

# JEWEL IN THE CROWN

**An Interventionist Industry policy may suggest a greater role for tariffs. On the other hand, it may not. Neil Hart explains.**

Questions concerning the future role for tariffs in the Australian economy must be addressed within the context of overall industry policy strategies. The purpose of industry policy is to achieve long-term changes in the composition and orientation of production in an economy. The major structural problem confronting the Australian economy is the inability of existing production patterns to generate sufficient (net) export earnings to reverse persistent current account deficits.

However, there are fundamental differences over the appropriate industry policy strategy for Australia. On the one hand it is often asserted that reductions in assistance to 'inefficient' sectors open up industries to foreign market 'discipline', with the increased competition being the key to improved economic performance in such sectors. Therefore, microeconomic reform and the removal of all industry assistance represents the desired policy direction. If this strategy is accepted, the eventual elimination of instruments of protection such as tariffs is imperative. On the other hand, those supporting a more interventionist approach to industry policy would argue that there is an important role for government to complement or even replace 'market forces' through specific sectoral planning and assistance packages. In such a setting the role of tariff protection is less clear-cut.

The non-interventionist or 'market forces' approach to industry policy is one of the jewels in the crown of the 'economic rationalist' approach to policy making. Particular economic structures or directions for change, it is argued, are predominantly determined by the natural endowments of the country concerned rather than strategic choice. Competition enables trade flows to be directed by the market according to a nation's comparative advantage determined largely by its natural or pre-existing endowments of resources. Economic theories are tendered as testimony to the losses in a country's overall welfare inevitably arising from market distortions created by measures such as tariffs.

However, the real world does not conform to the relationships portrayed in these economic models. Markets are, instead, characterised by imperfect competition and subject to numerous, complex and effectual market interventions by governments of all political persuasions. In such a setting international trade flows fail to bear witness to natural endow-

ments or the doctrine of 'comparative advantage'. Instead, as strategic trade theorists argue, trade flows increasingly reflect the arbitrary or temporary advantages to one country or another chiefly resulting from economies of scale or shifting leads in technological races. Intra-industry trade, rather than the exchange of commodities of one industry for another, now dominates trade between industrialised countries.

It follows therefore that theories based on the notion of competitive markets such as those regularly expounded by the Industry Commission, need to be supplanted with policy recommendations derived from the premise that strategic decision making by firms is made in a context of imperfectly competitive market structures characterised by increasing returns and barriers to market entry. Competitive advantage is not something which is simply inherited, but is created. The central point is that governments can alter the strategic game played between domestic and foreign producers by using measures which are, by their nature, unavailable to individual firms. Once this point is understood, the imperative for an interventionist approach to industry and trade policy becomes apparent.

It is generally agreed by advocates of the interventionist approach that a solution to Australia's current account difficulties requires a reduction in Australia's dependence on commodity exports, which are subject to a declining terms of trade and a falling share of trade. The major challenge therefore is to increase the export income generated from Australia's production of manufactures. To achieve this requires export-oriented assistance measures targeted at manufacturing activities. As the *Pappas-Carter Report* commissioned by the AMC highlighted, it is activities which integrate Australian manufacturing selectively into global scale industries which would most usefully attract government assistance. Also of particular importance are 'value-adding' activities associated with the processing of Australia's natural resources. Useful assistance measures could include export subsidies, perhaps in the form of selective and conditional depreciation allowance, particularly for large capital intensive downstream processing projects. A system of condition grants or confessional interest loans with the specific aim of accelerating the application of advanced manufacturing technology would also play an important role. Risk-

sharing assistance to established firms investing in targeted export developments—a technique used in Sweden, France, Japan and the US—also seems a productive approach. Governments need to actively seek bilateral and multilateral trading agreements and assist in the international marketing of Australian produced manufactures.

It needs to be emphasised that support for this type of industry policy strategy does not necessarily imply opposition to a programmed reduction in

tariff protection, or to microeconomic reform in areas such as transport and communications. However, reduction in existing forms of protection such as tariffs should be taken as being contingent on the introduction of positive industry assistance packages. What is required is a fundamental renovation of the structure of industry assistance, not its demolition. ■

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# WOLF IN SHEEP'S CLOTHING ■

In recent years there has developed within the labour movement a greater appreciation of the role of the market in shaping economic development. In line with this greater understanding, it is now broadly accepted that tariff protection has not helped the development of world class industries. The most internationally uncompetitive sectors of the Australian economy are, in most cases, also the sectors which have been most heavily protected.

The connection between tariff protection—a specific form of protection—and internationally poor performance has been grudgingly accepted by some sections of the labour movement. In general, the damaging consequences of protection on economic performance have not been fully appreciated—hence the current search for a new form of protection to replace the final removal of tariffs at the end of this decade.

The search for a new protectionist framework has been dressed up as a search for industry policy. What precisely is meant by industry policy is not very clear, but it seems to have something to do with positive industry assistance initiatives and structural adjustment assistance. Presumably it is the government that is to provide these assistance measures.

Since these measures will incur costs on the community purse, the government will either have to increase taxation or draw resources from other areas of need to pay for them. Irrespective of how these measures are funded, it is clear that government provision of assistance to one group must be at the expense of another group or activity. The cost may well be borne by the more needy in the community, who have traditionally been provided for by government, and who are unable to afford to fund glossy reports and lobbyists to convince government of the importance of their special interest. Given the

competing claims on government, the key issue is how to choose which claims to meet. It is in this area that the latter day protectionists have failed to make a convincing case. The advocates of industry policy have advanced two major arguments in favour of it. These stress:

- the need to export more high value-added products such as elaborately transformed manufactures (ETMs). These high value-added industries are desirable because of their growing importance in world trade and because they provide the platform for high value-added input services.
- the need to create and develop industries which have a strong 'linkage relationship' with other industries (such as the car industry). These linkage relationships generate positive effects across a range of activities, including high value-added services.

The first argument, that ETMs should be encouraged by active industry policy, is not convincing because it fails to establish the market failure the policy is supposed to correct. Agreement that ETMs are desirable is not an argument for active industry policy. If these high value-added industries are generating returns above those to be achieved in sectors that are low value-added, one could expect, all things being equal, that capital and other resources would flow into these sectors.

The fact that Australia runs a trade deficit in ETMs is not a sign of market failure. It is a sign that some other country is a more efficient producer of these items than we are. The desire on the part of some special interest groups to encourage the government to increase support for these industries is understandable but it should, nevertheless, be rejected on economic grounds.

The second argument put forward by advocates

**Tariff reductions don't necessarily mean an end to protection, according to Michael Costa. Industry policy has to be junked too.**