

**The Carpet Institute of Australia Limited**

**Submission to the Productivity Commission**

**Inquiry into the Post 2005 Assistance  
Arrangements for the Textile, Clothing  
and Footwear Industries**

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## **Executive Summary**

The Carpet Institute of Australia Limited (CIAL) welcomes the opportunity to present this submission to the Productivity Commission's inquiry into post-2005 assistance arrangements for Australia's Textile, Clothing and Footwear (TCF) manufacturing sector.

The carpet industry is a significant segment of the broader TCF sector, with an annual manufacturing turnover of around \$750 million and workforce of 3,300 people, predominantly in regional locations. The Industry also creates demand for other suppliers and service providers to the sector, including transport and distribution, engineering and testing services, conservatively estimated to contribute to the employment of a further 8,000 people.

The CIAL is the peak industry organization representing the carpet industry in Australia. CIAL membership comprises carpet and carpet tile manufacturers, manufacturers of intermediate products such as yarn, synthetic latex, adhesives, and manufacturers of associated products such as carpet underlay. Associate members of the CIAL include companies that supply goods and services to manufacturers and to the broader carpet industry.

CIAL company participation covers the whole supply chain, from yarn spinning/extrusion through manufacturing, retailing and cleaning. CIAL members constitute around 95 per cent of total carpet activity in Australia.

This submission addresses the Commission's Terms of Reference to the extent that they are relevant to the Australian carpet industry. In particular, the CIAL submission outlines the very significant contribution the carpet industry makes to the Australian economy. The submission also discusses the effectiveness of the existing policy arrangements and the rationale for, and nature of, future policy measures needed to secure the industry's future.

A positive response by the Government to the industry's recommendations would result in further strategic investment as the industry strives to reposition itself, continually improving its international competitiveness in a volatile and uncertain world trade environment. The industry's vision is for an innovative industry with a sustainable presence in the global carpet market.

### **The Australian Carpet Industry**

The Australian carpet manufacturing industry is a capital-intensive manufacturing sector producing around 50 million square metres of carpet in a typical year. Traditionally the carpet industry has focussed on supplying the local market, which is relatively small and open to import competition. Since the early 1990's the industry has made a concerted effort to pursue growth through exports and has made good progress. It now exports around 10 per cent of overall output, worth around \$75 million last year.

The industry has worked hard to create a distinctive and sustainable niche in the global export market, which is based on the supply of wool products for high-end commercial and residential installations. It has achieved this through its competencies in design, production and manufacturing flexibility.

The industry has undertaken significant structural change over the last five years, investing heavily in new plant and equipment. CIAL members have invested approximately \$150 million since 1997. A major focus of this investment has been in yarn spinning and extrusion facilities to create self-reliance in carpet yarn and to gain greater control over product and process innovation.

The carpet industry is an integral part of Australia's industrial infrastructure and an important driver of local economies. The industry has a long value chain in Australia that extends from raw fibre and polymer creation, through yarn spinning/extrusion, carpet weaving and tufting and to point-of-sale.

The industry is also an important regional player with major factories in Geelong, Benalla, Castlemaine, Bendigo, Devonport, and the industrial regions of Southern Queensland. Other major plants are located in Tottenham, Braybrook and Dandenong.

Direct employment by the carpet industry has increased by 14 per cent since 1997.

The carpet industry is making in-roads into developing a position in the global industry. It is doing this by addressing competitiveness issues at home and exporting high value-added products. It is an industry that has strong prospects for the future. However, there is still a long distance to travel over the coming decade. The industry will strive to maximise opportunities, but these efforts can be significantly aided with the support of positive policy from Governments.

### **The Global Environment**

The major international trends in the industry include consolidation of manufacturers into fewer but larger groups, greater vertical integration of yarn and carpet manufacturing, retail consolidation, and the potential emergence of Asia as a player in the world carpet market. Each of these influences is reflected in the Australian carpet industry.

As it the case with other mature capital-intensive industries, globalisation is making its mark on the carpet industry. Responding to changing world investment and trading patterns is a significant challenge for the Australian industry.

The industry has made positive steps to respond to the changing environment. Globalisation has created opportunities for the Australian industry to tap into world trade and investment flows and manufacturers are seeking to further penetrate the Northern Hemisphere residential carpet markets for wool and wool rich products. The commercial carpet market in Asia also presents significant opportunities for high value products.

However, global reordering has resulted in new capacity being established in emerging economies such as Malaysia, India and more recently in China. These and other Asian countries enjoy certain ‘advantages’ over Australia as a manufacturing location: under-regulated labour conditions, weaker environmental standards (textile and yarn production are large users of water resources), a protected home market, discrimination against imports, and the provision of incentives and supportive policies to local companies to establish value-adding operations.

### **Effectiveness of Existing Assistance Arrangements**

The tariff pause and TCF Strategic Investment Program (SIP) have been effective in promoting structural change in the carpet sector. However, there is still a long way to go.

Maintaining tariffs at 2000 levels (15 per cent for carpets) has provided a period of stability for the industry and given companies the opportunity to re-orient their operations. The introduction of SIP has also been crucial. The Program has provided encouragement to companies to implement much-needed capital investment programs and to restructure.

