

# Submission to Australia-India Comprehensive Economic Cooperation Agreement

Australian Wool Innovation

July 2011

## OVERVIEW

Australian Wool Innovation (AWI) is the wool industry's R&D, marketing and industry services body. The goal of AWI is to help increase demand for Australian wool. It seeks to achieve this goal through the following key activities:

- Increasing information and knowledge through the targeted investment in on-farm and off-farm R&D to enhance the profitability, international competitiveness and sustainability of the Australian wool industry;
- Increasing demand and market access for Australian wool through targeted investments in marketing and promotion; and
- Providing a range of industry services to support the broader wool industry, to build human, leadership and technical capacity, and to ensure market access.

AWI's head office is in Sydney, with offices located in key markets including China, France, Germany, Hong Kong, India, Italy, Japan, South Korea, Spain, Taiwan, Turkey, the United Kingdom, and the United States.

AWI is one of the fifteen rural research and development corporations. In 2010-11, nearly 56,000 woolgrowers contributed levies to AWI in order to make investments on their behalf in research, development and marketing along the entire wool chain in the areas of wool production, textile product development, and marketing and industry affairs.

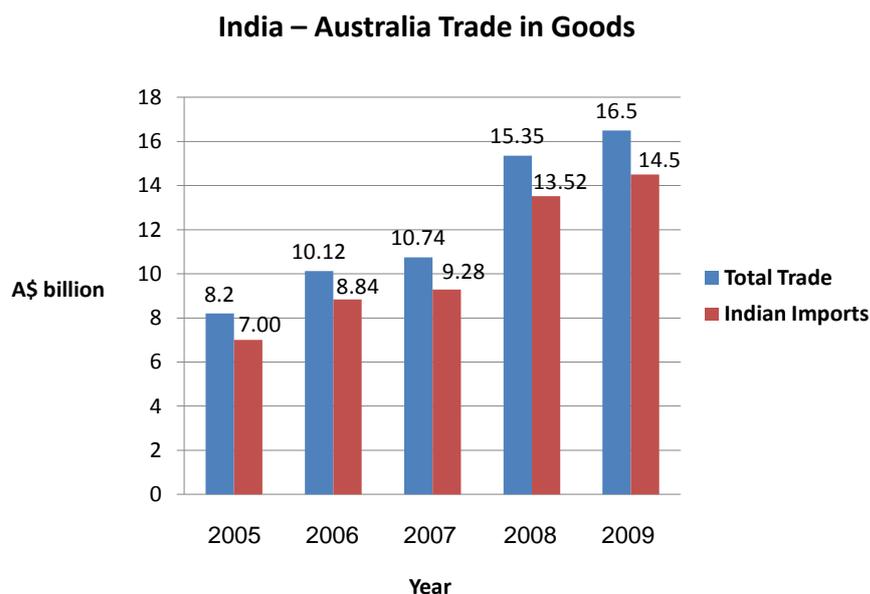
The Department of Foreign Affairs and Trade (DFAT) is seeking public submissions and comments on the merits of a Free Trade Agreement with India, including on any particular market access issues and/or other factors affecting two way trade and investment with India. The Joint Free Trade Agreement (FTA) Feasibility Study, July 2010, has concluded positively on the FTA. To quote from the Study, *"India and Australia produce highly competitive and largely complementary goods for export to international markets. While economic activity in each country has led to substantial growth in bilateral goods trade, tariffs and non-tariff barriers continue to raise the cost of imports, imposing implicit taxes on businesses and consumers alike"*.

AWI's case in support of an FTA with India is based on two key points:

- **The Australian wool industry's profile complements that of the Indian industry's need for apparel grade wool;**
- **Australian wool industry is seeking to diversify its risk by identifying alternative export and manufacturing destinations, reducing the dependence on China.**

## BACKGROUND

India is one of the fastest growing of all Australia's major markets with exports growing at an average annual rate of 25% during the five years to 2008-09. India was Australia's fourth largest export market of all goods in 2008-09. While agriculture constitutes only 2.9% of Australian GDP, agriculture accounts for 10.2% of Australia's exports. Wool export constitutes around 34% of the total agricultural exports to India, (Annexure1.A).



