that end of small business - but if I had to summarise what the core philosophy of our programs in New South Wales to assist small business is, it is all about getting them to become exporters, whether it's our high-growth business program focusing in on those companies that show high growth and are already exporting or about to, or providing 10 little small businesses who have capacity to export but don't have an export department within their operation. We have provided them, through a very creative plan - congratulations, Loftus - between ABL and us - between the 10 of them, we're supplying them with an export manager.

The flavour of what I'm trying to give you is, we are geared towards export, so therefore getting access to markets is important and therefore getting other countries to reduce their tariffs is important. Therefore it seems to me that we shouldn't get rid of the one little thing that we have got that attaches a few dollars and cents to it: our tariff barrier. Sure, we have to rely on what I might call diplomatic means and trade talks and all the rest of it.

Could I just also talk about the cycle we're in. Those small businesses in particular that worried about Y2K - and they didn't all, but a lot did - they have come through that. It was a headache and it took up a lot of their time and money. They've got GST. I'm going to be neutral for the purposes of this exercise of whether it's a good or a bad thing, but it is a compliance nightmare and no-one - no-one - can argue that. It's not only a compliance nightmare in terms of time but in terms of expenditure, and if you want me to prove it, I will. We've got the Ralph report coming through. Interest rates have gone up; hopefully they don't go up any more.

Can I suggest to you that this is just not a good time to give them, in some cases, a fifth whammy of reducing tariffs. I understand that our trade obligations require us to review but not to actually reduce till about 2010. Could I suggest that we've got those 10 years to use that 5 per cent to try and target some of our trading partners; see if we can't use it for some benefit. And I'm not arguing that it should be strictly reciprocal and proportionate. I think you do what deal you can. And I'd also argue - my reading tells me that nuisance tariffs are around the 2 and a half per cent. I presume there's some controversy about that, but my reading tells me that 5 per cent is not a nuisance tariff. You do collect more than it costs you to administer it.

MR COSGROVE: Yes.

MS NORI: You agree?

MR COSGROVE: I do.

MS NORI: Fantastic. How about that? So again I think we can distinguish between the nuisance tariff and a tariff that serves some purpose. I'm sure AIG talked about the floating exchange rate implications. Quite clearly, the reason some of our exporters can export is because the currency at the moment is low. If it goes up, they will face tariff barriers in the countries they are seeking to export to, their product will be more expensive because our currency is more valuable, and there will be a flood of cheaper imports if we get rid of the 5 per cent tariff.

For all those very good and cogent reasons, I believe you should recommend to the federal government, I respectfully submit, that we not reduce those tariffs by 1 July next year; that we take our time over the next 10 years to see if we can't use the strategy of trying to induce our trading partners to reduce some of their tariff and non-tariff barriers, and I would also urge you to perhaps step outside your economic model a little and suggest to the federal government that they have to take the wider context of the level of consciousness or, indeed, hostility in the community and recognise that it's very hard to implement any economic policy if fundamentally you don't have the community with you. We have to lead as politicians and governments. I'm not looking for a complete alignment, but if you just get that little bit too far ahead of the pack then it won't work and all your beautiful models and mathematical calculations will come to nowt, and then we'll all lose out. Thank you.

MR COSGROVE: Thank you, minister. That was a very interesting set of remarks and we'll be reviewing the transcript when we get back to our desks very carefully. I know you're a busy person and I don't want to detain you, but let me just try to pick up a few of the points you made, starting with the final one. I know it's hard to sell free trade. We have tried but, seemingly, in the eyes of several of the participants, including now yourself, have not succeeded to help people to understand what's been going on as tariffs have come down. We have introduced some material in the draft report which shows that despite what, as you said, has been a really sizeable reduction in tariff assistance over the last 10 or 15 years, the manufacturing sector has continued to grow; it has become much stronger in export markets.

MS NORI: Though it does form less of our economy as a market share of the economy.

MR COSGROVE: Yes. That's partly a function of lower tariffs.

MS NORI: Yes.

MR COSGROVE: But I think it's mainly a function of two other things. The first is the growth of personal incomes, household incomes, over the medium term and the fact that certain items produced by manufacturing at least are fairly long-lived. You know, you don't need a refrigerator every second year, or even a car. But also I think it's a function of technological progress. New products have been created for consumers to buy and they do want them, and so we have seen in every economy much stronger growth as incomes rise. And technology progresses in the services sector. That's true of all economies, even the developing economies.

We will have to address that issue further. I hope we can do more. I think to some extent it's the problem that you mentioned of the $3 chocolate bar. We actually think it's a few $3 chocolate bars; we have a bit of a disagreement with AIG on that. But it's not a lot, there's no doubt about that. But at the same time, almost every policy change tends to be incremental. It's rare for countries to go instantaneously, let's say, for the sake of argument, from a 50 per cent tariff to free trade. If they want to go that far, they will do it over a period of let's say 10 years. So in any one year you can look at the results and say, "Oh gee, there's only a couple of chocolate bars in that for me, and there are people who are going to lose their businesses. Some will become unemployed." That's not easy to sell. We understand that, and it's a task for us. The federal government wants us to do as much as we can to try to explain the benefits of trade liberalisation. We're doing our level best but maybe we're not doing well enough.

But there is a point which I think is often overlooked, and maybe we should do further work on this, presentationwise at least, in our final report. That is, I think it's the case, and I know over the centuries of economic thought about this type of issue there's a general degree of agreement about this point - the point is that one person's tariff-assisted job tends to be another person's unemployment. Now, why is that the case? Well, it's essentially because the gains from trade liberalisation and the costs of maintaining a degree of tariff assistance are borne by the community in which those changes are occurring.

We can all see that particular vulnerable business or this particular group of vulnerable people presently in employment who may well lose their sources of income if, let's say for argument's sake, the tariff were to go to zero. What we can't see - and this applies to many areas of economic policy - are the businesses which will be created as a result of that change, and the people presently unemployed or newly entering the workforce who will have new opportunities made available to them.

I think what we were trying to say in the draft report is that if you look at the pattern of recent history that is more or less what we see. As you rightly say, the manufacturing sector has become relatively less important. There has been a lot of change in the relative significance of the agriculture or mining industries, but you have big growth in output and incomes generated by new activity in the services sector and, of course, at the total economy level we've been growing very rapidly. Our productivity performance is a lot better than it used to be, unemployment is much lower than it has been, although of course everybody - I'm sure you, too - would like to see it lower.

We try to explain that better if we can. The question left to be addressed is, are the undoubted costs which would be borne by some people if tariffs were to be reduced to zero sufficiently great that they do not warrant seeking to obtain those three chocolate bars for everybody else? To some extent I think that's a matter of judgment. We do try to use analytical tools available to us to help enlighten that judgment. We do our best to try to make the right judgment, but we're always pleased to have reactions from people such as yourselves to enable us to reconsider.

MS NORI: And all the other states and territories.

MR COSGROVE: And lots of manufacturers. Mind you, there are a number of people - more than you might think - who have reacted to the draft report saying, "That'll do us. We think we should go to zero tariffs." In my own experience with the commission, that's a little unusual. I was involved, for example, in the inquiry into the textiles, clothing and footwear industries where - - -

MS NORI: Lucky you.

MR COSGROVE: Yes, indeed. I survived. But there it was a very one-sided discussion during the course of the inquiry, I think because that inquiry was focused on a particular industry whereas this, as you've said, is across general manufacturing as a whole and I think for even some manufacturers there may be gains coming out of removal of tariffs. For example, a lot of those existing 5 per cent tariffs are applied to capital goods, and most manufacturers are the people who use capital goods. There are miners, agricultural people as well, but manufacturing does use a lot of capital goods so their costs would be lower. At the same time, of course, they wouldn't have as much assistance on the output side.

We have a gentleman with us today, who will be appearing after you, who is disadvantaged at present by the fact that the product he produces can be brought into Australia from overseas duty-free, yet he must pay a 3 per cent tariff on the componentry which he needs from overseas to manufacture his product. In that sense, the present arrangement is subsidising a foreign producer, which makes little sense from the point of view of the welfare of the Australian community. I'm reacting a bit, you can see - - -

MS NORI: No, I appreciate the interaction.

MR COSGROVE: I do agree with you that it's a very tall order and there are certainly some worrying signs in the community generally. I'm pleased to see that there's also a degree of resistance to those recent events in some quarters and, while we've yet to finalise our report, we had thought at least at the draft stage that the balance of likely community-wide benefits relative to the more narrowly incurred costs was sufficient to justify going to zero tariffs. But as I was saying to AIG this morning, we will be looking with a great deal of care at what people are telling us about the content of the draft report and the recommendations in particular, and putting it all in our pipe and smoking it again over the next month.

MS NORI: All right. I'll leave you a copy of the document that I've read from, but not verbatim. As a final response to what you've just said, I acknowledge that clearly there are some winners and losers, whatever we do. I guess come down on the side of saying that for the gains - and I'm not taking it out on this gentleman, whichever one he is; if you're looking at his case only, yes, you would get rid of them. But if you're looking to Australia's future and I believe export has to be our future - small population; huge country with all those infrastructure issues; such a vast land mass, beautiful as it is; the tyranny of distance really is an issue for our economy and all the rest of it. You understand all of that.

MR COSGROVE: Yes.

MS NORI: Therefore, export has to be - it is the most significant solution to the kind of problems we face as a land mass and a small population.

MR COSGROVE: Unfortunately, though, tariffs have the nasty effect of taxing export production.

MS NORI: They can do - I understand that point - but I say to you it's going to go beyond Australia. If we don't start seeing some reduction from our partners - I mean the USA and Canada have actually put theirs up. I know why they do it - because they can.

MR COSGROVE: They're big boys, yes.

MS NORI: They're big boys and girls, and they do it because they can.

MR COSGROVE: Generally speaking, though, the trend remains downwards and, to a large extent, it's a downward trend resulting from unilateral action by countries rather than by what comes out of international trade negotiating rounds. This is occurring mainly, but not entirely, in the developing countries, where tariffs are still rather high in many cases - not all of them - but they I think have come to realise that keeping high tariffs is not doing them any good and so they're coming downwards.

MS NORI: No. But we haven't got high tariffs.