For example, many mills have pursued vertical integration strategies with the acquisition of major yarn making facilities and equipment – ie, wool yarn spinning capacity, man-made fibre extrusion and yarn texturing plants. As well as reducing costs, this strategy has enabled manufacturers to move closer to self-sufficiency in carpet yarn systems. It has also allowed manufacturers to capture more of the value chain in their businesses; it has improved manufacturing flexibility and given manufacturers much greater control over product and process innovation.

There is no doubt that SIP and the tariff pause have helped to strengthen the Australian carpet industry’s position domestically and externally, and have moved the industry towards international competitiveness.

### **Future Industry Directions**

Over the past decade, the Australian carpet industry has shown that it can respond positively to changing and challenging circumstances. Over the last five years the industry consolidated its export performance, invested heavily, increased employment and importantly, is now recognized as a reliable supplier of quality products to world markets. The industry’s focus moving forward will be to develop new markets and build on this performance. This will require an ongoing commitment to quality and the development of innovative products, supported with exceptional levels of service.

However, a strong domestic base is vital to sustain export development. Accordingly, the domestic policy environment will be a critical factor in the ongoing development of the industry.

## **Post 2005 Policy Arrangements**

Given the nature of industry investments, a long-term planning perspective is critical to the industry.

Under current policy arrangements the outlook is little more than two years ie to 2005. The industry understands that the reason for the current review is to provide greater certainty and predictability regarding the policy environment. However, the industry contends that a 10-year planning horizon should be adopted.

## **Tariffs**

Significant progress has already been made in opening the Australian market to increased competition with the tariff falling steadily since 1990 from 39.5 per cent to the pause rate of 15%. The Australian tariff on carpets is broadly in line with rates applying in Canada and Europe, and significantly below the rates applying in the Asia/Pacific region.

The carpet industry acknowledges the legislated tariff reduction of 33 per cent from 1 January 2005 across all TCF products. However, it also needs to be recognised that current policy has placed the Australian carpet industry in a position of disadvantage compared to other interior textiles. For example, tariffs on bed linen and towels (currently 25 per cent) will phase to 17.5 per cent in January 2005. The CIAL contends that carpet should not be subject to any further tariff cuts until other interior textile tariffs ultimately phase down to the same level as carpet tariffs.

It is also our view that to reduce tariffs further in the absence of a clear movement to lower tariffs in major markets (and other non-tariff barriers) would severely undermine investor confidence in the Australian carpet industry.

### **CIAL POSITION:**

**CIAL submits that the carpet tariff should be held at the 2005 levels for a period of at least 5 years, and any further reductions should be the subject of an Industry Tariff Review.**

## **TCF Strategic Investment Program (SIP)**

SIP has been vital in securing support for continued investment in the latest technologies in plant and equipment, and fostering innovation in new products and processes.

It is essential that this support be maintained beyond 2005 if the industry is to build on the gains made and strengthen its international position.

**CIAL POSITION:**

**CIAL submits that SIP should be extended for a further 10 years beyond the end of 2005.**

**In addition, the CIAL believes modifications need to be made to improve the effectiveness of the Scheme. In particular, consideration should be given to:**

- **Increasing Type 1 grant payments as a proportion of eligible expenditure from 20% to at least 30%**
- **Including repairs and maintenance in the value added calculation for Type 1 payments**
- **Developing guidelines for demand driven activities such as expenditure related to offshore warehousing and distribution facilities for Australian-made products.**

**Market Access**

Improved market access for Australian carpet exports remains a key priority for the industry. The export share of Australia's total carpet production has almost doubled in the past five years, with exports now worth around \$75 million a year. However, the cost of developing new export markets is significant.

Increased market access to countries in the Asia-Pacific region offers significant prospects for the industry, particularly in the area of wool carpets. It needs to be recognized that overseas trade barriers in these countries can act as a disincentive to renewed investment, especially given the mature nature of the Australian domestic market.

**CIAL POSITION:**

**CIAL supports efforts by the Australian Government to identify and progress potential bilateral free trade agreements with a number of countries. The development of these agreements will raise a number of issues of relevance to the carpet industry and it is important that a close dialogue is maintained between Government and industry on these issues (especially with the US/Australia negotiations).**

**CIAL also welcomes the new Doha Round of multilateral trade negotiations. It is vital that this Round achieve real and meaningful trade liberalisation in the markets of our major trading partners.**

## **Regional Issues**

The carpet industry makes a significant contribution to various regional economies in Australia through the direct provision of employment and the flow through effect of demand for products and services within those regional economies.

However, the cost imposts imposed on production facilities in regional areas are generally greater than similar activities in metropolitan areas. This imbalance should be recognized and addressed. Otherwise, further mill closures are likely to occur in the regions with displacement of employees who cannot be readily absorbed in other local jobs.

**CIAL POSITION:**

**CIAL contends that special consideration needs to be given to address the unique circumstances of regionally based employers.**

## **Employment Disincentives**

Pay Roll Tax and worker compensation premiums continue to be a major concern for the industry acting as a disincentive on employment and increasing the cost of doing business in Australia.

**CIAL POSITION:**

**CIAL urges Governments to review and overhaul their policies in relation to these issues.**

## **Industrial Relations**

The ability to tailor work practices to support flexible manufacturing systems is crucial to the competitiveness and viability of the Australian carpet industry. With respect to the critical area of workplace flexibility there is still a considerable way to go in ensuring that Australian workplace practices are internationally competitive.

The industry will continue to pursue improvements in these areas, to improve workplace practices and introduce greater flexibility.

