TIME FOR A Turnaround

Paul Keating is relearning about the economy fast. Roy Green suggests he also needs to unlearn some of the 80s orthodoxy about industry policy. A sensible industry policy for the 90s is, he argues, a vital element in the renewal of Labor’s vision.

History is against governments attempting a strategic realignment during their term of office. It is usually something undertaken in opposition, and most governments which try their hand at it are probably destined for the opposition benches anyway.

The last government to try were the Social Democrats in Sweden, who subsequently lost power to a conservative coalition. On the other side of politics, the British Tories have made an extraordinary attempt to shift ground with the replacement of Mrs Thatcher by the affable ‘Butskellite’ John Major. Whether the attempt is successful will depend on overcoming the traditional contempt of the electorate for a government which could not get it right the first time around.

This is not to say that internal renewal is impossible. After all, governments are constantly having to adapt their policies to changed circumstances—often with some success, as we have seen on a number of occasions in the life of the present Labor government in Australia. The later it is left, however, the harder it becomes to explain away past ‘mistakes’ and, even more importantly, to rekindle support for a new approach.

What then, are the chances of a Labor government led by Paul Keating renewing itself in time for the next election? Not good, say the commentators. Everyone knows that Keating was the architect of the policies from which he and his new Treasurer are now desperately trying to distance themselves. And the scope to take radical measures, as he also recognises, is severely limited by the deteriorating international situation.

Yet Keating could still square the circle provided that he resists the temptation, held out by some commentators, to move further in the direction of Dr Hewson’s economic plan, and begins instead to stake out new ground for Labor’s social democratic philosophy. The one opportunity
he has to retake the initiative is the economic statement to be released later this month, and the ground which must be staked out there, in clear and distinctive terms, is a new approach to industry policy. Of course, the statement must address the problem of short-term job creation, but it must also, to be credible, establish a longer term vision of what Labor stands for in the 1990s and how it is different from the conservative Opposition.

I shall argue that industry policy is the ground on which Labor could, at least potentially, develop a substantial strategic advantage not only with the trade union movement but also with the wider electorate. It means, however, overturning the complacent reliance on unfettered markets associated with Canberra’s key economic ministries and, instead, constructing a more interventionist approach to microeconomic reform, which has so far placed the burden of change on wages policy. The point is not just that the economic orthodoxy has got it theoretically wrong, but that it is increasingly irrelevant. Like old-fashioned state planning, it has been superseded by the evolution of new technologies and production systems in world competitive manufacturing firms.

The trend in all successful economies is now towards strategic industry policies combined with greater worker involvement in economic decision-making. This is obviously fertile territory for the renewal of Labor’s philosophy since it offers a coherent social democratic vision of the future which also happens to make good practical sense; and it is far removed from the paternalistic ideology of the ‘New Protection’ introduced early this century. With a little reshaping of tripartite structures, the institutional prerequisites are in place in Australia today for the design of such a strategy, and the shift in wages policy to productivity bargaining provides ordinary trade unionists with the opportunity to play a major role in its implementation.

So far, the basic assumptions behind the Labor government’s microeconomic reform agenda have been those of orthodox economics. It is important at the outset to understand what these are, and what they imply for current policy before considering an alternative approach. They state that optimal efficiency is achieved only by creating perfectly competitive markets, including those for factors of production such as labour. Essentially, this means removing ‘impediments’ to the operation of free markets and eschewing any form of intervention which may ‘distort’ the necessary competitive signals.

The impediments these economists have in mind in the product market are tariffs and other protectionist (and ‘new protectionist’) measures and, in the labour market, the traditional wage-fixing role of the Industrial Relations Commission. Ideally, they would also include in these impediments the monopoly power of trade unions. But, unlike the Thatcher government’s notorious 1985 Employment White Paper and its local counterpart in the Australian Opposition’s industrial relations policy, Labor’s Accord with the ACTU precludes any attempt to free up the labour market in this way. Instead, market economists here must be satisfied with the decentralisation of wage fixing, as a means of approximating the price of labour to its marginal productivity, rather than its wholesale deregulation with the removal of minimum legal rights and standards.

It is not my intention to argue here that the government’s reforms of product and labour markets have been futile. Far from it. What I would suggest, however, is that progress in this area since 1983 has been achieved despite rather than because of the assumptions which underlie the policy. Moreover, the current policy paralysis is due in large measure to the failure of the government either to follow these assumptions through to their logical conclusion which is found in the Opposition program or, on the other hand, to jettison the assumptions explicitly in favour of a more interventionist approach. The first approach implies an open confrontation with the trade union movement and would mark a further step towards a low wage, low productivity economy in Australia; the second, as we shall see would permit the government to chart a course for a high wage, high productivity future.