MR COSGROVE: No, we haven't. We're in the relative free trade zone, you could say, of countries around the world.

MS NORI: We're better than that.

MR COSGROVE: Although we're not quite as clean as you might think when you look at tariffs. You correctly said that we don't, on the whole, indulge in non-tariff barriers, but we are as a country a fairly extensive user of anti-dumping mechanisms and we're also, as we've found out to our cost recently in some cases, perhaps a little more inclined to rely on quarantine arrangements than we should.

MS NORI: I think AQIS does a great job.

MR COSGROVE: They do, but we've recently been taken to the WTO by a couple of countries and we've lost. So that suggests the international body of opinion felt that we were on the wrong side of the argument in a couple of those cases.

MS NORI: We'll see what they do about Howe Leather.

MR COSGROVE: I agree with your overall conclusion that, yes, we're towards the free trade end of the spectrum, which I think is a good place for us to be.

MS NORI: Thank you. Thank you for your time. I appreciate it.

MR COSGROVE: Thank you.

MS NORI: Did you want to ask, Mike - - -

MR WOODS: No. I think we've covered the ground. It's a series of dilemmas that we have to balance.

MS NORI: Thank you.

MR COSGROVE: Our next participant is Atom Industries. Would you mind coming to the table, please. I apologise that we're running a little behind schedule. I hope we haven't inconvenienced you unduly. Mr Notaras, as you did at our first round of hearings, would you mind identifying yourself and the capacity in which you're with us, please.

MR NOTARAS: Yes. My name is John Arthur Notaras. I'm the general manager of Atom Industries.

MR COSGROVE: Thank you. We'll need to rely on you to take us through your present submission. Thanks.

MR NOTARAS: I'll basically read it out.

MR COSGROVE: That's fine.

MR NOTARAS: We are the inventors and manufacturers of the Atom lawn edger which is 100 per cent Australian manufactured, except for the 31 cc and 34 cc petrol engines which are not manufactured in Australia and have to be imported. We have to pay import duty on these engines - tariff item 8407.90.30 - whereas overseas manufacturers can bring into Australia the same engines we are using, with the entire unit duty-free under the same tariff item 8467.89.00 that our lawn edger is classified under. We have not asked for tariff protection for ourselves.

This import duty was imposed as we were and continue to be told by government departments that, "All sectors in Australia needed to contribute to bringing the budget back to surplus." However, all sectors did not contribute, as the Australia domiciled importers of foreign manufactured goods also should have contributed. If Australia is in hardship and we have to pay extra taxes as import duty, we do not object to this. However, we do object to the fact that our Australian competitors, importing overseas manufactured goods, do not pay these extra taxes and therefore these overseas manufacturers are being subsidised by our Australian government because of the monetary advantage given to them by the government.

I might depart from the script there and agree with what you said before - that the tariffs cost jobs. In this case it's costing us jobs here in Australia. This matter is absolutely nothing but discrimination against we Australian manufacturers and is against Australia's national interest. As we pointed out on many occasions to several government departments, without this discriminatory tax we could compete more fairly, increase our domestic and export sales, increase our numbers of employees and therefore increase the tax base and therefore tax revenue for the Australian Tax Office.

Our export sales would increase due to more production resulting in lower costs because of economies of scale. Lower cost equates to lower selling prices, which leads to higher sales, high employment and more tax revenue for the ATO. With the exception of some people in Canberra, everyone agrees that our situation of being discriminated against is absolutely beyond comprehension and totally absurd. We wrote many many times to the Department of Industry and nonsensical, inane and ridiculous replies were received from that department which defied imagination and were insults to anyone's intelligence.

We finally requested an intelligent reply as opposed to all previous letters of misinformation received, and a clear answer to our questions which are as follows: (a) if all sectors in Australia need to contribute to bringing the budget back into surplus, then why don't all sectors pay, including the Australian domiciled importers who import overseas manufactured goods duty-free to compete against us? Why don't we have a level playing field in regard to this matter? Why are Australian manufacturers being discriminated against by our Australian government?

Incidentally, I'd like to depart from the script and say, "Whose side are they on anyway?" If, as the Department of Industry claims, because of the World Trade Organisation these particular overseas manufactured goods cannot have import duty imposed to produce a level playing field and we are not - and I stress "not" - asking for tariff protection, then in order to remove this discrimination to thus produce a level playing field, why can't this discriminating tax - ie, import duty - against us be removed, which would then result in the payout by our expanded tax base to be more cash positive for the Australian Tax Office? In a supposedly fair-minded democracy and supposedly fair-minded government, why is this discrimination occurring?

Needless to say, we never received answers to the above questions. Now we have the draft report which dealt with two types of tariffs - (1) tariffs that protect Australian industry: this occupies the greater majority of the report and the Productivity Commission has commended several timetables for the elimination of this tariff, preferring sooner rather than later.

Again, I depart from the script and say that I have sympathy for Minister Nori's comments. (2) tariffs that discriminate and unfairly tax Australian industry. This occupies the minority of the report and its tariff elimination recommendation is a minimum 12 months away. Why do we have to wait so long? Blind Freddy can see that this extra discriminating tax against Australian manufacturers that reduces our efficiency and productivity, is totally unjust and unfair and should be eliminated immediately. To say that this takes time to happen is nonsense, as your report states on page 2 that:

> On 19 September 1999 the minister had a select number of these tariffs, described as nuisance tariffs, eliminated by 1 November 1999.

In your overview on page xvii you correctly stated that:

> A virtually universal view of the participants was that this 3 per cent concessional tariff rate for business inputs under the TCS should be reduced to free as soon as possible, given that the TCS applies only where there is no Australian production to protect.

Why can't this be carried out immediately? I'll depart from the script again: there's no industry to protect, so why is this tariff being imposed? We all know, and it is mentioned on page 85 that this 3 per cent import duty was to raise revenue for the budget deficit, but as the Prime Minister stated in his letter to all Australians on 20 June 2000, "The budget is in the black." The Prime Minister also stated, "Many income earners pay too much tax," underlined, "while others pay too little, and that's not fair." Now, the analogy of the latter statement is that we Australian manufacturers pay too much tax, 3 per cent import duty plus, at the same time the government allowing duty-free entry, ie paying no tax, for competing products which are imported in a completely manufactured form.

Now, even blind Freddy can see that that's not fair. Furthermore, the Prime Minister stated:

> The old tax system discriminates against country Australia by imposing unduly high taxes on transport and taxes our exporters, which stops Australia from going further abroad. The old tax system contains hidden taxes.

And the Prime Minister says, "And that's not fair." Now, the analogy of that statement is that we Australian manufacturers are being discriminated against by the imposition of this revenue-raising hidden tax which stops Australia and exporters from getting further ahead. Again, blind Freddy can see that that's not fair. I would also like to add that in our original submission we advised that not only the 3 per cent duty had to be paid, but this duty cost attracts further on-costs to the final selling price, such as extra sales tax on the import duty component, added interest costs on the import duty component, added margins on the import duty component and all add up to the final selling price becoming much more expensive than the non-dutiable foreign manufacturers competitor's product.

This, therefore, had the same impact in simple terms as 5 per cent import duty or, to be more accurate, caused a selling price increase of 5 per cent to our great disadvantage. This was not mentioned in the report and it should have been, as a part of efficiency and productivity. On page 135 under Anomalies in Protection, Atom Industries is used as an example of local manufacture that, "considered that tariffs should be used to assist rather than tax local production". Now, this was never stated by us. In our submission we clearly stated that we were not, and I stress not, asking for any handouts or protection, and we only wanted this discriminating tax to be eliminated so that we could achieve economies of scale with our production and thus make our overall costs lower in order to compete more successfully in overseas markets, ie to be more efficient.

On page 136 the draft report includes a statement by the Australian Customs and Brokers Association advising that:

> This leaves Australia as one of the few, if not perhaps the only, countries in the world to apply to its manufacturing industry a form of taxation which has the

impact of encouraging imports by making such goods more competitive against locally produced goods.

Even blind Freddy can see that by making imported goods more easily sold into Australia by giving the overseas manufacturer a monetary advantage is nothing but a subsidy to that overseas manufacturer. This of course is discrimination and no different to that discrimination that the Prime Minister wrote about in his letter and, in his words, "That's not fair."

We have always stated that for the good of the country we do not mind paying extra taxes to cover a budget deficit, provided that it is applied equally. But in this case it was never equal. It was very discriminatory and applied to Australian manufacturers and not to equivalent fully-made product manufactured in other countries. Now that the budget has been in surplus for a number of years, this absurd tax is even more galling, more unfair and more discriminatory than ever. In fact, from 1 July, under the revised legislation of the Trade Practices Act, it could be deemed unconscionable conduct by the government.

We ask that this unfair, discriminatory tax be lifted immediately, so that we can improve our efficiency. After all, the Productivity Commission is supposed to be just that, ie productive and efficient. We Australian manufacturers have to live and exist in the real world. We have to compete vigorously. Not only survive in the real world, but to expand and prosper. We do not have the luxury of working at the output and pace of the Canberra bureaucracy, or have the very generous salary packages. We are world-class designers and manufacturers who are endeavouring to obtain economies of scale in our Australian market, so that we can more successfully export to the world.

Many people in Canberra say, "It's only 3 per cent," but that is the limit of their thinking. It is much more than that, and the added underlying principle of this is absurd, and against the national interest for a strong manufacturing sector. I quote The Economist magazine's February 2000 industrial production figures which state that the average industrial production of Austria, Belgium, Britain, Canada, Denmark, France, Germany, Italy, Japan, Netherlands, Spain, Sweden, Switzerland and the USA increased over the previous 12 months by 4.07 per cent. However, Australia's industrial production increase for the same period was only 1.7 per cent. This is very alarming, considering Australia was supposed to be in a boom period while Europe was, at that time, in an economic slump.

Australia's gross domestic product increased about 4 per cent for this period, but this 4 per cent growth rate should have been reflected in the industrial production increase. With the anti-manufacturing policies of government, it is no wonder Australia is slipping further behind the rest of the industrial world, and to the detriment of future generations of Australia. Why wait 12 months to remove this absurd, unjust and discriminating tax? There is nothing hard in deciding and implementing the lifting of the 3 per cent import tax immediately, as was previously done by the minister. Even blind Freddy can see that.

