FEARS FOR AUSTRALIAN MANUFACTURING

During July, the daily press carried a number of warnings on behalf of manufacturing capital about the "resources boom" that is said to be impending. Readers have had it put to them that Australian manufacturing will be imperilled by the impact of greater exports of raw and processed minerals on the exchange rate, supposedly by increases in wages due to the increased demand for labor by the mining and processing industries, that even the Treasury now admits the need for substantial Australian equity in the resources projects to ensure that some of the profits are retained for some Australians, and that these profits may not be made available for the needed transformation and expansion of the manufacturing sector (beyond, of course, the inclusion of processing itself).

But there are problems with which a resources boom would confront Australian capital remaining in manufacturing that are not addressed by these warnings. This set of Economic Notes will establish just which of the problems are really significant and may suggest that very little manufacturing outside of mineral processing would be sustainable without protection.

There is, to be sure, some short-term coincidence of the interests of Australian manufacturing capital and of workers in the continuance of the existing protection of manufacturing; but it should not be thought that the coincidence of interests goes very far. Continuance of protection of the clothing industry, for example, has enabled "rationalisation" in the form of greater mechanisation, less employment, less output and greater profits. More generally, the continuance of protection may be important to Australian manufacturing capital only insofar as it allows companies to accumulate earnings with which to buy into the resources projects. Once they have done so, they may scrap their existing manufacturing plant. And, of course, the resources projects, when they come on line, will not provide anything like the employment provided in existing manufacturing.

The "Gregory Thesis"

The impact of an expansion of mineral exports on manufacturing through the exchange rate has been much discussed of late. The discussion commonly refers to Bob Gregory of the Australian National University who developed the argument in an article published in 1976.(1) The argument is that additional export revenue, along with an augmented inflow of capital to finance part of "the resources boom" will so add to the demand for Australian dollars that the value of the Australian dollar will rise substantially in relation to the values of international currencies. The international currencies have to be exchanged for Australian dollars to be used to finance wage payments, purchases of equipment locally, and payments of dividends and interest on locally-provided funds. They must be exchanged if they are to be deposited with various Australian financial intermediaries, even if only for the time being. Once the value of the Australian dollar increases, however,
the value to Australian companies of most existing export contracts declines, as do the prices — in Australian terms — of imported commodities.

Most existing export contracts are written in terms of international currencies, not in terms of the Australian dollar; so an increase in the value of the Australian dollar means that an export contract yields fewer Australian dollars. A decline in the Australian dollar prices of imported commodities provides a considerable benefit to importers but depresses the profits of Australian companies producing in competition with imports. Just how long that portion of export revenue that is actually foreign-owned is left in Australia obviously has an important bearing on the behavior of the exchange rate. Clearly, the fears of Australian manufacturers and rural exporters would be ameliorated if foreign-owned revenue were quickly remitted abroad; but then the possibility of using the foreign-owned funds in some manner to finance additional investment in Australia would also disappear.

Wages

Some fear of wage rises has recently been expressed by the Australian Industries Development Association, among other organisations. (2) The fear is evidently that if construction of various resources projects were concentrated within the same four-to-five-year periods, there would be a sharp upward pressure on wages in the construction industry and that high wages which large transnational corporations could afford to pay particular categories of skilled workers employed in the operation of power stations, smelters and so on would need to be paid for the same jobs elsewhere in the economy.

The wordy editor of the Australian Financial Review has added the caution that the flow-on of these last wage increases would be stimulated by decisions of the Conciliation and Arbitration Commission. (3) However, McGuinness' understanding of the effect of centralised wage determination in Australia may be completely wrong.

What McGuinness likes to suggest is that the less productive Australian industries are forced by the decisions of the Conciliation and Arbitration Commission (CAC) to pay wages that are determined by the ability to pay of the most productive industries — or of those industries in which wage increases can be most readily passed on through price increases. But the CAC may, instead, determine awards on the basis of the ability to pay of the least productive industries — or of those in which wage increases cannot be passed on. The very fact that, in the view of the CAC, it has been plagued by over-award payments — that there are widespread over-award payments — is surely evidence of this. That is not to say, of course, that the principle of the ability to pay was not swamped for a time by the high wage increases conceded to public servants by the Whitlam government. Left to itself, the CAC is unlikely to constitute a threat to manufacturers.

Australian Equity

Evidently, even the Australian Treasury has come around to the view that it is necessary to specify a minimum degree of
Australian equity in new investments. (4) Under such a "foreign investment guideline", Australian capital would at least receive a portion of the distributed profits from the new resources projects. The change in the Treasury view has evidently arisen from its pessimism about the efficacy of any other mechanism for transferring surplus generated in mining and mineral processing. It is only surprising that the Treasury has not become pessimistic much earlier.

Transfers by way of taxation are severely limited by Fraser's 1976 amendments to the Income Tax Assessment Act and by the possibility of transfer pricing; and the lack of re-investment of undisturbed mining and processing profits in other areas within the Australian economy during the past decade and a half hardly suggests that anything different will occur under similar policies during the eighties.