### India is an important market for the global wool industry

India is the second largest import market for wool in the world after China. The proportion of total world raw wool imports consumed by India remained constant, at around 10% of world total, between 2005-2009.<sup>1</sup> Indian imports of world raw wool were 89.9 Mkg, 77.1 MKg, and 59.6 MKg in 2005, 2008 and 2009 respectively.

This trend is despite the aggregate numbers for worldwide wool imports declining by 28.9% over the same period.

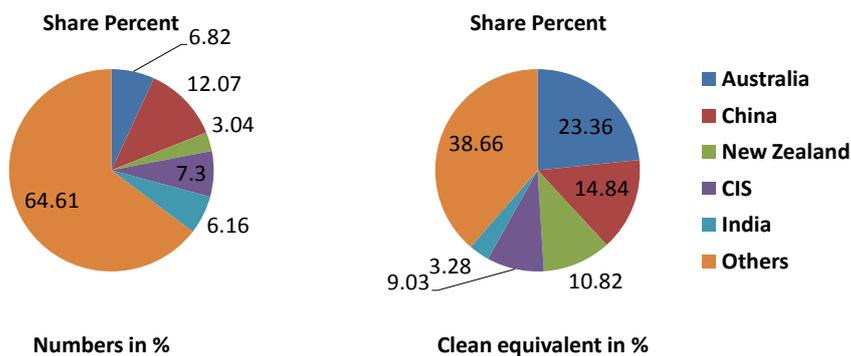
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<sup>1</sup> IWTO Market Information 2010, p27

## India is a major producer of wool

India has the fourth largest population of sheep in the world – an estimated 65 million head - with China, CIS and Australia leading respectively. India is the fifth largest wool producing country in the world producing around 36 million kg (clean equivalent) or 3% of the world's total production. Australia is the largest wool producing nation globally.<sup>2</sup>

### World sheep population & wool production 2009



### Industry outlook for India for raw wool consumption is very encouraging

Dun & Bradstreet (D&B) India report that in the next decade, Indian consumption of raw wool is estimated to double, from 114.2 Mkg in 2008-09 to 260.8 Mkg by 2019-20.

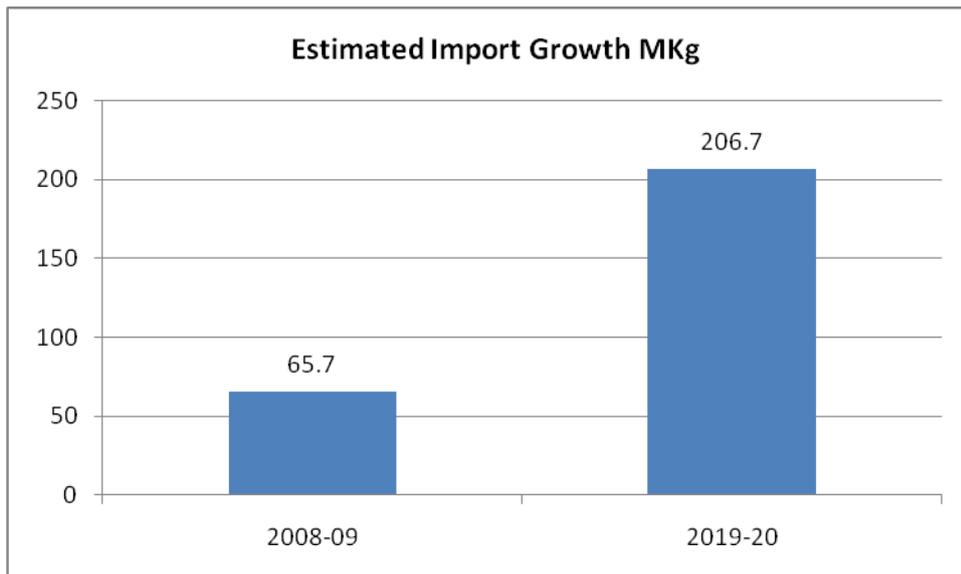
It expects exports of woollen products to continue their strong growth. During the period between 2009/10 to 2014/15 exports of woollen yarn, fabrics and made-ups (i.e. scarves and accessories) are expected to record a Compounded Annual Growth Rate (CAGR) of 11.6%, with this growth forecasted to continue during 2015/16 to 2019/20 by 13.9%.