MR COSGROVE: Thank you very much, Mr Notaras. Before - - -

MR NOTARAS: And I would like to ask the question: why can't it be lifted immediately?

MR COSGROVE: Well, that's a fair question and let me say in response to it that I think we will certainly be reconsidering this aspect of the draft report. I think we've probably been led to the recommendation of the draft report, in a sense, by the terms of reference, which I'm not saying is something that we absolutely had to do. But if you remember, the terms of reference asked the commission to report initially on the scope for a reduction in the 5 per cent general tariff. Then they asked us to look into the implications of such a reduction for concessional tariff arrangements, including the one which is so rightly troubling you.

MR NOTARAS: Yes, but I can't understand. You people are the Productivity Commission - - -

MR COSGROVE: Let me go on. This, I think, was perhaps an unduly restrictive interpretation of the terms of reference, and it's something that I will certainly have another look at. I think it's almost incontrovertible that your position is a correct one and I can think of little reason why there should not be an early removal of the 3 per cent duty which you have to pay.

MR NOTARAS: But what does "early" mean in Canberra, glacial-pace terms? Does it mean in a month or two or does it mean two or three years or what?

MR COSGROVE: Governments can do things whenever they like, and we can't control them. We're only advisers.

MR NOTARAS: You could certainly put a recommendation in for immediate - - -

MR COSGROVE: Exactly, and that is something which we will give consideration to, I assure you.

MR NOTARAS: I trust that you will. If you would, please.

MR COSGROVE: We will. I think you've opened our minds with your most recent submission. I do also owe you an apology, it seems, for the wording which troubled you on page 135. I've had a quick look while you were speaking, and I can see that we might have attributed a position to you on the basis of some wording in your first submission which should not have been attributed, and we will try to make sure that we get that right in the final version.

I wonder if I could ask you a question? You say on the first page of your current submission that without the 3 per cent duty, which you pay, you could compete more fairly, increase both your domestic and export sales, the size of your workforce and hence the tax base. Is it possible for you to give us any indication of the magnitude of those changes that you think you would be able to achieve if you didn't have to pay the 3 per cent duty on your engines?

MR NOTARAS: Firstly, obviously if we didn't pay the 3 per cent our prices would come down. So that would obviously help us in sales tremendously, and with more sales we would have to produce more so we would need more people. Now, I just can't say off the top of my head exactly what it would be.

MR COSGROVE: Could you even qualitatively suggest whether it would be likely to be smallish or more significant in terms of your existing scale of operations?

MR NOTARAS: Well, it could make a difference to us of probably 20 per cent.

MR COSGROVE: Really?

MR NOTARAS: Yes, in sales.

MR WOODS: If, on reflection, over the next day or so you were able to give us some further evidence on that, that would be helpful. I do press the immediacy of the timing because we need to produce our final report.

MR NOTARAS: Sure.

MR WOODS: But, you know, a reflected view in the near future would be very helpful.

MR COSGROVE: Another thing, and this may not be a fair question to you, Mr Notaras, and I'll follow it up when we return to Canberra, you mentioned at the top of page 2 of your submission under point D that if, as the Department of Industry claims, because of the World Trade Organisation these particular overseas manufactured goods with which you are competing cannot have import duty imposed. Have they given you any basis for that statement?

MR NOTARAS: No, just the usual misinformation that they - - -

MR COSGROVE: It strikes me as strange.

MR NOTARAS: I mean, we received one letter and they said - when we first complained about this issue they said, "We're entering a free-trade area and we can't increase tariffs for you."

MR COSGROVE: Are these engines made in New Zealand by any chance?

MR NOTARAS: No. Ironically, we were the first and last Australian country ever in Australia's history to manufacture a lightweight engine, and that was back in the early 1970s. With the structural changes that occurred in that time we went through great pain to rise out of the financial burden that we had to face. I mean, it took us many years to pay back the banks for the money we lost on that then project which, I might also say, was very much recommended at the time by the Canberra bureaucracy as a part of increasing manufacturing in Australia. We went into it, unfortunately, then there was a change of government and everything changed after that and we lost our shirts. But we managed to rise out of that, like I say, ironically, because that engine was a very, very fine engine. As a matter of fact we made four different engines.

MR COSGROVE: Now, where do they come from?

MR NOTARAS: They come from the USA and Japan. We virtually have no engine manufacturing - Victa is the last remaining small engine manufacture in Australia.

MR COSGROVE: But they're too big for your needs?

MR NOTARAS: They're much too big for us. I mean it's totally out of the question. Ours was a lightweight, small capacity engine.

MR COSGROVE: Mike, anything?

MR WOODS: No, I've had the pleasure of examining Mr Notaras in the first round - - -

MR NOTARAS: I might add the fact that - you asked me about the letters from Canberra. The replies we received said that they couldn't assist us in increasing our tariffs, and that's not what we asked. Then we wrote back and said, "You didn't read our letter. Your letter was a nonsense letter." Then they turned around and quoted the opposite thing and said, "We can't remove your tariff," or whatever. I mean, they just went around in circles all the time - very nonsensical, and an insult to one's intelligence.

MR COSGROVE: I think you've made a very clear and, as I said, incontrovertible submission to us, and it will be a part of the formulation of our final report.

MR NOTARAS: I trust it will be looked at - - -

MR COSGROVE: Absolutely.

MR NOTARAS: - - - and implemented immediately, because it's most unfair.

MR COSGROVE: Yes. Timewise I might explain, at least, the process from hereon in which could be of interest to you. We are due to give the government our final report late next month. We, however, don't control the timing of the government's decision on any recommendations in the report. That is a matter for federal cabinet in a sense. We expect to meet our deadline, but if you wish to expedite the process from there on, then I can only suggest that you press the urgency of your case with relevant federal ministers.

MR NOTARAS: Well, unfortunately it's very difficult to penetrate the wall of minders around all of these ministers.

MR COSGROVE: Yes, I'm afraid it is.

MR NOTARAS: It's almost impossible to get through. In fact it is impossible. Everybody passes everybody off to everybody else.

MR COSGROVE: I can understand your frustration.

MR NOTARAS: Very very frustrated, and the underlying principle for Australian industry I think is very very bad: to tax Australian industry and allow overseas imports to come in duty-free. It's just crazy.

MR COSGROVE: Yes, we find it very difficult to disagree with you. Thank you once again for coming along. It's a very helpful submission.

MR NOTARAS: Thank you.

MR COSGROVE: I'm just going to take a short break for a couple of minutes.

MR COSGROVE: Our next participant is the Broken Hill Proprietary Co and, as was the case at our first-round hearings, I would like you each to identify yourselves for our transcript and indicate the capacity in which you're giving us evidence today, please.

MR McDONALD: Ross McDonald, manager government and investor relations, BHP Steel.

MR LANDY: Bernie Landy, vice-president marketing, BHP Steel.

MR MARJORIBANKS: Andrew Marjoribanks, manager business relations, BHP Steel.

MR COSGROVE: Thank you very much and thank you again for your further submission, which we have had a chance to read but I imagine you'd like to make a few points related to it.

MR LANDY: What we'd like to do, Mr Cosgrove, is just to probably summarise so that it can stimulate some further discussion.

MR COSGROVE: Sure.

MR LANDY: Thank you firstly for the opportunity to come and have another talk to you about this issue. It's an important issue for BHP Steel, and we really are here representing BHP Steel. It's the part of BHP that is affected mostly by the decision that you're contemplating.

Consistent with our previous proposals, including the one we've just submitted to you, our view is that the general tariffs should reduce in line with agreed timetables but not reduce unilaterally without an offsetting trade benefit. So we are still consistently of the view that the arrangements under APEC, which sees the tariffs reducing to zero by 2010, is still an acceptable target for us and we don't see any reason why it should happen sooner than that.

We believe there's no real case for an immediate reduction in the general tariff rate. We as a company and we as a significant part of Australian industry are affected significantly by this decision, we believe. About 10 per cent of the tariffs under the reference are steel-related tariffs, so we have a significant interest here, and we are here representing the 17,000 employees that BHP Steel has and just put forward the fact that our industry represents about 5 per cent of the manufacturing GDP in the country. The other important point to stress is that virtually all of the employees that I just mentioned, the whole 17,000, are outside of capital cities and reside in regional Australia, so our industry does touch the lives of many ordinary Australians outside of the capital cities and in many cases we're the major employer in those regional centres.

As I said, I'd like to summarise. Our arguments boil down to really two things: that any reduction in tariff should be reciprocal and proportionate with our competitors and trading partners. From our observations, all steel-producing countries operate with tariffs. Nowhere do we see the steel industries free of tariffs. Australia already has a low-tariff regime compared to some of our competing nations who manufacture steel, so we believe that we're out of synchronisation with our major trading countries and competitors, particularly in the Asia Pacific region. For example, when we export quite a considerable amount of steel to the region, tariffs are charged on the steel that we export, and we don't see any real change happening in our export markets to see any reciprocal nature of tariff reductions. BHP on its own is exporting about $1 billion worth of steel per annum and we are facing tariffs and duties wherever we're exporting to.

We question the statement made in your report that this gives Australia negotiating leverage, by going to a zero tariff. There has been some commentary made by Minister Vaile in this regard, where I guess he is recommending that we keep that ace up our sleeve if we are looking at negotiating with our trading partners. We don't see any of our trading partners walking up to the plate and dropping down to zero, so basically why should Australia take the lead? Why can't we use the fact that we have that as leverage in negotiations? So rather than offer it up in the short term and proactively, why can't we use it to help us negotiate better outcomes in the future would be a recommendation that we would make.

The second point of our argument is that we believe the benefits of reducing to zero for the community and for consumers is likely to be very minor. But what happens with going to a zero tariff: we think that an important part of the economy - that is, manufacturing industry in this country - comes under added pressure. If I can talk about the steel industry particularly for the moment, we believe that we're a globally competitive company servicing not only the Australian steel industry but the global steel industry, and I think we're recognised by our competitors and our customers as fitting that description. So, as we said the last time we got together, we believe that there is enough in the competitive dynamic to keep us all honest, if I can use that sort of jargon.