Prescriptions from the point of view of capital

In any case, a foreign-investment guideline specifying equity participation is not of itself much of a protection for Australian capital. Such a guideline can be subverted by the practice of disguising foreign shareholdings behind ostensibly Australian nominee companies. More importantly, however, the control of undisturbed profits can remain in the hands of foreign shareholders even where Australian equity is actually well in excess of 50 per cent.

It might be possible, in principle, to devise a set of policies that would promote the transfer of surplus generated in the resources projects to manufacturing industries which would be profitable without substantial tariff protection. McGuinness believes that policies of increasing "the skills and mobility of the labour force" and developing manufacturing technologies would do a lot to help. (5) Regardless of what such policies would mean for Australian workers, it is difficult to imagine that they would be of much help to Australian capital while international capital is in the course of its own restructuring of important manufacturing industries, while state governments continue to compete with each other for "international investment projects, and while any Australian company which were to develop a new technology could be easily taken over.

Just what sort of a manufacturing sector would be viable in Australia without more than the natural protection afforded by Australia's geographic isolation is not likely to be revealed to anyone in some sort of divinely inspired vision. Nor would the elimination of tariffs and other forms of protection necessarily make it possible for a number of purely domestic manufacturing industries to become significant exporters. That is not to say that the costs of many Australian manufacturing industries are not substantially increased by tariffs applying to the inputs they need. The Industries Assistance Commission has calculated that, for 26 of 173 manufacturing industries, the costs of protection of inputs amounted to more than 40 per cent of the assistance being provided to the 26 industries themselves. But it was the view of the Crawford Committee that the elimination of these costs would be an insufficient inducement to persuade domestically orientated manufacturers to become exporters. In the view of the Crawford Committee, manufacturers would need export incentives even more generous than those currently in force — incentives which, at the time of the last budget, were estimated to involve an outlay of $170 million during 1979-80. About the nature of the industries that could become the bright new possibilities for Australian manufacturing capital very little, if anything, is even said.

Further Problems

In the meantime, there are other problems developing for manufacturing capital. Australian banks were uttering warnings over twelve months ago about the danger of Australia's official borrowing abroad. (7) Taken at their word, they were evidently concerned about the future claims which the servicing of foreign official debt will make on Australia's receipts of foreign exchange. The level of overseas borrowing has been expanded in order not only to help finance the budget deficit but to limit the recent depreciation of the Australian dollar, for fear of the effect of a greater rate of depreciation on costs of living, costs of production and the Australian dollar returns to exporters. It
might not appear that debt servicing would be a problem once an upsurge in foreign investment had properly begun. But it could remain a problem if the increased foreign investment so destabilised the balance of payments that the federal government had to impose import controls from time to time in order to ensure that there was sufficient foreign exchange available for the servicing of official foreign debt. The balance of payments might well be destabilised by the irregularity of ever-increasing remittances of profits abroad. In other words, provision of foreign exchange for the remittance of profits might so threaten the servicing of official debt from time to time that it would lead to sporadic import controls.

If there were an upsurge in foreign investment, the various official borrowers might decide to replace foreign debt with domestic debt. Presumably, the inflow of foreign exchange would substantially increase the liquidity of Australian financial intermediaries, for the time being, so enabling them to buy official securities. However, the scope for this solution is limited by the fact that many of the official borrowers are not directly responsible for the management of the balance of payments.

Any increase in the degree of instability of the balance of payments itself imposes difficulties on relatively small Australian capitals involved in the production of internationally traded commodities. Either industrial capital must itself bear the risk that the rate of exchange may suddenly become more or less favorable; or it must bear the cost of insuring against such a risk by trading on the forward exchange market and paying the commissions to money-market dealers which this involves. An exporting company may, for example, insure against the possibility of a rise in the value of the Australian dollar by contracting to sell, at some time in the future, the international currency in which it is to be paid for its exports. The contract would be to sell at present prices minus a discount to cover commission.

What may also be concerning Australian capitalists about the growth of official overseas indebtedness is that the servicing of any official debt makes a claim on public revenue. Now if tariff revenue were to decline with the progressive elimination of tariff protection, this claim would become more important. The urgency of replacing any loss in tariff revenue with increased revenue from other sources would increase with the extent of the debt burden.

Finally, it must be acknowledged that any decrease in costs to manufacturers arising from a decline in rates of tariff protection of inputs will continue to be offset by increasing fuel costs as long as the present pricing arrangement for crude oil is maintained. In ALR's "Economic Notes" of March this year, it was observed that a pricing arrangement less generous but nonetheless still competitively subservient to the oil companies could provide considerable assistance to existing and potential manufactured exports, while also lessening the burden on Australian workers.

All in all, the problems which a "resources boom" would present for Australian manufacturing capital are likely to be considerable. They reflect not only the international orientation of monopoly capital in the mining and mineral processing industries, but the absurdity of leaving investment to the whims of private enterprise. It is little wonder that Australian manufacturing workers are supporting the maintenance of existing tariff protection.

Gavan J. Butler, August 11, 1980.

FOOTNOTES
5. op. cit.