**CIAL POSITION:**

**CIAL supports the thrust of the Australian Industry Group recommendations on workplace reform in its Submission to the Productivity Commission on this Inquiry.**



## **Section 1 Introduction**

### **1.1 Foreword**

The Australian carpet industry has continued to change substantially over the past decade in response to the various challenges and opportunities it has faced over this period. Since 1997 in particular, the industry has undergone further restructuring at both the industry and enterprise levels. In 2003 we are seeing the emergence of a progressive, technologically advanced and innovative industry, capable of competing with the best in world markets.

The tariff pause and positive assistance measures are providing the right stimulus for the carpet industry to continue to invest, innovate (through technologically advanced manufacturing processes and creative product development) and enhance its international competitiveness. The industry is a quality employer, it adds value to natural resources and creates wealth, it earns foreign exchange through the export of sophisticated products, and is an important player in Australia's regions.

How this performance is built on will, to a significant extent, be shaped by the policies that Government puts in place beyond 2005.

The broad areas of policy concern that are highlighted in this submission include, access restrictions in overseas markets, employment constraints and, of course, tariff and industry policy settings. The submission provides recommendations to Government on the responses required in each area.

### **1.2 The CIAL and Companies Party to this Submission**

The Carpet Institute of Australia (CIAL) is a national industry association representing the collective interests of the Australian carpet industry.

Members of the CIAL include carpet manufacturers, manufacturers of intermediate products such as yarn, synthetic latex and manufacturers of associated products such as carpet underlay. Associate members of the CIAL include companies that supply goods and services to manufacturers and to the broader carpet industry. Membership covers the whole supply chain, from yarn spinning/extrusion through manufacturing, retailing, and cleaning.

There are some 45 Members of the CIAL and these account for 95 per cent of total industry output. A list of CIAL members is at Appendix A.

## **Section 2 The Australian Carpet Industry**

### **2.1 Key Features**

The key points on the carpet industry in Australia are:

- Carpet manufacturing is a capital-intensive activity. Annual turnover is approximately \$750 million.
- The carpet manufacturing industry is becoming highly concentrated with the two major manufacturers Feltex Australia and Godfrey Hirst accounting for almost 70 per cent of industry output. A further 10 medium sized manufacturers account for the remaining 30 per cent.
- The industry is a major producer of carpet yarn, the primary ingredient of carpet. Yarn manufacturing is a high value adding activity, produced in the vertical operations of seven large/medium carpet manufacturers.
- The carpet industry has extensive upstream and downstream linkages in the economy:
  - All the coarse wool grown in Australia is processed by the carpet industry
  - 13,050 tonnes of scoured wool was converted to carpet yarn in 2001/02.
  - The carpet industry is a major consumer of polymer chip - around 12,000 tonnes of nylon and polypropylene polymer was extruded and processed into carpet yarn in 2001/02.
  - The carpet industry is a major consumer of other locally made intermediate products including, adhesives, synthetic latex, specialty chemicals, and dyestuffs.
  - An infrastructure of professional service companies has built up around the carpet manufacturing industry, including specialist engineering companies, technical services and testing laboratories.
- 3,300 people are employed in the carpet and carpet yarn manufacturing industries in Australia. According to ABS figures, employment in the industry has increased by 14 per cent since 1996/97.

### **2.2 Industry Restructuring**

There have been major changes in the industry as a result of restructuring, and vertical integration.

There is also a much stronger inter-dependency with the New Zealand carpet industry. The most pronounced impact has been the acquisition of former US owned Shaw Industries Australia by Feltex of New Zealand (now operating as Feltex New Zealand). In addition, all Australia's wool carpet manufacturers are sourcing some of their fibre and yarn requirements from New Zealand trade spinners.

Other recent and significant restructuring is evidenced by:

- Queensland-based Beaulieu Australia acquired Vogue Carpets Mills and will be rationalising the combined operations at a single site at Yatala in Southern Queensland later this year. At the same time Beaulieu has invested heavily in new synthetic yarn extrusion facilities to service its own yarn needs.
- Godfrey Hirst acquiring the DuPont extrusion plant in Bayswater Victoria. This acquisition and further significant investment has allowed Godfrey Hirst to become a fully vertical operation adding to Riverside Textiles, the company's texturizing plant in Geelong.
- Victoria Carpet Company has expanded its spinning mill at Castlemaine and also acquired Pacific Textiles at Bendigo (formerly an independent wool yarn spinner).
- There has also been rationalisation in the intermediate sector most notably the closure of Albany Spinning Mills (in Albany, Western Australia) and also the closure of Amoco Australia's carpet backing plant (Liverpool, New South Wales).

The changes described above are consequences of company repositioning to address changing trading conditions and global market developments.

### **2.3 Other Intermediate Goods Manufactures**

Apart from carpet yarn and backing materials, the carpet manufacturing industry is a major consumer of adhesives and synthetic latex and specialty chemicals and dyestuffs. Synthetic carpet latex is manufactured locally by BASF, Dow Australia and RLA Polymers.

The carpet industry is also a major consumer of dyestuffs and specialty chemicals. Most of these products are imported although secondary processing is carried out in Australia.

### **2.3 Regional Significance**

The carpet industry is a major participant in regional areas with the main concentrations in Geelong, Benalla, Bendigo, Castlemaine (in Victoria) Picton (NSW) and Devonport (Tasmania).