D&B India also forecast this trend for the exports of readymade wool garments (i.e. clothing), projecting a CAGR of 19.1% during 2009/10 -2014/15. The growth momentum is expected to accelerate during the following five years, with exports projected to record CAGR of 21.5% during the period between 2015/16 and 2019/20.

D&B India estimates imports of raw wool to increase significantly going forward, from 65.7 Mkg in 2008-09, they are expected to increase to 206.7 Mkg by 2019-20.

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<sup>2</sup> Ibid. 1, p. 8



### **Importance of textiles industry to the Indian economy**

The Indian textile industry generates 4% of India's total GDP, 14% of total industrial production, 17% of India's total export earnings and provides direct employment to over 35 million people. The textiles industry is the second largest provider of employment after agriculture.<sup>3</sup> India's performance in key world textile export markets has been notable in recent times: in 2008, India was the fifth largest supplier of textiles and clothing.

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<sup>3</sup> Ministry of Textiles, Government of India, Annual Report 2010-11

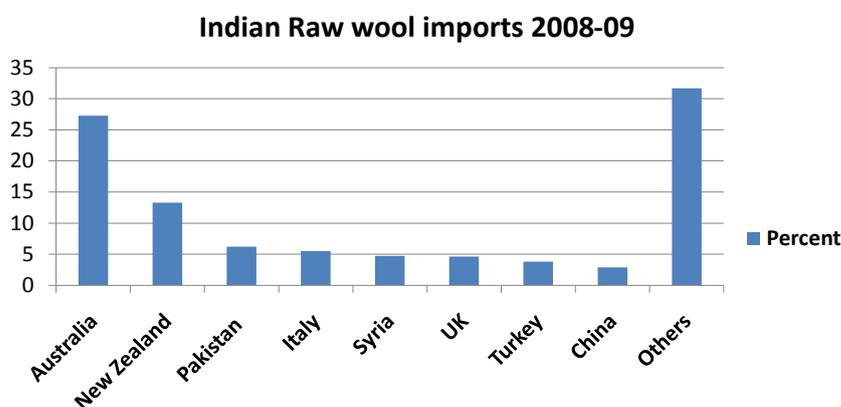
## AWI'S CASE IN SUPPORT FOR AN AUSTRALIAN-INDIAN COMPREHENSIVE ECONOMIC COOPERATION AGREEMENT

AWI's case in support of an Australian-Indian Comprehensive Economic Cooperation Agreement is based on two key arguments: the complementarity that exists between the two industries; the need for Australia to diversify its risk and reduce the reliance on China.

### COMPLEMENTARITY OF THE AUSTRALIAN AND INDIAN INDUSTRIES

#### Australia is an important supplier of wool to India

According to the Indian Directorate General of Commercial Intelligence and Statistics (DGCI&S), (Ministry of Commerce and Industry) in 2008-09 Australia was the largest supplier by volume of wool imported to; India (27.3%), New Zealand (13.3%), Pakistan (6.2%), Italy (5.5%), Syria (4.7%), UK (4.6%), Turkey (3.8%) and China (2.9%).<sup>4</sup> The volume imported to India from Australia represents 57% of the total value imported.<sup>5</sup> Further, the Joint FTA Feasibility Study states, "Australia's wool exports to India have also played an important role as an input to India's exports. India is Australia's third largest export market for wool with exports of US\$98 million in 2008-09 representing around 50% of India's wool imports. India uses Australian wool to make clothing and textiles exported around the world".