The facts are though that the industry that we participate in, particularly in Australia, is coming under increasing pressure. We're seeing imports of steel products come in, notwithstanding a fairly low or almost an historically low Australian dollar exchange rate relationship. That hasn't stopped the growth of imports. We are constantly reviewing the propositions that we have to our customers to ensure we maintain competitiveness, and we will continue to do so. We see a move to going to a zero tariff as, at the very least, poor timing, particularly if it happened in the immediate term.

The industry has probably been restructuring for the last 15 to 20 years. It hasn't stopped restructuring. We are restructuring even as we speak. We referred last time to the situation at Newcastle. We're in the process now of spinning out that company so that it can survive and prosper on its own. BHP Steel in its own right -

the remaining part of the steel industry is continuing to work for workplace reforms and improve its competitive position to its customers. That will not stop. Reduction of costs will not stop. It's very high in the objectives of the company.

If we consider that the main element of competition that we have is imports, we believe that going to a zero tariff basically gives the imports a leg up and what you will see is an increase in the volume of imports coming into the country, impacting negatively on the employees in our regional centres, etcetera. Having said that, we're not frightened of competition because we're dealing with competition every day.

The other aspect of timing is that we are now seeing the steel market in Australia come into a period of downturn. We have come through a fairly buoyant period of construction, particularly with the Olympics, etcetera; there have been some quite high-profile projects around. We believe that we're coming into a period of downturn. Residential housing is coming off. We're coming into another difficult period. What we see when our market goes down is the volume of imports doesn't necessarily come down with it, so potentially the import share can go up and Australian industry suffers as a result.

So on the one hand, from a steel industry point of view, we disagree to any suggestion that the tariff should go to zero. Speaking as a supplier to manufacturing industry generally, our understanding is that the move to zero tariffs will affect manufacturing industry; also that imported finished goods will be affected and potentially can come in at a cheaper price, thus affecting the manufacturing industries in Australia which are also customers of BHP Steel and other steel-making enterprises in the country.

I suppose the point that we'd really like to make is that we believe that we are part of an industry that is making serious moves to restructure itself, is making moves to improve its competitiveness. We believe that with the existing tariff regime, we're on the low end; that a move to zero actually places us at a significant disadvantage with our trading countries, other trading countries and also our competitors in other steel-making nations. It increases the pressure on our industry for no apparent gain from our point of view for the community or consumers. That would be our summary.

MR WOODS: Any further comments?

MR COSGROVE: Should we proceed to some questions?

MR WOODS: I think your supplementary submission, as did your first one, highlights some of the on-balance judgment that needs to be made in this process. Your opening comment is:

> BHP supports trade and tariff reform and the economic benefits flowing from reducing trade barriers.

So you understand those macros quite clearly and we have no dispute with you on that point. From there, you then talk about "shouldn't reduce unilaterally without an offsetting trade benefit" and there are all sorts of logistical issues that that would raise as to how do you determine when other parties have sufficiently reduced theirs that warrants you also making the next step. We explored a bit of that in the previous hearing. I don't know if you've given any thought to that, as to how the government would in some objective way assess when other countries have made sufficient progress that would warrant us also then, in a reciprocal manner, reducing our tariffs.

MR LANDY: I'm not sure we can comment on when is the appropriate timing. I guess our position is that 5 per cent is a fairly low tariff, so we've shown some good faith as a country in regard to keeping our tariff levels at a reasonable rate compared to others. I think, Ross, we're seeing 10s and 15s in our competing markets.

MR McDONALD: In our Asian markets.

MR LANDY: So I think Australia can actually stand up quite upright and say, "Well, what are you guys going to do about reducing tariffs?" As we mentioned just in that discourse that I just went through, why not use it as a negotiating chip? When it's already making reasonable moves to have tariffs that really aren't that restrictive, why does Australia have to lead the pack? There are plenty of other countries that have got a lot of head room in their tariffs who actually improve their position, so we see it as something that can be used in negotiations rather than any leadership position that our country ought to be taking in this area.

MR WOODS: I understand your perspective on it, provided you would agree then to the consequence being that you would then get zero tariffs for Australia out of that process.

MR LANDY: I think that's a more acceptable outcome to us ultimately than I guess the recommendation that the commission is making by proactively going in that direction sooner rather than later.

MR WOODS: I'm wondering then though how that affects the argument you put subsequently that tariff reductions would put added pressure then on your own operations. Is that pressure acceptable in those circumstances? What relative weight do we give to these two arguments because they seem that they could potentially be somewhat in conflict?

MR LANDY: I think what we see with - it doesn't take a lot of import competition to cause us - let me just use some illustrative figures. Let's say we had the whole market - this is mythical and not realistic but let's say we, or any other manufacturer, owned the whole market. What we find is that even if you have a very small percentage of imports coming in, the offers, etcetera, that we make, it's almost the tail wagging the dog situation, that a very small amount of competition can cause you to change many dimensions of your offer to your customer base.

MR WOODS: Yes.

MR LANDY: And we have been reacting that way for many years. So you finish up getting into a situation where you get competitive, you cut your costs so that you can provide a competitive offer to your customers but you still need to maintain the volume of business you had to continue to support your cost position. So if you're down at internationally competitive levels, which we are in many of our segments, the further reductions in volume can actually start to cause problems with the critical mass in relation to keeping capacity fully loaded, etcetera. So you really start to get into the situation where you may have to idle capacity in the extreme.

MR COSGROVE: If you are at an internationally competitive cost level, and let's for the moment just operate in the existing world of the 5 per cent tariff, why is it that imports are increasing their share of the market?

MR MARJORIBANKS: Can I make an observation or answer?

MR COSGROVE: Yes, sure.

MR MARJORIBANKS: We said before in our previous submission that we have got a mixture of imports, some from developing countries, and the definition of "developing country" does not mean in all cases that their steel industry is also developing. I mean, some countries have quite sophisticated steel industries and they are called developing countries. We made the point that our average tariff - even though steel tariffs are 5 per cent notionally - our average tariffs are 3 per cent which is a mixture of zero per cent and 5 per cent. Incidentally, on this question of timing, the 2010 figure of course, which we're defending, refers to developed countries. 2020 is the developing countries and it's the developed countries which pay the 5 per cent tariff coming into this country, and I think that point should be underlined, because already from developing countries there is zero tariff on steel.

MR COSGROVE: But you have, as you've said, been operating for some time in an environment of the relatively low value of the Australian dollar in foreign currency markets. It may be that some of the countries from which these imports are coming have also had weak currencies. Is that true or not?

MR MARJORIBANKS: So the answer to the question was, which is imports, that they are increasing, but as we said in our first submission they're increasing from developing countries.

MR COSGROVE: Yes, and my question was then how does the exchange rate - - -

MR MARJORIBANKS: The question then is why should we have overlaid from developed countries tariff-free entry?

MR COSGROVE: Sorry, say that again?

MR MARJORIBANKS: Well, we've made the point that in a zero tariff environment, which we are already in in relation to developing countries, which is largely the surrounding countries in the region, we've had an increase in imports, and that is putting pressure on us.

MR COSGROVE: Yes.

MR MARJORIBANKS: In our latest submission we talk about virtually doubling in a decade 600,000 tonnes - I forget what the figure is but it's in there - to 1.4.
MR COSGROVE: Are you saying - probably not but there's a possible implication there that the tariff is not providing any assistance to you if your - - -

MR MARJORIBANKS: Not from developing countries.
MR COSGROVE: But it is still from some developed countries.

MR MARJORIBANKS: Yes.
MR COSGROVE: Yes, I see. What is the proportion of steel imports now between developed and developing countries?

MR McDONALD: About 60 per cent of imports are from the Asian area.
MR COSGROVE: Does that include Japan?

MR McDONALD: That would include Japan, yes. That is a bit of a mixture between developing and developed countries but that gives you an approximation. But Asian imports as a group have increased 20 per cent in the last 12 months.

MR MARJORIBANKS: We gave you, I think - am I right in saying this? We gave an addendum to our original submission which details - - -

MR WOODS: Yes, we've copied it.
MR COSGROVE: We'll refer to that later.

MR WOODS: Just to pick up on your timing issue, because I detect an underlying theme from your submission. It's not the end point of a zero tariff regime that you're arguing against, it's the when in the process - you use phrases such as "premature tariff reductions" or "early years of transition" - that type of phrasing. I'm wondering if you could sketch out just a little of the factors that you would see that need to be taken into account. You refer to the environment currently of surplus steel-making capacity. Is that likely to wear itself away either with redundancy of plant or increased demand or some combination of the two worldwide? Is that going through a cycle that you can observe? Is there a domestic cycle that you're taking into account, the restructuring of your own business? What are those factors that would then give a guide to what timing other than later is better?

MR LANDY: Well, if I can just talk to the point about capacity, just to open up. A consistent feature of the steel industry is, probably since at least the 1970s, following the post World War II reconstruction of industries in many countries - overcapacity has plagued the steel industry throughout the world, so overcapacity still remains a feature. The presence of overcapacity does cause economic behaviour in regards to pricing in some areas and antidumping suits are quite common right around the world in the steel industry, so I don't see that situation changing any time soon, to be honest.

There is still a lot of capacity in the former Soviet Union which will be supportive for just economic survival reasons. The ambitions of Asian countries who are developing usually are to have a steel industry pivotal to their economic development plans. Some of those plans got put on hold during the recent Asian crisis but we're assuming they'll come back onstream, so we think there's going to be no shortage of steel foreseen.

Our cycles are generally fairly long cycles. In fact the down cycles tend to be deeper and longer than the up cycles - would be a feature that we've observed. So we see the ramp as fairly down. So basically we're in an industry when only the strongest and fittest will survive longer term, we believe. So we're not going to get a bunk-up - as BHP and as the Australian steel industry - from any economic change or any major global restructuring in the industry. That is why we have been very consistent in our view that the APEC agreement is really something that we believe is realistic given the nature of our particular circumstances: long cycles, boom and bust, overcapacity, industries being slow to change that situation, rationalisation probably being avoided for political reasons in some cases. I think we would remain of the view that the APEC agreement is the thing that we think should prevail in this situation.