In Geelong around 1,200 people are employed by the industry alone. The carpet industry is the 2<sup>nd</sup> largest manufacturing employer in Geelong and Godfrey Hirst is the 2<sup>nd</sup> largest employer after the Ford Motor Company. Similarly, the Victoria Carpets' spinning mill in Castlemaine is the 3<sup>rd</sup> largest employer in the region. The company also operates a large carpet yarn mill in Bendigo.

Within the Melbourne metropolitan area, the industry is also very localised. For example, the industry employs around 1,200 people in the TCF dependent areas of Dandenong and Tottenham/Braybrook.

## **Section 3 Market and Industry Features**

### **3.1 Key Features**

The carpet market in Australia is a mature product market, experiencing slow growth. Since 1990/91, the total Australian carpet market grew, in volume terms, by less than one per annum. Total market supplies for the year ended June 2002 was 49 million square metres. At point of sale, this translates to around \$1.5 billion in sales.

The Australian domestic market has experienced low rates of growth for well over a decade. At the same time, the carpet import share of total market supplies has doubled and exports have also increased strongly.

For the year ended June 2002, imports of machine-manufactured carpet totalled 9.6 million square metres valued at \$122 million. In market share terms, imports have risen from 11 per cent of the market in 1991 to 20 per cent of the market in 2002.

In addition to imports of machine manufactured carpet (on which tariffs apply) a further 3.6 million square metres of handmade carpet and rugs were imported. These products, used in conjunction with resilient products, compete with locally manufactured broadloom carpet. Inclusion of duty free rugs increases the import share of TMS to 27 per cent.

In relation to exports, the carpet industry's strong performance has been a function of the challenges facing the industry, a favourable exchange rate and the stimuli provided by Government policy measures, particularly the highly successful Import Credits Scheme (ICS), which operated from 1991 to 2000.

Significantly the carpet industry continued to record strong export growth beyond 2000 despite falling world demand for textile products. In 2001/02 carpet exports totalled 4 million square metres or 9 per cent of total industry production (up from 5 per cent in 1996/97). In value terms, carpet exports in 2002 were worth approximately \$75 million, up from \$57 million.

SIP has been an outstanding success for the carpet industry. It has accelerated investment in new capital equipment and provided further stimulus for industry restructuring, capital investment and innovative development.

## **Section 4 International Context**

### **4.1 Key Features**

Australia is the eight largest carpet producer in the world but in reality accounts for a fraction of global production. The USA and Belgium are the dominant global suppliers of carpet.

In 2001 the US industry produced around 2 billion square metres of tufted carpet compared to around 45 million square metres of tufted carpet produced in Australia that year. The next largest carpet manufacturing country is Belgium whose industry is around 6 times the size of the Australian industry in terms of square metres produced. Beyond Belgium the carpet industry has a major presence in most advanced western economies, particularly those in Western Europe. Other major producers include the UK, Japan, France, Canada, Germany and the Netherlands.

In recent years significant start up investment has been injected into carpet mills in China. If this continues then China could potentially emerge as a player in the global carpet industry in the future.

Overseas firms have always been involved in the Australian industry. However, the share of industry output in foreign control increased significantly after the major changes in industry structure in 1993. Currently more than half Australia's carpet industry capacity is foreign owned.

While foreign firms tend to focus on the local market, inter-country trade with the company group and global product sourcing and supply is increasing.

### **4.2 Globalization**

The major international trends in the industry, all mirrored in Australia, are:

- consolidation of manufacturers into fewer but larger groups;
- greater vertical integration of yarn and carpet manufacturing;
- increased use of low cost polypropylene yarn systems;
- retail consolidation;
- manufacturers taking strategic positions in retail and commercial distribution

The Australian industry has taken significant and positive steps toward creating a sustainable role in the global industry.

The industry also recognises that there are significant opportunities to tap into world trade and investment flows. The Australian carpet industry has already demonstrated that it has the ability to further penetrate the Northern Hemisphere carpet markets for wool and wool rich products. Similarly there are opportunities in Asia where demand for commercial carpet is growing with economic development and the growth of the tourism and hospitality industries in the region.

The Australian industry has consciously taken the decision to differentiate itself from its major world competitors, by moving into higher value, higher priced product. However trade access issues still create problems in target markets, particularly in Asia.

Significant capacity is being installed in emerging economies such as Malaysia, India, and China. These countries enjoy certain 'advantages' over Australia as a manufacturing location: under-regulated labour conditions, weaker environmental standards (textile and yarn production are large users of water resources), a protected home market, discrimination against imports, and the provision of incentives and supportive policies to manufacturers to establish value-adding operations and employment. The highly 'managed' trade in carpets will continue for some time, yet this is the very environment in which the Australian industry needs to operate and forge a sustainable presence.

### **4.3 Scale and Scope Issues**

#### **4.3.1 Production Runs**

The small domestic market creates scale disadvantages for Australian manufacturers. In addition, the market is diverse in terms of consumer taste and fibre preference, and this further constrains production run size.

In Australia, a high volume product for the residential market would run at around 20,000 square metres per month by the major manufacturers. The same type of product at a US carpet mill would run at around 440,000 square metres per month. The difference in production run size gives the US producer a significant cost advantage over the Australian manufacturer.