In this country, perhaps uniquely, wages and industry policies have had to carry the stigma of their common origin in the nexus between industry protection and centralised arbitration in the early part of the century. It is at least arguable that, at the time, this pairing permitted a higher level of output and employment in manufacturing and a growth of real wages than would otherwise have been possible—but circumstances in Australia and the world economy have since changed beyond all recognition.

The main problem with the traditional protectionist strategy was that there was no incentive in the tariff policy arrangements, or in the associated strategies of multinational firms in Australia, to develop world competitive manufacturing technologies and work practices. The problem was accentuated in the post-war period not only by the secular downward trend of primary commodity prices, which contributed to macroeconomic instability as well (the ‘stop-go’ cycle), but also by the increasing trade dominance of high value-added—the so-called ‘elaborately transformed’—manufactured goods.

While manufactures in general were already established as the fastest growing area of world trade at the onset of the post-war boom, by the mid-1980s, according to recent calculations, high research-intensive manufactures were the fastest growing specialised segment of trade in manufactures. This has become known as the ‘new competition’. If the case for comprehensive tariff protection has disintegrated in this environment, the question still remains what should replace it: the free market or a new outward-looking approach to industry policy.

The policy response in Australia to the growing significance of high value-added manufacturing in world trade has been of two types. The first, largely developed by the Industry Commission and its predecessors, was based on the classical theory of comparative advantage. By reducing, and ultimately eliminating, tariff protection, it was argued that this approach would permit only efficient and
competitive firms to survive, thus bringing down the cost of all goods and services to Australian consumers and enhancing general economic welfare.

The approach is epitomised by the Garnaut report, *Australia and the North-East Asian Ascendancy* (1990), which recommended an ideologically pure zero tariff regime by the year 2000. Any approach of this kind has costs and drawbacks, however—drawbacks which are usually downplayed. The main defects in the Garnaut approach are, firstly, that there is no mechanism, apart from spontaneous entrepreneurial combustion, by which inefficient firms can become efficient and competitive; and, second, that the closure of 'inefficient' manufacturing firms tends only to reinforce Australia's dependence on primary commodity exports. Perhaps most importantly, the inconvenient fact which proponents of this approach fail to address is that world trade today is characterised not by comparative advantage but rather by 'comparative disadvantage' for resource-based economies.

By 'comparative disadvantage' I mean the tendency in resource-based economies for the exchange rate to rise above the level at which manufactured export and import substitutes can become competitive, even with significant efficiency improvements. This problem is compounded by the fact that devaluation, particularly where it occurs as a result of an unfavourable reversal in the terms of trade, can also prove counter-productive due to the combination of sudden and unpredictable cost pressures and the belief that the potential advantages offered by devaluation may only be temporary.

This was the effect that large North Sea oil and gas discoveries had on the Netherlands and UK, where the decimation of manufacturing firms (mainly in the price sensitive engineering and capital goods sectors) by policy adaptation to commodity-based exchange rate fluctuations became known as the 'Dutch disease'.

By contrast, economies without a significant resource sector, such as Germany and Japan, have been able to adjust exchange rates to the goal of long-term competitiveness in high value-added manufacturing, thus maintaining continuity in their investment, training and research and development strategies. Ironically, instead of using agricultural or resource surpluses to subsidise employment in 'sheltered industries', these economies are able to subsidise their farmers and (in the case of Germany) grossly inefficient coal producers out of the surpluses generated in manufacturing.

The second type of policy response to the problems faced by resource-based economies, initiated publicly in Australia by the 1979 Crawford report on structural adjustment, has been to recognise the necessity of "gradual reductions in some Australian protection levels" but only as part of an "industrial development policy". This approach is now identified with the Australian Manufacturing Council (AMC) report, *The Global Challenge: Australian Manufacturing in the 1990s* (1990), which, although not theoretically explicit in its assumptions, nevertheless places the emphasis on making domestic industry competitive in conjunction with reducing tariffs rather than undertaking tariff reform in isolation from other instruments of policy.