MR WOODS: But does that mean do nothing until 2010? That's not the feeling I got out of the wording in your submission. I got the sense that it was some time during that transition, not that you were arguing do nothing until the death knock.

MR LANDY: I think what we're saying is the commission is recommending that Australia deviates from the APEC agreement for some other plateau that it ought to be the longest horizon possible - - -

MR WOODS: Got it.

MR LANDY: - - - inside of that plateau.

MR WOODS: Thank you. That's clear enough.

MR MARJORIBANKS: And we come back to this 2020-2010 argument and ask you to keep that in perspective, because this whole debate from other submissions and so on seems to focus on 2010, but APEC of course is a 2020 deal.

MR LANDY: That's right.
MR COSGROVE: Could you tell me, Bernie, I've seen some recent press mention of the company OneSteel. How does that relate to BHP Steel. Is it the same thing with a new name?

MR LANDY: As we talked the last time we met up with you, we talked about the situation that BHP had decided to divest a number of its steel assets. Those assets will be assembled as a new company with the name OneSteel, and those assets will be put into a legal entity which will be spun out to BHP shareholders indicatively later this year. So it will become a separate company totally with no ownership by BHP as a corporate but the current shareholders of BHP will start with the shares of OneSteel and they can trade those as a free investor.

MR COSGROVE: So OneSteel will be operating in a somewhat different product market.

MR LANDY: Yes, it's essentially the long products side of BHP and BHP will cease to make those types of products.

MR MARJORIBANKS: But today we are representing the whole of BHP Steel including the about to be - because hence our regional comments would affect Whyalla and the operations we still have left, and Newcastle.

MR COSGROVE: The press reports I saw may have been inaccurate. Perhaps some of the statements a little more rosy than they might have been but there was a reference in the Financial Review earlier this month in which the chairman elect, Peter Smedley, is said to be confident that the new company will be a success: "OneSteel is an exciting company and will have a great future." Would you like to comment on that?

MR LANDY: We hope it does.
MR COSGROVE: Yes. What else would an incoming chairman say?

MR McDONALD: In which case, though, tariff reductions are threatening in that environment.

MR LANDY: Yes.
MR COSGROVE: That's why he can say that when we're getting - - -

MR LANDY: I think it's fair to say that - - -
MR COSGROVE: - - - submissions from people that you're really under a lot of pressure and may not have a great future.

MR LANDY: I don't want to underestimate the effects of imports on that business but I think it's fair to say that the flat products of our business, which is the business that remains with BHP, both the volume and share of imports in that side of the business is greater than in the OneSteel product range.

MR MARJORIBANKS: Historically products like galvanised steel have accounted for 25 to 30 per cent of the market. Historically long product imports have accounted for not much more than 5 per cent, so that just backs up what Bernie was saying.

MR WOODS: From memory you produce about 6 million tonnes a year of which you export 2 million-odd. Is that the sorts of - - -

MR LANDY: Yes, that's correct.

MR WOODS: What sort of product - - -

MR MARJORIBANKS: When you say "you know" are you talking about the whole of BHP Steel?

MR WOODS: The whole, yes. Yes, I've moved off OneSteel into all steel.

MR MARJORIBANKS: The whole thing is more like seven, three export and four export.

MR WOODS: I'm not quite up to date. My figures are the year before.

MR LANDY: But the figure of 2 million tonnes is about right for exports. We're a little over 2 million tonnes. We were at 3 million tonnes but with the closure of the iron and steel-making capacity at Newcastle, we're down to about 2.2.

MR WOODS: Okay.

MR LANDY: And that's about a billion dollars to what - - -

MR WOODS: That was the figures I had in mind, and that was your billion dollars. What particular segments of the market do those exports lie in?

MR LANDY: We supply a lot to, let's say, other companies - a bit like BHP - who don't have an iron and steel-making front end, but they actually reprocess the steels into essentially flat products for their own domestic markets. Ultimately we would perceive that most of the steel that we produce would end up in construction-related markets in our international export markets.

MR COSGROVE: So you're exporting what you might call an early or semi-processed stage of the product?

MR LANDY: To a large extent. All steel products of the nature of the ones we produce actually get made into something else anyway. We don't export many finished steel intensive products. But we do have a lot of value added products which is metallic coated, prepainted steels, which also essentially go into construction applications.

MR WOODS: So somebody else then turns them into a fabricated product which then ends up in a building.

MR MARJORIBANKS: In some cases it's our own offshore factories - - -

MR WOODS: That will then do that process.

MR MARJORIBANKS: - - - that will produce corrugated steel and things like that.

MR WOODS: You're very reliant on the end product - ie the fabricated steel product - for your export success, in a sense, that you're able to tap into those markets and provide the semi-finished product on the way through. You've said here though that, "The steel industry is threatened by global sourcing of fabricated steel projects", but it seems to be the global sourcing that in fact is the primary reason for your success in exports. Am I missing a logic point there somewhere?

MR LANDY: Can you just run the question past us again?

MR WOODS: Your statement is, "The steel industry is threatened by global sourcing of fabricated steel projects," but if there wasn't global sourcing, I suspect your exports wouldn't have been so successful as they are. Is that not true?

MR LANDY: I think the fact that we've been successful in our export markets is because we've been competitive enough to be successful. So we've earned our position over a period of about the last 12 to 15 years. The point that we're making on imported fabricated steel is what we are seeing is that much of this fabricated steel, although we're missing a sale of the raw material in this case - say a plain plate or a plain beam - but what we're seeing is that our customer base has been affected by that particular dynamic directly.

MR WOODS: But it's the very broad nature of global sourcing that's also benefiting you in other countries, because they're choosing to globally source, presumably.

MR MARJORIBANKS: Bernie has already explained that a lot of our customers are steel industry people themselves who - it's not a question of global sourcing so much as filling in a gap in their production chain for their own domestic industry.

MR COSGROVE: But isn't that global sourcing? You're getting more trade globally within the industry. Typically in the past what we've tended to see is what is called inter-industry trade. I sell you a tractor and you sell me a pair of shoes or a hundred pairs of shoes.

MR MARJORIBANKS: Yes.

MR COSGROVE: But, increasingly, because of the advantages of specialisation, even within a particular industry, there's now, "You sell me a flat seel product and I'll see you something that's more heavily processed."

MR MARJORIBANKS: But there's not a lot of evidence that the stuff we're exporting is coming back in the form of those fabricated products.

MR LANDY: The reason we put it in the papers is that it's an illustration of manufacturing industry coming under threat. That's the context in which we should look at this. Imported fabricated steel has a duty on it of 5 per cent. Presumably it's going to be caught in the same decision that the commission is making recommendations about. I don't actually have the figures in my head about what the duty would be in Indonesia, for example, or in China if Australian fabricators wanted to export fabricated steel there. I'd suggest it would be substantially higher than 5 per cent, so our customers are competing with that particular situation, plus a regime in some of these exporting countries - the countries which export fabricated steel - where their workers are maybe getting 200 or 300 US dollars per month, maximum, in wages.

MR WOODS: Yes, I understand that. But you are also using the trend towards global sourcing as a way of being successful in your own exports.

MR LANDY: Of course we are. It's a way that we're growing as a company. Absolutely.

MR MARJORIBANKS: But when we do export the semi-finished, of course, we are paying tariffs going into those countries.

MR WOODS: Yes. Happily, you're still successful.

MR McDONALD: Just on the point of the manufacturing sector, we notice your report talks about "the decline in the sectoral share of manufacturing as a per cent of GDP". I think you make the point that this is fairly normal in terms of other OECD countries. The thing that concerns us is the pace and the extent of the decline in the Australian context and particularly the build-up of manufacturing imports which are outpacing manufacturing exports. Now, we hear a lot about ETMs and manufacturing exports. We hear very little about the build-up of manufacturing imports which are growing at a far greater rate, and that's starting to erode into fabricated metal markets.

MR COSGROVE: But as a country, Ross, we can't accumulate exports indefinitely. We've got to import. We export so we can import. The other point you were making about the pace of change in the manufacturing sector is entirely understandable. The reason is that the other countries got to low tariffs much sooner than we did, so their swing down in the relative share of manufacturing occurred earlier than ours. Ours is essentially dating - well, not entirely, but I think largely dating from the period from about the mid to end 80s. That's when our tariffs started doing that.

MR McDONALD: We notice your draft report doesn't refer to the possibility of a build-up of imports post any tariff reduction.

MR COSGROVE: Okay, yes.

MR McDONALD: We see that as perhaps an oversight.

MR COSGROVE: We'll try to address that.

MR WOODS: Yes. I'm happy to pursue that.

MR COSGROVE: In this same vein of how the derived demand for your product is faring, I again noticed a press report which indicated that Smorgon had won a rail wagon contract from Hamersley against overseas competition including, I was interested to see, from China and Japan, as well as the US. The report said the railway manufacturing industry had won $500 million of work overseas, "whilst being able to minimise foreign inroads into Australia". Do those sorts of success stories have significance for BHP Steel? Are you significant suppliers into those sorts of operations?

MR LANDY: Does this relate to something like railway wheels or bogies?

MR COSGROVE: It says "wagons" - rail wagon contract. Do those sorts of products use considerable amounts of steel?

MR LANDY: They do use a lot of steel.

MR COSGROVE: Of course, that could be imported steel. I realise that.

MR LANDY: A lot of that is in castings.

MR COSGROVE: Yes.

MR LANDY: That are made up probably from scrap and alloys, etcetera. The intensity of the types of products that we're making is relatively low and, in fact, in many of these railway wagons - I'm not sure if it's these railway wagons - that are exported for mining applications actually have stainless steel contained in them and we don't manufacture stainless steel any more.

MR WOODS: Yes, we understand that.

MR LANDY: BHP doesn't get a lot of benefit out of something like that.

MR MARJORIBANKS: In terms of the 6 million tonnes or so consumed in this country every year, that would be a very small amount of steel.

MR COSGROVE: Yes, okay. I don't think I have anything else in the way of questions to you. Any further remarks you want to make to us?

MR McDONALD: There was one point about your 57 regions examined in terms of economic activity and employment effects. One of your tables indicates that fabricated metals is one of the most affected.