<sup>4</sup> Dun & Bradstreet India, Final Report – National Fibre Policy - Sub Group on Wool, December 2009, p. 16

<sup>5</sup> Ibid.4, Exhibit A38, p. 50

### **The India wool textile industry is focused on coarser quality wool**

The majority (85%) of the wool produced in India is of coarse quality used mainly in the manufacture of hand knotted carpets, 10% is of coarse grade used mainly for production of blankets, and only 5% is of apparel quality wool. According to the Indian Ministry of Textiles, *“Indigenous wool is mostly suitable only for carpet manufacturing and its production has remained stagnant at around 50-55 million kg., with no improvement in productivity and quality. In spite of continuous efforts, there has been no success in developing good quality apparel grade wool indigenously.”*<sup>6</sup>

Additionally, in its Annual Report for Woollen Textile Industry, 2010-2011, the Office of the Textile Commissioner states, *“The total wool production in India is not enough to meet the total requirement of raw wool for woollen industry. The bulk of Indian wool is of coarse quality and is used mostly in the hand-made carpet industry. Since indigenous production of fine quality wool required by the organized mills and decentralized hosiery sector is very limited, Indian industry depends almost exclusively on import”.*<sup>7</sup>

### **India imports fine apparel Australian wool**

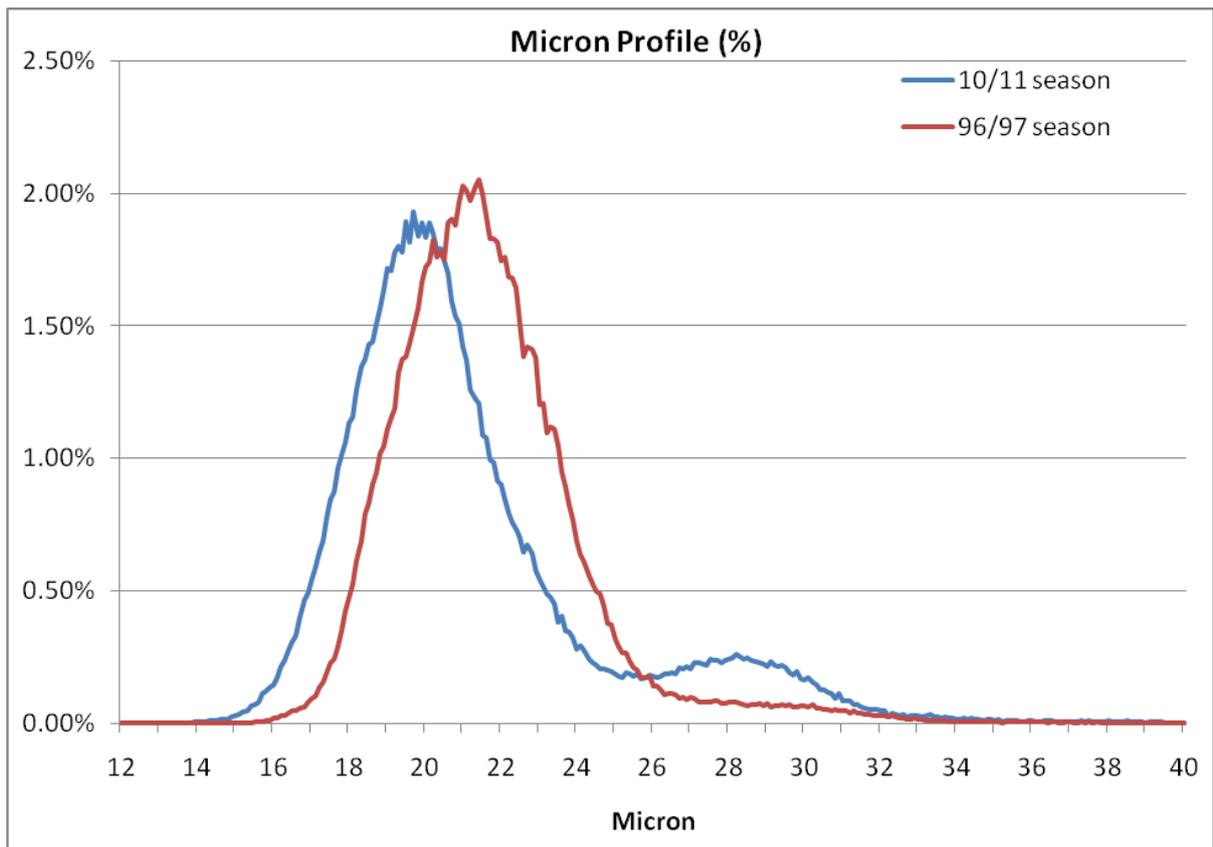
The wool India imports from Australia is used by the textile industry to manufacture fine apparel products and accordingly Australian wool does not compete with the domestic Indian wool industry. Indian wools are generally 28.0 microns and coarser. In contrast Australia’s wool profile is much finer, with the majority of Australian wool produced being finer than 21 microns; in 2010/11 less than 10% of the Australian wool clip was coarser than 28 microns. More than 75% of the wool produced in Australia is between 18 and 24 micron making it most suitable for use in fine apparel products.<sup>8</sup>