It is claimed, of course, that the 'new' approach to industry policy is nothing more than an attempt to resurrect the old, discredited protectionist arrangements in a different guise. The lack of evidence for this claim is matched only by the enthusiasm with which it has been embraced by newspaper editorial writers and officials in the federal bureaucracy. The new approach stems both from modern theories of how markets work (or don't work, as the case may be) and from the recent experience of more successful industrialised nations. In particular, there are two features of this approach which distinguish it fundamentally from previous attempts at industry policy in Australia.

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The first feature is the shift in the rationale for tariff protection and industrial assistance from the retention of jobs in manufacturing industry, however uncompetitive, to the preparation of firms and sectors for carefully targeted export strategies in world markets. The second, as I noted above, is the transformation in the primary role of wages policy from centralised pay fixing, which characterised the 'historic compromise' between labour and capital in the early part of the century, to support and facilitation of work reorganisation, training and joint consultation at the workplace.

Since 1983, the Labor government has shown little sign of accepting the case for an outward-looking industry policy which dares to speak its name except, as we see in a moment, at the margins where it has been tolerated on the grounds of demonstrable market failure. Curiously, however, it has offered less resistance to the idea of permitting the vacuum to be filled by wages policy, particularly in its most recent incarnation as award restructuring.

The result of this accommodation between the prescriptions of economic orthodoxy and the power relationships of the Accord has been internal inconsistency at best, with the ever present danger of the whole strategy collapsing under the weight of its own contradictions. With the good fortune of the demand expansion phase of the strategy now evaporating in the recession along with Labor's popularity, the contradictions are laid bare and require a resolution if disaster is to be avoided at the next election. To understand the steps which must now be taken, it is necessary first to retrace briefly those already taken in the two phases which characterise the government's approach to industry policy and labour market reform so far.
In both phases of policy, the government's product market reforms were largely centred on across-the-board tariff cuts, though in the initial phase they also included a number of ad hoc industry plans to reinvigorate traditionally protected areas of manufacturing. However, these modest plans were not sustained or extended to other sectors. Nor were they matched by support from labour market policy which, at this stage, consisted mainly of employment and training measures and an abstract commitment to 'industrial democracy'. The 1986 Heavy Engineering plan, for example, had to make do with a provision making assistance to firms conditional upon jointly negotiated changes in work practices.

Crucially, apart from the handful of industry plans, there were no formal industry policy structures established to ensure that company decisions on investment were open to wider scrutiny and accountability. Nor were legal rights and opportunities provided for workers to influence those decisions. The government's approach at this time proceeded on the assumption that once the macroeconomic settings were in place the market would deliver the necessary investment in new technologies and skills. But, to the government's evident surprise, the assumption was found wanting.

The conclusion drawn from the first phase of policy was that whatever intentions some may have had of using the micro reform agenda to bring back industry policy to centre stage, its dominant thrust became accelerated tariff reductions and the removal of transport bottlenecks, especially on the waterfront—with which landlocked Canberra has been obsessed for decades.

The terms of trade collapse of 1985/86 created the conditions for the second phase of policy which signalled the government's recognition of the limitations of macro policy by shifting the focus to microeconomic reform. The problem was that whatever intentions some may have had of using the micro reform agenda to bring back industry policy to centre stage, its dominant thrust became accelerated tariff reductions and the removal of transport bottlenecks, especially on the waterfront—with which landlocked Canberra has been obsessed for decades.

The measures were supplemented by the federal government's Workplace Reform Program, established by the Department of Industrial Relations (DIR), which featured a network of Workplace Resource Centres as well as more traditional assistance packages to union and employer organisations engaged in the rewriting of awards. These centres anticipated the need to translate the new awards into action at workplace level, without which award restructuring would have been futile. They were designed to provide advice and information on a commercial basis to firms in the process of restructuring, but only on condition that the process was operated through joint consultative machinery.

In addition, largely as a result of the AMC report referred to earlier, the government announced the introduction of a Best Practice Demonstration Program which would encourage selected firms to adopt international best practice approaches at the workplace. This program, to be run jointly by the AMC and DIR, is a further indication of the degree to which industrial policy may be pursued legitimately only in the guise of workplace reform.

It was with considerable unease and after some delay, however, that the Industrial Relations Commission was prepared in October 1991 to issue formal guidelines for productivity bargaining with no overall pay limit. Even so, the guidelines were well framed—and, by stipulating the need for joint consultation arrangements at the workplace, they provide workers and unions with a further opportunity to widen the bargaining agenda, possibly to encompass decisions on investment as well as training and work reorganisation.