MR MARJORIBANKS: Yes. The negatives appear to be all in our area. Referring to a table on page 110, sheet metal products employment is negative .75 and fabricated metal products negative 1.99, and in terms of regions Wollongong is.03 but Whyalla is minus .04.

MR COSGROVE: Yes. What you need to bear in mind in interpreting those figures - and I don't wish to deny your essential point that there will be adverse effects in these areas of employment at least - they are not to be viewed as annual reductions in employment. This is an estimated long-run reduction in employment of less than 1 per cent - as you can see, according to the footnote, nine years after implementation. So if we look at sheet metal products you have, according to these estimates, an annual average loss of employment of less than .1 per cent per annum.

MR MARJORIBANKS: Yes, okay.

MR COSGROVE: I don't know what's happening in those sectors, but it may well be that employment is already declining by more than that for other reasons. That's why we were, I think, forming the view in the draft report that the likely adjustment effects are not great - to put it modestly. They seem in fact to be pretty small, as are the benefits. It's the same on both sides, we think.

MR LANDY: Thanks for the opportunity, gentlemen.

MR COSGROVE: Thank you for coming along. We will certainly give a careful look to your submission today.

MR WOODS: Thanks for the several submissions that we've had. It's been a useful progressive dialogue during the process. It's been helpful.

MR LANDY: Thank you.

MR COSGROVE: We will take a break for lunch now and resume at 1 pm.

(Luncheon adjournment)

MR COSGROVE: We're resuming now, and the next participant is Australian Business. Is that the correct title?

MS MOXHAM: That's correct, yes. It is Australian Business. We call ourselves ABL officially now.

MR COSGROVE: For the purposes of our eventual transcript of today's proceedings, would you please identify yourself and the capacity in which you're giving evidence to us today.

MS MOXHAM: Certainly. My name is Susan Moxham. I'm the industry policy adviser at Australian Business or ABL, and I'm representing the members of our organisation as it affects them - the general tariff.

MR COSGROVE: That's fine, Susan. Thank you. We received your submission recently. We've had a quick read of it, but you might like to make some points to us.

MS MOXHAM: Certainly. We did a survey of our members. We did a random survey. We could have just singled out the manufacturing sector, but we felt that for balance we really did need to look at the membership right across the spectrum, and that meant when we fined down the questionnaire - which was a specific questionnaire designed to capture members or companies that were really going to be affected in one way or another by any recommendation to change the current situation with regard to the general tariff - we had very small numbers because a lot of the people who are our members come from the service sector and they really didn't know a lot about it and they sent the questionnaire back or they weren't really interested and, if they said anything, they expressed a lack of interest.

So what I'm saying is that the survey - I've included also now all the graphs which give you a breakdown, right down to every single person who answered that questionnaire and capture the representation in the different industry sectors. What came out of that is something that probably will not surprise any of you. It was largely that the manufacturing sector and the steel and the chemical industries clearly - they're the ones that are most affected.

They're also a historical part of our membership base so whilst we understand the general drift of all of our members having a general disinterest in this particular review, we also acknowledge that a lot of industries, that seem to be important for some sort of critical mass for other sorts of industry sectors, are finding it very difficult and are starting to express some concern about their future viability if the general tariff were to be abolished immediately. I mean, I think we all acknowledge that change is inevitable, but it's just about the pace of change.

MR WOODS: Can I just clarify, if I may, therefore you sent it out to a thousand members. The response here reflects 360 members and we look with interest at the further detail that you will provide but, for the purpose of today's discussion, that 360 would be predominantly in the manufacturing sector. You would have had - - -

MS MOXHAM: Definitely that is the case.

MR WOODS: So where we're talking about then the particular responses, we are talking about manufacturers making those responses.

MS MOXHAM: Definitely, yes. I can actually give you a breakdown of the different industries and it will be interesting, when you go through the figures, to notice the construction comes out differently from some of the others. It sort of disappears on some of the questions altogether. We have it broken down into mining, agriculture, manufacturing textiles, manufacturing automotive, manufacturing other, retail wholesale, business property finance, other services and construction. They're all the different ANZIC categories that we broke it down to.

MR WOODS: Thank you.

MS MOXHAM: I might just take up some points then. It is probably appropriate now for me to just sort of reinforce why I'm here. I didn't want to come unless we felt we had something substantial to say. We know there's a lot of people making a comment on this review but we were given to understand that the position we were coming from was a little bit different from that of some other bodies that were representing the industry.

Tariff reduction on Australia's part we feel should be commensurate with corresponding reductions in both tariff levels and non-tariff barriers by countries involved in multilateral, regional or bilateral negotiations. Likewise, investment obstacles, which still are very prevalent in a number of our trading countries, shall be removed on an accelerated basis. Investment should form part of these trade liberalisation negotiations.

One of the things we struck was in the review there was - the commission confined itself to multilateral trade agreements. In our report, as you would have noted, we seized upon a statement by the Prime Minister last January where he commented on the failed talks in Seattle and recognised that probably multilateral trade talks were off the agenda for a while and that there was now a need for Australia to look at other ways of engaging in trade agreements and that would have to take place bilaterally or regionally.

We felt that if the recommendation of the commission was to be embraced, that it would cut off those opportunities for bilateral and regional trade negotiation. That doesn't exclude the opportunity for a multilateral opportunity further down the track, of course, it just means that Australia is going to be able to negotiate from a more powerful position from where we see the interests of the manufacturing community. We also think there's a real importance, in any adjustment program, for the industry to be encouraged to export because we acknowledge that exports are really important for Australia and it's also pretty important for the trade deficit.

Another point that was made by our organisation was that whilst a multilateral approach to trade negotiation should be pursued, an alternative approach which would run in parallel is for Australia to pursue bilateral negotiations with key trading partners and this was in the context of China. The general feeling is that it's great that China signed up to bilateral trade agreements but it's all very well - they need something that is going to commit them to that bilateral agreement - and the opportunity for Australia to negotiate, whether it be by 5 per cent tariff or other sorts of negotiations, is seen as critical to enforce that bilateral trade agreement. That is coming from our head of trade in our organisation. He feels very strongly that countries can sign up to these agreements but in the end it's up to the countries that want to trade to actually make sure that something is made to come out of all of that.

MR COSGROVE: That's always a risk and it underlines again the special value of the multilateral approach because there you have a body with sanctions of various kinds available to countries who have agreed to do certain things and who don't.

MS MOXHAM: That's right, yes, and that's essentially what we're saying as well. Another point that was made was that often for agreements struck, whether under the multilateral umbrella or bilateral arrangements - the subsequent full and proper implementation of the agreements not carried through on the agreed timetable will sometimes - that's if at all, you know - there are those sorts of inconsistencies that crop up from time to time with these agreements and it is thought that Australia needs to pursue the implementation aspects with a sustained vigour to ensure compliance.

There is also another point that was drawn to my attention: that Australia is a signatory to the Bribery of Officials Act which came into effect in Australia in December 1999. A large number of Asian countries are not signatories to this convention which places Australia at a distinct disadvantage in many instances when attempting to secure major contracts in Asia. A concerted push needs to be made by the Australian government to pressure non-signatories to sign up and, likewise, a number of signatories do not enforce the legislation. Again, Australia needs to bring pressure to bear on these wayward countries.

I think that's really the nuts and bolts of what I want to say. It's really about trade. It's an important part of where we see future policy for industry in the future.

MR COSGROVE: Thanks, Susan. We need to take some more time, particularly to look at the additional detail that you're providing to us today and to do justice to the written submission that we received recently, but I was interested in a couple of results from your member survey, bearing in mind as you told us a few moments ago that the respondents are effectively manufacturing, and maybe one or two other sectors, but predominantly manufacturing.

I'm looking here at page 7 of your submission under section 5.6, the main findings. There's a point there that says 65 per cent of those who responded indicated that the tariff does not create a competitive disadvantage. If you just bear with me a moment - perhaps you can help me - where is that spelt out later on?

MS MOXHAM: That's the fourth point, I think. It's 64.9 per cent and - - -

MR COSGROVE: Yes, and later on you have a little more material on - - -

MS MOXHAM: When I go into the actual question?

MR COSGROVE: Yes.

MS MOXHAM: That was question 4 then, okay?

MR COSGROVE: Four, yes. "This question asks the level of disadvantage which the tariff created against fully-imported products. 65 per cent of those who answered this question said that the tariff created little or no disadvantage." So are they saying that - - -

MS MOXHAM: Yes, that's right.

MR COSGROVE: - - - the tariff is not deterring imports with which they're competing.

MS MOXHAM: That's exactly right.

MR COSGROVE: Then the second-last of those points, back on page 7, also says, "Removal of either tariff" - that is, the 5 per cent general tariff or the 3 per cent TCS duty - "would have no effect on business." Yes?

MS MOXHAM: That was because most of our members were ignorant of the existence of the 3 per cent.

MR COSGROVE: Of the?

MS MOXHAM: Of the opportunity to have a discount on that tariff to 3 per cent. That was an issue that cropped up in the questionnaire: a high level of ignorance of the benefits of - - -

MR COSGROVE: They didn't know, yes.

MS MOXHAM: You know, duty drawback, TEXCO, all of those programs were, in the main, not commonly known by our small members. They were certainly - - -

MR COSGROVE: Yes. I see that point but I think the one I'm focusing on more particularly is question 10 where it is spelt out as saying that 82.3 per cent of respondents said removal of the tariff would have no effect on their business. You get the impression from those answers - and we will need to look closely at the details, of course - that the tariff may be serving little purpose in terms of assisting these people to compete against imported product which then raises the question, why is it there? Do you see what I mean?

MS MOXHAM: It's a perfectly reasonable question. We, ourselves, understand that a lot of members and a lot of people in industry are doing different things to the chemical companies and the steel-making companies and that they would like to see it removed. I mean, we had a couple of them come in saying exactly that. I guess we're in the situation of trying to acknowledge their point of view in this questionnaire because, after all, we have to represent all their views but, by the same token, I think we're trying to say, "Yes, but we are losing a bit of critical mass there," and it would be a bit sad to see all steel production disappear from the country.