The US volumes obviously provide the scale-based benchmarks for World Best Practice (WBP). Australian carpet manufacturers believe they have the technical capacity and skills to match WBP unit costs but they cannot do this without a higher level of throughput.

Since 1991, exports and rationalisation activity have improved the run sizes of some Australian products. However, at best, exports might add 15-20 per cent to standard range products and this is still well out of range of the run size that can be achieved internationally. In addition, the high volume synthetic lines produced in Australia are generally not suitable for the international market because they would compete against the same products supplied by overseas manufacturers.

Exports are an important source of additional volume for manufacturers but are generally less profitable than sales to the domestic market given the costs associated with export, and the inherent difficulty in penetrating overseas markets. As the industry builds its reputation in world markets, establishes a presence and gets its marketing mix right, companies are commanding better prices with export programs becoming more profitable.

#### **4.3.2 Plant Scale**

Australia's two largest manufacturers, Feltex Australia and Godfrey Hirst, rank within the top 40 manufacturers around the world by total company turnover. However, their scale advantage is considerably less than their overall size and turnover might suggest.

The Australian market is a diverse product market with consumer demand for many product styles, price points and carpet constructions. Unlike the US market, which is almost entirely synthetic and heavily oriented to cut pile products, the Australian market has the added dimension of wool and wool blends and loop pile and texture constructions. Because of this added diversity Australian manufacturers produce a larger range of stock items compared to overseas plants of similar size. For example, the two major mills produce around 100 product lines each for the residential and commercial markets, some of which are manufactured in relatively small quantities. A similar sized plant to a Feltex Australia/Godfrey Hirst operation in the US would produce probably less than 15 per cent this number of products.



## **Section 5 Performance of the Australian Carpet Industry**

### **5.1 Performance and Competitiveness Measures**

#### **5.1.1 Productivity**

Labour productivity is an important issue for the industry, particularly in yarn spinning operations, the labour intensive side of the industry. As an example, Australian companies with Trans-Tasman investments now view New Zealand as the preferred location to base yarn production due to lesser costs of production and more flexible labour arrangements.

However, there have been significant productivity gains at the broad industry level since 1997, with sales revenue per carpet manufacturing employee increasing by some 20% over the period. This is on the back of strong growth in overall employment since 1997 (up 14% since 1997).

#### **5.1.2 Investment and Technology**

Since 1997 the industry has invested over \$150 million in new plant and equipment and recurrent investment expenditure – a significant statement about the industry's medium term future in Australia. In fact, the carpet industry has clearly led the TCFL sector on this measure since 1997.

To facilitate export growth and import replacement, the industry has invested in new fibre extrusion and yarn spinning capacity, warehouse and distribution facilities, carpet making equipment, and product and process innovation.

The level of technology employed by the leading tufted and woven carpet manufacturers is directly comparable to the technology employed by leading overseas carpet manufacturing firms.

#### **5.1.3 Export performance**

Industry exports have continued to grow since the 1997 Government review and now represent almost 10 per cent of industry output. In volume terms, exports have increased from 2.8 to 3.9 million square metres over the same period.

It is also worth noting the strong growth in average export values, up 30% over the past five years. The increase reflects the move into premium markets where products carry higher levels of design and innovation.

#### **5.1.4 Comparative Product Pricing**

The price of carpets to the Australian consumer has fallen considerably in real terms and the cost today of carpeting an average home is about the same in nominal dollars as it was 20 years ago.

Strong domestic competition between manufacturers, competition at retail, product development and technical change, improved productivity and strong competition from other flooring products have all had an impact on pricing.

### **5.2 Competitiveness Reforms**

#### **5.2.1 Taxation Reform**

The Howard Government's reforms to personal and company tax were welcomed by the carpet industry. However, state payroll tax remains a sensitive issue as it represents a significant cash impost on the operations of medium/larger manufacturers. With the national tax reforms now bedded down and working well, a concerted effort at the government-to-government level is required to remove state payroll tax.

#### **5.2.2 Workplace Reform**

The industrial relations environment in the carpet industry is generally stable although there have been a number of major disputes at some work places. These disputes have generally related to industry wide issues where prominent carpet manufacturers have been targeted for strategic reasons.

Most large to medium sized firms in the industry have had Enterprise Agreements in place for some time. The Enterprise Bargaining processes have contributed to some improvement in labour utilisation. However, manufacturers believe that the productivity gains achieved have been relatively small and the scope for further gains is practically non-existent due to the rigid nature of the bargaining process. Pattern bargaining is also emerging as a significant problem.

The Australian Industry Group (AiG), the main industrial organisation representing industrial relations issues for the TCF sector, will make specific recommendations on IR matters in a separate submission.

#### **5.2.3 Training**

Institutional support for industry training at the operator level is weak to non-existent. However, a large amount of training is conducted by the industry but it is internal to firms. Carpet manufacturers use sophisticated capital equipment in most operational areas so training occurs by necessity.

More generally, the industry believes that the national training agenda and reforms have added complexity to an issue that should be relatively straightforward. The perception in the industry is that Government intervention in industry training and reform policies have failed the needs of firms. Any improvement in the delivery, quantity and quality of training has had more to do with the efforts of firms than support provided through the training infrastructure.

### **5.3 Infrastructure Reform**

There is a strong perception in the carpet industry that the micro-economic reform program has failed to deliver a significant improvement in the cost structures facing the carpet industry.