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<sup>6</sup> Report of the Working Group on Textiles and Jute Industry for the Eleventh Five year plan 2007-12, Government of India, Ministry of Textiles, December 2006, page ci.

<sup>7</sup> <http://www.txcindia.com/html/Woollen%20Report%20Annual%201011%2001022011.pdf%2015032011.pdf>

<sup>8</sup> AWEX Micron Profile



According to the Indian Central Wool Development Board, Ministry of Textiles, *“Since indigenous production of fine quality wool required by the organized mill and the decentralized hosiery sector is very limited, India depends upon imports. Imports have been mainly from Australia and New Zealand, the major supplier is Australia. New Zealand wool is being imported mainly for the carpet sector for blending with indigenous wool.”*<sup>9</sup>

**Australia’s wool trade with India can be further developed**

Earlier in 2011, a high level ministerial delegation from Indian visited Australia. The specific purpose of this visit was to foster closer cooperation and relations. Detailed discussions were held regarding the development of the Indian wool industry how the learnings India could adopt from the Australian industry right along the supply chain to improved production and husbandry practices, objective fibre testing, and the auction and selling system.

The Indian delegation expressed a keen interest in developing a Memorandum of Understanding between the Indian Ministry of Textiles and the Australian Ministry of Agriculture, Fisheries and Forestry of the Australian Government which could lead India to develop and be considered as a major supplier of woollen products in the global market. A draft MoU - which included an extensive list of measures and wide range of industry partners across the Australian industry - was circulated some weeks after the visit.

<sup>9</sup> <http://woolboard.nic.in/html/iwi.htm>

This delegation included the Indian Minister of State for Textiles, the Joint Secretary of the Indian Ministry of Textiles and the Executive Director of the Wool Industry Export Promotion Council.

Further to these recent discussions, AWI has worked for many years to assist the Indian industry to create a “Brand India” campaign to help the Indian industry improve product innovation, marketing and branding initiatives. It is with such efforts from both the government and the industry’s end that AWI is trying to develop the wool trade for the long term.

## **DIVERSIFICATION OF RISK FOR THE AUSTRALIAN WOOL INDUSTRY**

### **Australian wool industry should diversify its risk by expanding its market in India**

China is the world’s largest importer of wool. In addition, China is the major importer of Australian wool. In 2005, 2008 and 2009<sup>10</sup> China’s share of global import of raw wool was 28%, 39% and 49% respectively. China received 71.7% of Australia’s wool exports in 2010-11, and registered a growth of 3.3% over the volume imported in 2009-10.<sup>11</sup>

China’s share of Australian exports has steadily been increasing over the past 20 years. The market has traditionally been viewed as a cheap manufacturing centre, with the majority of Australian wool on-sold to other markets as tops, yarn or garments.

However the Chinese market has changed significantly in recent years. The significant growth of the Chinese economy has been reflected in the emergence of an affluent middle class which increasing disposable incomes. This has had a two-fold impact on the Australian wool industry; firstly this increasing affluence has witnessed an increase in Australian wool staying in China for domestic consumption. Secondly the associated wage inflation (some reports of up to 15% in 2010/11)<sup>12</sup> has resulted in significant increases in production costs.

Consequently China is no longer the “cheap manufacturing” centre it once was, making it a less competitive low cost supplier for the future, and to minimize dependence on China as the major processing hub of its wool.

Recognising these trends AWI has focused efforts to diversify its risk by expanding into markets such as India.