I think some people are more concerned about this now when they saw the Australian dollar drop, because that meant that we have gotten rid of tariffs and things are starting to cost us more from overseas and we have lost the industry. We have lost that opportunity to deal with being able to produce alternatives to those products. Really what we're saying is that we feel that Australia, whilst it's a small country, needs to help some industry to be retained in Australia for those sorts of situations where we might see the prices drop. There is still an opportunity for industries to rise up again and seize a competitive opportunity. I think that's important; that we can respond to - there's a flexibility and a responsiveness still left in the Australian manufacturing sector that can say, "Well, there's an opportunity here. We can still do it," you know, "We haven't lost that skill altogether."

MR COSGROVE: The sector as a whole has been growing during the period of tariff reductions since the late 80s - not particularly strongly - it has lost relative importance in the Australian economy as a whole, particularly as services sector growth has occurred. Are you intending to imply that there is something more strategic about the manufacturing industry than other industries?

MS MOXHAM: No, I'm not. I think what we're trying to say is that that sector has had a traditional way of doing things and they need to be able to modernise. We know they can't keep doing things the way they have been doing them. It's like textile, clothing and footwear. We understand all of that but we also recognise that it's sometimes very hard, culturally, for these organisations to turn around and change when there is an accelerated tariff reduction program - a policy of an accelerated tariff reduction program in Australia. I think that has tended to make a lot of people give up.

I think we tend to think that if it had been a bit slower, maybe some of those companies might have stayed there and responded to the increased competition internationally instead of dealing with dumped product, dealing with lower tariffs, dealing with international change. It was a bit difficult for some of them, I suspect, and so really, we say, we know that everyone is on the same continuum ending in the same place at the end of the day but wouldn't it be nice if we could do it a little bit more sensitively. We could just foster, still, an industry that - and didn't lose everything in the result, because I understand in the States that they have actually retained a lot more of their industry in these sectors than we have as a proportion of population. I think we should be mindful of that, that they have actually managed to keep quite a hard core of these industries in their country.

MR WOODS: Is that in part what lies behind your comment that the survey results indicate an increasing preparedness on the part of industry to embrace changed circumstances? So you're saying they understand where it's all heading but, on the other hand, you're looking for a time frame that allows them to adjust, and presumably organisations such as yourselves are out there working with them to help.

MS MOXHAM: That's right.

MR WOODS: In that context I noted what I thought was a fairly pivotal point in your submission, that, "Individual companies cannot be competitive solely on the basis of price." We have received a lot of evidence that the tariff and the competitive pricing of actual or potential imports would be the one thing that makes or breaks their existence. We have in fact seen evidence of that sort of view progressively as tariffs have come down and, for the last 5 per cent, we're hearing it once again. But you list out there quite a useful list of other factors that affect productivity and survivability of industry, so it isn't just a price point.

The survivability of a particular company depends, as you say, on quality management, customer service, achieving international best practice, so there is a whole range of factors, and tariffs I think need to be always seen in that light: that whether a company survives or not is not just dependent on whether they lose their 5 per cent tariff but whether they give attention to all of these other factors. Some of them are quite significant factors and can make a difference much greater than whether or not they have a 5 per cent tariff, I would suggest.

MS MOXHAM: That may be true, but we're looking at particular industries and I'm not entirely certain that those traditional industries have got all those other criteria available to them for - - -

MR WOODS: I understand that, but presumably the point is that if they were aided in improving in these areas then that would be at least as significant to them as the protection that the tariff may currently offer.

MS MOXHAM: Sure.

MR WOODS: If there were some way of assisting, and organisations such as yourself, which I am very familiar with in other roles, do a lot in the way of assisting management, training and financial management and the like.

MR COSGROVE: Susan, earlier today we were discussing with AIG a similar survey of their members and it had become clear to us that the presentation of the results was done in what I called an unweighted fashion. That is, each respondent was given the same weight as another, so that it was possible that the chap making 1000 toothbrushes a year was the same as BHP Steel. I mean, that's a characterisation of the situation. Are your results similarly unweighted in that way or have you tried to attach industry weights to them?

MS MOXHAM: No, I haven't.

MR COSGROVE: No, okay. I just wanted to understand that.

MS MOXHAM: We didn't do that, no. The profile of this survey would include some larger companies. It's largely small business to medium-sized enterprises, there's no doubt, because that's where our membership base is. We do run-downs from time to time in industry sectors. We always have a larger propensity of members in the manufacturing sector right across the spectrum, whether it's food or TCF or steel, chemicals. We just seem to capture that base of membership but they do seem to be, in the main, smaller companies.

MR COSGROVE: On the basis of a quick read I don't have any further questions to ask you - and nor does Mike?

MR WOODS: No.

MR COSGROVE: Thanks for providing this submission to us and we will be glad to have - - -

MS MOXHAM: Receive this?

MR COSGROVE: - - - a look at your survey results.

MS MOXHAM: Yes, that's fine.

MR COSGROVE: You might pass them on to our staff on the way out, that would be fine.

MS MOXHAM: Thank you very much.

MR COSGROVE: Should we treat that also like a public submission from your group?

MS MOXHAM: Certainly, and I'll send you another electronic copy with the tables in it so that you can put that up on your Internet site.

MR COSGROVE: Excellent.

MS MOXHAM: Okay, I shall do that.

MR COSGROVE: Thank you very much.

MS MOXHAM: And thanks for finding time at 1.00. I had a real busy morning this morning, so thanks for that.

MR COSGROVE: No problem at all. Glad you could come.

MS MOXHAM: Thanks.

MR COSGROVE: Are there any other participants wishing to appear? We will need to have your name and the capacity in which you're giving these remarks to us today.

MR FREWER: All the necessary administrative details?

MR COSGROVE: Yes, that's right, so we can identify you on the transcript.

MR FREWER: My name is Greg Frewer and I represent a company called Australchem Pty Ltd. We are located up in the Newcastle area as a chemical manufacturer and we actually put in a submission at the earlier stage.

MR COSGROVE: Right, yes. I'm sorry, I don't have it with me today.

MR FREWER: No, that's all right. It sort of went into the production of the draft report. The comments and observations just are fairly brief. I'm certainly not in a position to go into the detail, if you like, of the modelling and all this sort of thing.

MR COSGROVE: No. We don't expect everybody to take an interest in that.

MR FREWER: Just as an observation first, the boxes 3.3 and 3.4 which give some typical arguments for and against, I presume that they were indicative of the representative cross-section of each of the for and against?

MR COSGROVE: Well, that was what we were trying to convey, yes. Whether we succeeded - - -

MR FREWER: Yes, right.

MR WOODS: See the star at the top of box 3.3.

MR FREWER: Yes.

MR COSGROVE: Yes, there you are.

MR FREWER: Yes. But I just make the observation that in the ones against tariff reductions, they are all of a similar sort of argument - different in degree, certainly. In those against, though, two out of the six are arguing for no tariffs in industries where there's no local production - they say that there's no local production of their particular area of interest - and two others are arguing for a reduction to zero by 2003. So I observe or presume from that - maybe incorrectly - that the biggest weight of argument in terms of written submissions was in fact for either a slow-down in the reduction of the tariffs or no further reduction at all.

MR COSGROVE: Yes, that's the case.

MR FREWER: Okay.

MR WOODS: Purely on numbers of submissions I think - from weight of argument.

MR FREWER: Yes, the arguments that were put in. The other comment that I would make: on page 33, where the draft report talks about the methodology of the responses, etcetera, and then goes on to say, "It's difficult to accept the removal of the 5 per cent tariffs could have such a large aggregate effect," etcetera - given that in the past more substantial reductions in tariffs were accompanied by an increase in manufacturing output, I guess the comment I would just make there is that improvement in industrial efficiency or manufacturing efficiency, which I guess is what goes hand in hand with increased output and what has occurred previously with earlier reductions, tends to be an exponential sort of a thing. If you're woefully behind in efficiency, it's very easy to make up the big changes. As you get more efficient, it becomes more and more difficult and it's an exponential decay.

I would just ask that that sort of comment be taken into account when you refer to - well, what happened previously may not necessarily be applicable any more. If the industries have reached a level of efficiency where there is little room to move any further, then even though in previous larger tariff reductions they were able to make big changes to their efficiency and remain competitive, that may in fact be now reaching the end of the tail, as it were.

MR COSGROVE: I think that's a fair comment, Greg. The only qualification to it that I think I would mention is - and here I'm speaking from memory, but I think it's still the case that actual levels of productivity in Australian manufacturing - and here I'm talking across the board, not of any particular part of manufacturing - are some way below the highest levels of manufacturing productivity, which still tend to be in the United States.

MR FREWER: Right, yes.

MR COSGROVE: So in that sense we've still got some way to go to get to best practice, but - - -

MR FREWER: As a general comment, yes.

MR COSGROVE: As a general comment for the sector.

MR FREWER: But certainly in some areas there may not be room to move.

MR COSGROVE: Quite. That's quite possible.

MR FREWER: I can only speak for my own area and say, well, what else can we do, given the sort of product we produce and the sort of technology that's involved? You are stuck with the big-cost items such as labour compared to a lot of the overseas manufacturers, particularly in the Asian area where wage rates are a lot lower, and of course cost of raw materials tends very often to be more expensive here than it is overseas.

MR COSGROVE: Yes. Often though - in fact, typically I would say - wage levels reflect productivity, otherwise they impose inflationary pressure on the economy and require it to be slowed down. So you're right to say that there are very much lower levels of wages in certain Asian countries, but productivity levels are very low as well and their unit cost, the gap in terms of unit costs of labour, while they may still exist, are not nearly as great as the comparison of wages would indicate.

MR FREWER: Yes.

MR COSGROVE: What about the effect of the decline in the exchange rate of the Australian dollar for your company?

MR FREWER: At this stage it hasn't had any apparent effect. If it stays down low for long enough then we would expect to see an impact on the cost of imports, but I think that most of the importers, who are obviously our competitors, have probably got sufficient forward cover on their transactions to cover themselves at this stage with either stock already in the country or with previously purchased US dollars or whatever it may be.