Without question there have been improvements in some business costs facing carpet manufacturers, but the view of the industry is that the major and critical areas of reform have either failed to deliver competitiveness enhancing returns to firms or critical reform areas have not been adequately addressed. Key concerns have not changed since the 1997 inquiry. These are the payroll tax, workers compensation premiums, and air and sea freight charges.

## Section 6 Impact of Trade and Industry Policy

### 6.1 Tariffs and Imports

As can be seen from the following graph, Australia's carpet tariffs have been reduced dramatically over the last decade. At the same time, imports have increased at an inversely proportional rate. The General Rate of Tariff for carpets is currently 15 per cent and the scheduled 2005 rate is 10 per cent.

**CHART 6.1 - Tariffs and Imports**



If the import growth to date is extrapolated through to 2005, the consequential displacement of local production would be significant. In the absence of significant growth in the domestic market and/or a surge in exports, the projected level of imports will increase adjustment pressures in the industry and prompt further rationalisation activity.

### 6.2 Import Sources

New Zealand is the largest overseas supplier of carpet to the Australian market. However, New Zealand's position in the Australian market has declined sharply relative to other sources of supply. Since 1991 the NZ share of the import sector has fallen from 61 per cent of total imports to 27 per cent of total imports.

The US and Belgium, the largest centres of world carpet production, have traditionally represented the likely growth countries for carpet imports into Australia. Together they still account for the major share of imports. However, strong growth in Chinese imports

is potentially a precursor to China's share of the market increasing over time, as it has done in other TCF product lines around the world.

### **6.3 Export Strategies and Constraints**

#### **6.3.1 Strategies**

There are significant opportunities in export markets but there are also limitations that need to be understood.

The direction of company export programs has increasingly been the supply of high value-added wool and wool rich carpets to the contract and mid-to-high end residential markets.

Strategic exporters in the industry are targeting two types of market:

- the rapidly growing commercial building developments in Asia (China, Japan, South Korea, and Singapore) where contract wool/wool rich carpets are marketable and in demand; and
- mature and more affluent residential markets (such as North America) where wool and wool rich products have opportunities in the high-end residential sales area. For example, the natural fibre share of the total American market is around 1 per cent of the market compared to 30 per cent in Australia, but relative to the size, the volume is large. The US, Canadian and UK residential markets are regarded as good opportunities for Australian manufacturers.

#### **6.3.2 Constraints**

The return from export sales is lower than domestic sales and it is difficult to compete with other overseas suppliers in many of these markets. The products also carry much higher distribution and infrastructure costs.

The lead times involved in exporting carpet are long and the costs are substantial, arguably greater than many other TCF exports. Being an opportunistic exporter (selling the odd container of carpet) is very different to taking a strategic position on export development. The latter requires large investments in distribution, warehousing and after market infrastructure in the destination markets. Market presence and branding also take time to establish.

It is generally recognised that the vertically integrated manufacturers have the greatest opportunity to develop successful ongoing export programs. In wool and wool rich products, they have a cost and product advantage and vertically integrated manufacture provides much greater flexibility for yarn and product development.

## **6.4 Market Access**

Tariffs and non-tariff barriers (NTBs) continue to hinder Australian access into overseas markets. Often it is the NTBs that create the greatest obstacle, but these are not always readily apparent. Indeed exporters are generally unaware of the full extent of such barriers, they just know that certain markets are relatively impenetrable.

The Market Access Industry Participation Program (MAIPP) report lists those NTBs that are more readily identifiable

## **6.5 Effectiveness of Existing Arrangements**

The tariff pause and SIP have been very effective in promoting the necessary change at the industry and enterprise levels over the last few years.

Maintaining tariffs at current levels (15 per cent for carpets) has been very important. It has provided a period of stability for the industry by providing time for companies to restructure without excessive disruption to their domestic sales base.

Of more significance has been the introduction of the TCF Strategic Investment Program (SIP). Support for capital investment in particular (ie, the Type 1 Grants) has encouraged companies to implement ambitious new capital investment programs to restructure their operations.

The medium to large mills have invested heavily in vertical integration (back to the yarn stage), with the acquisition of major facilities and equipment for wool spinning, man made fibre extrusion and yarn texturing.

Their broad objective has been to become self sufficient in the yarn systems used to make carpet – wool, nylon and polypropylene – and establish greater control over product development.

Vertical integration has also reduced production costs, and internalised more value in the supply chain giving firms greater flexibility to position their products in export markets.

These changes would not have eventuated to the same extent if it had not been for the support provided through SIP.

Given the capital-intensive nature of the carpet industry (considerably more than most other parts of TCFL), the SIP Type 1 Grants (and matching Type 3 Grants) have been accessed more than the Type 2 Grants relating to R&D, innovation, etc. However, as the scheme has evolved, and as individual capital programs are being bedded down, the industry is becoming more focussed on the R&D and innovation streams of the scheme. Carpet manufacturers have compatible objectives with the Type 2 component of the scheme and this will drive further product development and process innovation over the remaining years of the current scheme.

CIAL members also saw significant potential in the TCF Technology Development Fund and Market Development Program as mechanisms to drive key initiatives at the industry level. In fact, CIAL had developed major proposals for the industry under these two programs. Unfortunately both programs were prematurely terminated in the 2002 Federal Budget.