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<sup>10</sup> Ibid. 1

<sup>11</sup> AWEX: Australian Wool Exports Snapshot, July 2010-May 2011

<sup>12</sup> China ups minimum wage as inflation persists, <http://www.chinapost.com.tw/business/asia/asia-china/2011/01/27/289231/China-ups.htm>

### India is a very important market for Australian wool

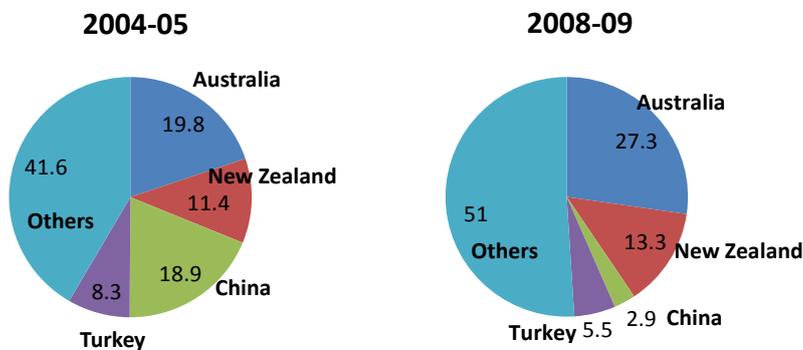
Australia's total wool exports to all destinations in 2010-11 were 355.3 Mkg (greasy equivalent), of which 26.8 Mkg were exported to India. India is the second largest export destination for Australian wool after China. India accounted for 7.5% of Australia's wool exports compared with 71.7% of exports destined for China. This reflects the high reliance on the Chinese market by the Australian industry.

The volume of Australia's wool exports has risen in recent years although they remain below their levels around the start of the decade. The weakness of the export picture is mainly due to reductions in scoured wool exports reflecting the decline of the early stage wool processing sector in Australia.

### Change in direction of India's raw wool imports

India's import of raw wool in the year 2004-05 was 84.7 Mkg and in the year 2008-09 was 65.7 Mkg<sup>13</sup>. However, over the past five years the change in direction of India's raw wool imports has seen the volume share change for Australia from 19.8% to 27.3%, New Zealand from 11.4% to 13.3% and China from 18.9% to 2.9%. Additionally, the statistics available from the DGCI&S show that in value terms, Australia's share has changed favorably from 48.38% to 57.78%, New Zealand's from 14.80% to 10.97% and China's from 8.65% to 1.29% during the same period.

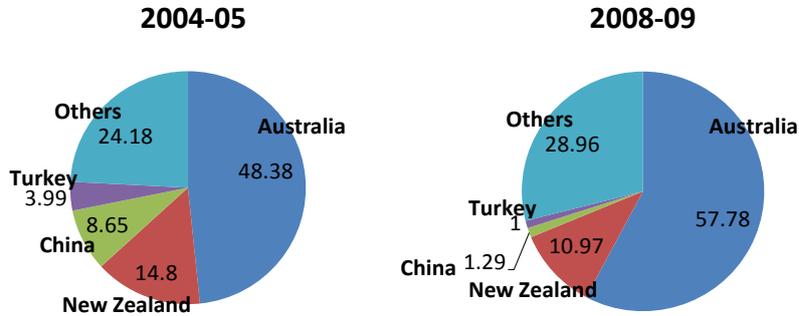
### India's Raw Wool Imports - Volume %



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<sup>13</sup> Ibid. 4

### India's Raw Wool Imports - Value %



This clearly indicates that the requirement for apparel grade wool in India is growing and Australia is the major supplier.

#### Protection of India's wool industry has reduced in recent times

India applies tariff and other duty barriers against imports of wool and wool textiles. However, these barriers have been reduced in recent years.

Year	Raw wool		Wool Tops		Yarn of combed wool	
	Basic Duty Ad.Valorem.	Total Duty	Basic Duty Ad.Valorem.	Total Duty	Basic Duty Ad.Valorem.	Total Duty
1996-97	25.00%	27.00%	50.00%	69.48%	50.00%	69.48%
2002-03	15.00%	19.60%	20.00%	47.76%	20.00%	47.76%
2005-06	5.00%	5.10%	20.00%	29.79%	15.00%	24.38%
2010-11	5.00%	5.15%	20.00%	35.10%	10.00%	26.85%

The total duty applicable comprises of the basic duty and additional charges (Annexure1.B). Additional charges that are being applied are as follows:

- An educational 'cess' to fund domestic education – a surcharge of 2% of aggregate duties levied.
- Duties to countervail local taxes – generally an additional duty of 4% for sales tax, VAT, local taxes and other charges levied on the sale of purchase or transportation of goods when imported into India.