MR COSGROVE: Yes, although I was thinking of a somewhat longer time frame. We had a trade-weighted index or - I'm guessing here now, but if you went back to the late 80s it might have been somewhere perhaps between 55 and 60 and now I think it's in the low 50s. It's not in significant decline over something like 10 years. You haven't seen that be of any assistance to you?

MR FREWER: Not particularly, no. We have certainly seen - well, the dollar was down in this area about, what, late 1998 sort of thing?

MR COSGROVE: Yes.

MR FREWER: As the dollar went up, we certainly saw import prices coming down. As it went up to 65, 70 - I think it actually peaked at just over 67.

MR COSGROVE: About 66 or 67, yes.

MR FREWER: So we saw prices come down. We haven't seen the prices - this is in terms of the tariff values - going back up as yet. If the financial pundits are right in telling us that the fundamentals are strong and there's no real reason for the dollar to be as low - - -

MR COSGROVE: That's usually a sign to sell the dollar.

MR FREWER: - - - we can only presume that, given time, it will get back up to the mid-60s again and probably strengthen from there.

MR COSGROVE: Which countries do your main competitors produce from?

MR FREWER: We get quite a lot of imports from China, India, Taiwan, some from Korea, but also from Europe as well - Germany.

MR WOODS: What's the degree of import penetration that you're competing against and how has that changed over the last five to 10 years?

MR FREWER: Well, we have only been involved with the business for the past two years or so. There's certainly been a growth in the volume of imports that have been coming in. There has probably also been a growth in usage, I might add, as well.

MR WOODS: I was going to say, is that picking up market growth?

MR FREWER: Yes.

MR WOODS: And so your production is still staying fairly - - -

MR FREWER: Well, no, we certainly have lost some volume, but it's not as great as the increase - - -

MR WOODS: Yes.

MR FREWER: Yes. So there's been a mixture of market growth and loss of some of our volume. I would make the comment perhaps at this stage too that you say in here, and I quite agree, that it's difficult to see that just tariffs on their own are going to necessarily kill an industry. But it is just one factor which adds to the difficulty in keeping ahead of the importers.

MR WOODS: I guess, in that respect, our comments receive some support from the previous submission that we had from Australian Business Ltd who were, and do in their submission, give some depth of coverage to the other factors where industry should be looking to improve itself, to put tariffs and prices more generally into a context of a total productivity improvement that business can go through.

MR FREWER: No, I would agree with that. It's not the only factor by a long way. But I guess it's one factor which, if you like, we have control over as of right now as to whether it stays or whether it goes. Other factors, particularly other factors that may be applied in the country that's exporting to us, we have no control over at all. If they have some form of subsidy, for example, over there, there's nothing that we can do about that. But we can, you know, determine whether or not we maintain this level of - - -

MR COSGROVE: I'm sorry to interrupt, but if it was a subsidy assisting their exports you could do something about that.

MR FREWER: If we were big enough, yes. But it's difficult for small businesses to really have an impact on that sort of thing. For BHP, who have the resources and the wherewithal, and the - - -

MR COSGROVE: This is not something that an individual producer would prosecute on its own behalf. I mean, the WTO, the World Trade Organisation is a body made up of member governments, and if you were able to demonstrate to our federal government that country X, competing with you in your market, is using government export subsidies, or even quasi-government export subsidies - as we saw in the Howe Leather case where it was shifted from an explicit export subsidy, even though it was called an import credit, to a production subsidy - they were still found to be contrary to WTO rules, because 90 per cent or thereabouts of Howe Leather's production were exports.

MR FREWER: Right.

MR COSGROVE: So you could, if you're really concerned on that point, take it up with the authorities in Canberra.

MR FREWER: No, I haven't got any specific sort of knowledge of that. I just make a general comment that, you know, what happens overseas is far more difficult to have any input on it than what happens within our own borders. I guess the other comment I would make, and perhaps it was made too by BHP in what they had to say this morning, was in relation to the timing. Okay, ultimately everybody wants to have free trade. It's a question of the time frame, and the question of whether or not everybody is sort of doing the same thing. My understanding is that, again, the US has probably higher levels of protection for a lot of its industries than is the case here - - -

MR COSGROVE: For some. It has higher for some and it has lower.

MR FREWER: Yes, and similarly over in Europe. We seem to be trying to, if you like, be not just the leader, but the ultimate leader in terms of having zero protection, when in fact these other somewhat more influential economies still see fit to provide some protection for their industries. Now, either they're wrong or we're wrong sort of thing. With the size of our economy and the size of theirs, you know, I can't help sort of thinking, "Well, why do we want to push this for the last 5 per cent so quickly," when in fact those other economies have got quite a bit to catch up to where we are now in many instances.

MR COSGROVE: Yes.

MR WOODS: Part of the answer to that could lie in looking at how Australian industry has responded to previous tariff reductions. If there is evidence that their productivity has improved, then that may suggest that the unilateral approach has been of benefit to us. In fact, we haven't had any witnesses come forward, with the exception of one yesterday, and they say they want to go back to the state of manufacturing of 10 years ago.

MR FREWER: Sure, and I would agree with that entirely. We said in our original submission that the previous reductions were valid and the improvement in our competitiveness was valid.

MR WOODS: In fact I recall your point, yes.

MR FREWER: I guess my comment there comes back to my earlier comment, and that is that it is an expediential situation and my belief is we're in the area now where the difficulty in getting the final bit of improvement in some instances, not all - as you say, there are plenty of industries that have got a long way to go, you know - we've reached a point where that 5 per cent becomes perhaps more significant than perhaps a 10 per cent reduction earlier on in the piece would have been.

MR WOODS: If it's a question of timing, what sort of objective criteria could government use to say, "Yes, here are the conditions that are now in place that warrant such a reduction to occur." We're having trouble trying to elicit specific measurable - - -

MR FREWER: Sort of a rationale for - - -

MR WOODS: Yes, rather than, you know, not yet. We understand the "not yet" approach, but it doesn't tell us, yes, but when. Is there any light you can shed on that?

MR FREWER: No, I couldn't. I suppose you need to think 10 years down the track, I guess, for that type of thinking and sort of saying, "Where are things going to be then?" With the way things are changing now you've got enough on your plate thinking what is going to happen next year, let alone what's going to happen in sort of five to 10 years.

MR WOODS: But I mean is it three years, is it five years? How would government know that it has got to that point?

MR FREWER: I really can't answer that.

MR WOODS: That's all right. It's a conundrum that hasn't come up with easy answers.

MR COSGROVE: No. Another aspect of the question which you posed a moment ago, you know, "Are the big countries which are still maintaining high levels of tariffs smarter than we are?" I think is that we are explicitly required in this inquiry, and indeed in all inquiries that we undertake, to look at the economy-wide effects, the community-wide effects.

MR FREWER: Sure.

MR COSGROVE: Of course, manufacturing production is a significant part of that, but it is only a part. It is the case, just the reality of life, and always has been, that people who are likely to be most directly and significantly affected tend to have a bit more say in these debates than do the average Australian households who stand to gain very little from a typical change in tariff policy. So it may well be that even in a large country such as the United States that that situation prevails, and that the dominant voice on the congressional hill comes from - - -

MR FREWER: Lobby groups, sort of things - - -

MR COSGROVE: - - - those who would be disadvantaged in some way by a reduction of assistance. Whereas it's not worth the time of a person living in West Pennsylvania or Minnesota to even write a submission, let alone bang on the door of a congressman's office and say, "Look, I really want that extra 10 bucks a year, or whatever it is, that this policy change would mean for me."

MR FREWER: Sure.

MR COSGROVE: There's a bit of an inequality there, I think, in terms of the - I wouldn't say noise, but the views that are put in these types of policy discussions.

MR WOODS: Which reverts to an earlier answer we gave about the weight of numbers of submissions to this inquiry, as distinct from the weight of argument.

MR COSGROVE: Yes, indeed.

MR FREWER: Yes.

MR WOODS: The two are separate matters.

MR COSGROVE: We haven't had a submission, for example from the Australian Consumers Association.

MR FREWER: Right.

MR WOODS: On behalf of all those who have cheaper products.

MR COSGROVE: On behalf of consumers.

MR FREWER: Just in terms of that, you make the comment too there, on the top of page 33, that:

> Considering the methodology and response rate to the survey, little quantitative significance should be placed on the results.

Could you just sort of comment on - is that to do with the lack of weighting, as it were, of the submissions or what?

MR COSGROVE: That's part of it. We went through this with AIG earlier today - - -

MR WOODS: This responds to their survey, not to submissions to us.

MR COSGROVE: Yes, that's right.

MR FREWER: No, this is on page 33 of the draft report. You say:

> The commission considers that the methodology of and response rate to the survey -

I presume it was the survey - - -

MR WOODS: The AIG members survey.

MR FREWER: Is that what it was? Sorry.

MR WOODS: Yes. It's not a reflection on your submission to us. It's a reflection on the survey that AIG - - -

MR FREWER: Okay, I've misunderstood that, yes.

MR COSGROVE: They surveyed 2600 of their members and the response rate was about 20 per cent which already is a bit worrying. But there were a number of other detailed aspects of the way the survey had been conducted and the way the results had been reported.

MR FREWER: Right.

MR COSGROVE: Which tended to signify to us that it needed to be interpreted with a lot more care than it had been. If you wish you'll see, in the transcript from this morning, a fairly full discussion of all of that.

MR FREWER: Right, okay.

MR COSGROVE: But no, it's not a - - -

MR FREWER: Not a response to the survey that it puts to this report itself?

MR COSGROVE: No.

MR FREWER: Okay, that's fine.

MR COSGROVE: Anything else?

MR FREWER: No, I think that pretty well covers the comments that I wanted to make, other than what I'd already submitted earlier, which you have anyway.

MR WOODS: Yes, which, thank you, we - - -

MR COSGROVE: You're still in the ring.

MR FREWER: Okay.

MR COSGROVE: Thanks for those additional remarks, Greg.

MR FREWER: Do you want me to do something with this?

MR COSGROVE: If you complete that form and pass it on to Claudia, yes, that would be good.

MR FREWER: I've done that.

MR COSGROVE: For our records, thank you. I think there being no further participants that concludes our public hearings on this draft report.

AT 1.51 PM THE INQUIRY WAS ADJOURNED ACCORDINGLY

INDEX