## **Section 7 Future Trade and Industry Policy Requirements**

### **7.1 A Changing World**

Like all major tradeable goods sectors, the global trading environment for carpets is ever changing. But in the international textile industry, change can occur rapidly and unpredictably due to the high degree of Government intervention. In fact, patterns of trade, investment and production in different regions will change considerably after 2005 when quantitative restraints imposed by the US, Europe and Canada under the Agreement on Textiles and Clothing (ATC) are finally removed. Whether these countries then impose other restraints under the guise of 'safeguards' remains to be seen but it is highly likely that all countries will pursue strategies to protect their industry's position in the world textile market. In our view, there will continue to be significant intervention and disruption in the world textile market for at least another decade.

While carpet products are not directly subject to ATC type restraints, the carpet sector will not be immune to these influences. For example, until recently the bulk of world carpet manufacture was centred in Western Europe and the United States. But as countries/industries start to reposition themselves in anticipation of the post 2005 environment, investment in carpet manufacturing is occurring in China (eg, China is now the third largest source of imports into Australia – see earlier discussion

From 2005 China will be one of the main sources of import competition in carpets, just as it is in practically every other TCF product category. Accordingly, the same pressures that have confronted other parts of the Australian TCF industries over the last two decades will face the carpet industry in the years ahead.

This threat means Australian manufacturers will need to work hard to differentiate products from mass-produced Chinese carpets. The industry has already made significant efforts to reposition at the higher value end of product markets, but this process has only really just begun.

To ensure the Australian industry can meet the challenges created by global industry developments requires a close partnership between Government and the Australian industry.

The Government can best address this situation through the retention of an integrated set of Industry development measures over the decade from 2005 to 2015.

### **7.2 Tariffs**

#### **7.2.1 Tariffs on Carpet**

The Carpet industry has continued to invest and restructure so that it can position itself better for the scheduled reduction in the General Tariff in 2005.



However, it should be acknowledged that the Australian carpet industry has been placed in a position of disadvantage compared to other interior textiles. For example, the carpet industry has lower tariffs than other finished textile consumer products (eg, tariffs on bed linen and towels are currently 25 per cent phasing to 17 per cent in January 2005.) The CIAL contends that there should not be further cuts in the carpet tariff until other interior textile tariffs are in line with the carpet tariff.

At the same time, other countries have continued to maintain restrictive barriers to entry and this has limited the industry's capacity to expand into new markets. If other countries were to reduce their barriers it would open up significant export opportunities. However, the positioning statements by various countries at the start of the Doha Round of Multilateral trade Negotiations indicates that all countries will move very slowly in liberalising their trade arrangements. Australia must refrain from rushing ahead of the pack.

The CIAL believes that Australia should not be further reducing tariffs unilaterally, but should link in with what our major trading partners do in the context of the Doha Round. There is no reason for Australia to have lower tariffs than those prevailing around the world and we are already at the point where Australia has the most open market in the world for trade in TCF products.

To provide stability and certainty and support investor confidence, the carpet tariff should be kept at the 2005 level.

However, no further reduction in tariffs for any sector of TCF should occur beyond 2010 without clear evidence that the rest of the world is liberalising its trade barriers to the same extent as Australia. A further review, solely of tariff schedules, should be held for this purpose.

### **7.2.2 Tariffs on Intermediates**

To compete internationally, carpet manufacturers need access to raw materials and intermediates at world competitive prices. Of particular concern is the 3% CTCO system introduced by the new Federal Government in the mid 1990's. It provides no positive policy impact and merely serves to make Australian manufacturers less competitive with imports. It should be removed at the first available opportunity.

Value added carpet yarns should continue to be assisted by the 5 per cent tariff currently applying. Carpet yarn spinning and extrusion capacity is integral to the industry export effort. Industry capability in wool and spun yarn production is necessary to develop products for export markets and also to develop products with a point of difference for the Australian market.

Yarn production is a high value-added activity and a large employment area of the industry. It is also the most vulnerable to further changes in the industry. Synthetic

imports will increase as tariffs fall placing further pressure on the woollen spinning side of the industry.

### **7.3 Positive Assistance – The Strategic Investment Program**

Positive industry assistance is vital as the industry moves forward. The best way to provide this support is through the extension of SIP.

Industry needs certainty and predictability in the support arrangements provided and SIP is now well understood and generally working well. However, some fine-tuning will significantly improve SIP.

#### **7.3.1 Broad Principles**

It is important that the principle elements of SIP are retained in the second phase of the program. That is, support of local manufacturing industry should be the key access criterion. Participants must be manufacturing in Australia and funds must be channelled to those firms that have a viable future in Australia as a manufacturer.

The Scheme should continue to be used to drive change and facilitate desirable industry restructuring. The best way to do this is to support capital investment to enable companies to improve efficiency and productivity so they can compete on world markets and against increased import competition at home. Supporting capital investment and product innovation is consistent with the long-term objective of maintaining a manufacturing base in Australia.

#### **7.3.2 Operational Changes**

The CIAL recommends a number of other operational changes to the Scheme:

- A greater balance needs to be struck between the various aspects of the scheme, and consideration should be given to lifting the grant rate for CAPEX from 20% to at least 30%. This will encourage rapid uptake of new technologies.
- Eligible expenditure should also be extended to include demand driven expenditure in such areas as offshore warehousing and distribution facilities for Australian made products.
- The Scheme does not give sufficient encouragement to expand existing export markets or develop new markets. The market access/market development component of the scheme has not been effective due to the administrative interpretations applied.
- The value added definition (for Type 3 Grants) also needs to be refined as it tends to undervalue the contribution of capital to a company's activities. The cost of repairs

and maintenance should be regarded as part of a company's value added (this is a significant component of a capital intensive firm's operational commitment).