## A SUGGESTED PATHWAY FORWARD-RATIONALISATION OF THE INDIAN DUTY STRUCTURE

AWI recommends the abolition of basic duty on raw wool, from the current rate of 5%, and reduction of import duty on wool yarn and fabrics from the current rate of 10% to 5%. This would result in a loss of US\$11.22 million<sup>14</sup> on raw wool duty and US\$1.87 million<sup>15</sup> on yarn and fabric duty to the Indian Treasury.<sup>16</sup> However, given the export potential and likely growth opportunity, the amount of direct loss of revenue can very well be over compensated by the rise in exports. Moreover, growth in these export intensive sectors would support employment generation.

Alternatively, the basic duty could be abolished on wools finer than 24 micron. This would ensure indigenous course wool industry is protected from coarse wool imports.

Additionally, relative to competing countries, India's greasy wool tariff of 5% is higher than China's within quota rate of 1%, but China also has an above-quota rate of 38% for wool imports above 287Mkg. Imports have approached this level in recent times. However, China's within quota rate of 3% for wool tops is much lower than India's 30% rate, although China's above-quota rate of 38% is higher than India's rate. China's tops imports have been well below the quota level in recent times.

China's tariff on worsted yarn at 8%<sup>17</sup> is much lower than India's, and in general one can suggest that China appears to apply lower levels of tariff barriers to processed wool products (e.g. tops and yarn) than India. This restricts the competitiveness of the wool processing sector in India relative to China and restricts the demand of raw wool by India.

## CONCLUSIONS

AWI considers the following issues are relevant to the desirability of an FTA with India:

- AWI believes that an FTA with India is desirable as a means of eliminating barriers to trade in Australian wool.
- India's actions in progressively reducing tariffs on greasy wool and tops over the past years warrant acknowledgement.
- However India's continuing reliance on tariffs against imports of wool, tops and yarn has a series of adverse economic impacts:
  - It serves to increase the cost of wool and wool products to its domestic textile and clothing industry. This reduces the competitiveness of wool as fibre and hence its demand is lower (in domestic and international markets) than otherwise would be the case.

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<sup>14</sup> Rs.51.6 crores based on an exchange rate of 1US\$ =Rs.46. (1 crore = 10,000,000,)

<sup>15</sup> Rs. 8.6 crores

<sup>16</sup> Ibid. 4, p.29

<sup>17</sup> APEC Tariff Database

- It shelters the domestic wool and wool products industry from international competition and hence reduces the pressure on the industry to compete, again ultimately reducing the demand for wool.
- It is therefore in India's own interests to continue the process of tariff reduction for wool and wool products, especially for wool top and worsted yarn, and this process should be continued until trade is fully liberalized.
- The Australian wool industry needs to diversify its risk by expanding market in India as a processing hub for its wool.

AWI looks forward to continuing close cooperation with DFAT and the Australian Government as the process of evaluating and negotiating an FTA with India progresses, and assures DFAT and the Government of its commitment to the process going forward.

### Annexure1.A

Australia GDP: US\$ billion, 2009	996
Agriculture @ 2.9% of GDP: US\$ billion	28.84
1% of this is exported to India: US\$ million	288
Wool exports in 2009 to India: US\$ million	98
Wool exports as a percent of Agriculture exports	34

### Annexure1.B

#### Import Duty Structure

<b>Item Description</b>	<b>Basic Duty</b>	<b>CVD Ad. Valorem</b>	<b>Education cess</b>	<b>Special Additional CVD @4%</b>	<b>Total Duty Ad. Val.</b>
<b>Wool</b>	5	Nil	0.15	Nil	5.15
<b>Wool tops</b>	20	8.24	Nil	5.2	35.1