This could, if handled correctly, become a source of strength for workplace managers, rather than simply a threat to their decision-making prerogatives (particularly in the light of evidence from the Australian Workplace Industrial Relations Survey (AWIRS) showing that the major constraint on workplace performance in Australia is not union obstruction but the policies of management beyond the workplace. Nevertheless, the problem with workplace bargaining from the viewpoint of economic strategy is its unco-ordinated character. Thus there is still an important role for wider, preferably tripartite structures to promote the development of coherent sector-based strategies.

Indeed, it is a peculiarity of Australian economic management in recent years that wages policy and labour market reform have been made to bear the weight that in other countries would be carried, or at least shared, by industrial policy. Just as the focus of economic management shifted after the trade crisis from a macro growth strategy to micro reform, so the emphasis of wages policy changed from overall wage restraint to workplace productivity improvement through industry and enterprise bargaining.

Since wage restraint had not contributed to the investment needed to increase productivity, more direct measures were required at the workplace, where nominal wage growth was less economically significant than the growth of unit labour costs. These measures were first signalled in the 1987 two-tier wage system which opened the way for workplace negotiations on 'restructuring and efficiency', and then more comprehensively in the Industrial Relations Commission's award restructuring decisions of 1988/89, which established a framework for genuine productivity bargaining.

The relevance of the sector level to industrial policy has been enhanced in recent years by the trend from traditional mass production industries, where economies of scale...
were the crucial factor, to more flexible manufacturing systems whose effectiveness requires carefully managed interdependence between smaller units of production. This interdependence has given rise to the much admired ‘clusters’ of competitive industrial success in places like Emilia-Romagna in northern Italy and Baden Wurttemberg in south-west Germany.

Such clusters cannot be imposed by state planning, but nor do they emerge spontaneously from the actions of individual entrepreneurs. Their growth and development must effectively be co-ordinated within structures which guide and assist firms with production techniques, personnel practices, producer-user linkages (‘networking’) and marketing strategies. The idea that these structures would have to ‘pick winners’ is a relic of past debates about planning versus the market, where the state is assumed to do they emerge spontaneously from the actions of individual entrepreneurs. Their growth and development have to ‘pick winners’ is a relic of past debates about planning versus the market, where the state is assumed to be the agency of planning. In this new approach to industrial policy, it would be more accurate to say that the winners have the opportunity to pick themselves within the framework of a sector strategy which they have collectively devised in co-operation with the government.

The appropriate agency for industrial policy in the Australian context must be a tripartite institution, with not merely advisory but executive powers, which is based on a network of sector planning bodies with representation from unions and employers. The role of the government is then not to impose a blueprint on industry, but to discuss and agree a range of strategies in each sector—encompassing, say, export facilitation—which would be supported by advisory and information services and, where related to the fulfilment of an agreed strategy, direct assistance to firms.

The national tripartite forum would have the task of ensuring that sector strategies are consistent both within industry itself and with the government’s broad macro settings. This would imply, for example, particularly in the recent period, that a current account improvement would not be sought solely by using monetary policy to depress demand. The reason is obvious. Not only are firms affected by high interest rates, but the influx of capital, as we have seen, drives up the exchange rate, making even relatively efficient firms uncompetitive. It is a classic case of inconsistency between macro and micro objectives, which would not arise if industry policy were to be assigned a central role.

There are many tripartite institutions in Australia (perhaps too many) which might be considered as candidates for the role I have described. The development of a new approach to industrial policy may well be the occasion for imparting a sense of purpose and coherence to the ‘alphabet soup’ of such bodies. In particular, a merger of the Economic Planning Advisory Council (EPAC) with the AMC would be desirable because it would not only permit the macro and micro dimensions of economic policy to be fused, but would also establish a ‘transmission mechanism’ to firms through the AMC’s industry councils which, at least potentially, form the basis of the proposed sector planning bodies.

The main task of the government, then, is not to intervene directly in the running of industry but to create the necessary ‘supply side’ framework for investment in long-term growth and jobs. This means developing representative tripartite structures, so that the elements of an agreed industrial policy may be developed, and providing legal rights for workers to information and consultation, so that the resulting sector strategies may be matched by strategies at the workplace. A new industry policy which releases the initiative and creativity of the Australian workforce in this way is the key to a high wage, high productivity economy. It also gives Labor the opportunity to shape a clear and compelling vision of social democracy for an extended period of government in the 1990s and beyond.

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Hewson's Package: What are we Fighting?

The "Fightback" Package Assessed Sunday 16th February, 2nd Floor, 327 Sussex St., Sydney. 12.30pm-5.30 pm.

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