- The program should run for a full 10-year period from 2005.
- Annual funding should be no less than was announced under the current program. ie. \$140 million per year or \$1.4 billion over the 10 years to 2015.

#### **7.4 Export Policy**

Continued export development is critical to the future of the Australian carpet industry. Exporting carpet involves long lead times and substantial investment in destination markets.

If the market access component of the SIP scheme cannot be enhanced, the CIAL recommends the introduction of a program to replace the TCF Market Development Program (this program was prematurely terminated in the 2002 Federal Budget).

#### **7.5 Free Trade Agreements**

The CIAL notes that there are a series of Free Trade Agreements currently being considered/ negotiated around the world and that Australia is an active participant in these negotiations. While Governments tend to talk more about the potential benefits of FTAs, risks also need to be addressed.

Australia has a very small domestic market and the local industry has excess capacity to service this market. Any significant increase in imports arising from preferential market access through a FTA could seriously disrupt the local market and undermine the viability of the Australian industry.

However, export development is very important to the Australian carpet industry and equally, some spare capacity could be directed to production for export. The CIAL recognises that FTA's can afford our industry preferential access into other markets, usually of a much greater size than available locally.

The balance of benefits and risks will vary from market to market, and from product line to product line. So the implications of entering into an FTA with any country need to be carefully considered, with each case examined on its merits. It is not appropriate in the context of this review to generalise on the benefits or risk of any particular FTA.

However, it does raise the point that the value of an FTA is only realised if the participating countries are able to gain preferential access to the other's market. This will only occur if there are significant trade barriers in place prior to the FTA.

Given the Australian Government's renewed interest in pursuing bilateral agreements (in conjunction with the multilateral pursuits under the WTO and Doha) it can be argued that further tariff reductions should only arise as a result of negotiated outcomes with our trading partners and where there is clear reciprocity in trade liberalisation from those partners. Furthermore, it would be counterproductive to reduce Australia's TCF tariffs unilaterally as a result of this Review as this would eliminate our negotiating leverage in future trade talks.

## **7.6 Employment Disincentives**

Pay roll tax and workers compensation premiums continue to be a major concern to the industry, acting as an employment disincentive and increasing the cost of doing business in Australia. The CIAL recommends concerted action by Governments to review and overhaul their policies in relation to these issues.

## **Appendix A – CIAL Membership and Company Location**

### **CIAL Membership**

#### **Full Members**

BASF Australia Ltd  
Beaulieu of Australia  
Brintons  
Dow Chemicals  
Dunlop Flooring Australia  
Feltex Australia P/L  
Godfrey Hirst Australia  
Interface Australia  
Northstate Carpet Mills  
Ontera Modular Carpets  
Quest Carpet Manufacturers  
Tuftmaster Carpets  
Ulster Tascot  
Victoria Carpets

#### **Associate Members**

Alexander Watt & Co  
Australia Carpet Makers  
Australian Floor Style  
Australian Wool Testing Authority  
Bridgestone  
Carpet Court (Associated Furnishers)  
Cavalier Bremworth  
Chaparral Carpet Mills  
Clariant  
Cooper Technical Services  
CSIRO - Textile & Fibre Technology  
DuPont  
Floors & Alternatives  
Freudenberg Far Eastern Spunweb Co  
Grass Manufacturers  
H Polesy & Co  
Honeywell Polymers  
Host Dry Extraction Cleaning  
Karndean Australia  
Label Concepts  
Melded Fabrics  
Newfurn Floorcoverings  
NUCCA (affiliated member)  
Rhodia  
Spectrum Carpets  
Summit Wool Spinners  
Supertuft  
The Woolmark Company  
Webber's Carpet Warehouse  
Wimbledon Unreal Grass Courts  
Wools of New Zealand

## Company Location

COMPANY	CARPET MILL	YARN
<u>Carpet and carpet yarn manufacturing firms</u>		
Australian Carpet Makers	Heidelberg	Heidelberg
Beaulieu of Australia	Archerfield	Archerfield
Brintons	Geelong	(Christchurch, NZ)
Camlet Carpets	Dandenong	
Chaparral Carpet Mills	Seaford	
Edwardstown Carpets	Edwardstown	
Feltex Australia	Tottenham, Braybrook	Dandenong, Tottenham, Braybrook
Godfrey Hirst	Geelong	Geelong, Benalla, Bayswater
Interface Australia	Picton	
Northstate Carpet Mills	Gold Coast	
Ontera Modular	Northmead	
Quest Carpet Manufacturers	Dandenong	
Tuftmaster Carpets	Dandenong	Preston
Ulster Tascot	Devonport	Devonport
Victoria Carpets	Dandenong	Castlemaine & Bendigo
Westwools	Fremantle	
<u>Other intermediate-manufacturing firms</u>		
BASF (latex)	Altona	
Bridgestone (underlay)	Dandenong, Melbourne	
Dow (latex)	Altona, Melbourne	
Dunlop (underlay)	Sydney & Melbourne	
RLA Polymers (latex)	Dandenong	

(The above list is not exhaustive).