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. ■

NEIL HART teaches in economics at the University of Western Sydney, Macarthur.

WOLF IN SHEEP'S CLOTHING ■

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

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 of interventionist industry policy—the need to create strong linkages—is closely associated with the view that manufacturing has a special claim on the community's resources. According to this line of thought, manufacturing matters because a substantial core of service employment is tightly linked to manufacturing. The 'manufacturing matters muddle' occurs because these alleged linkages are drawn too tightly.

For example, it is not correct to claim that production inputs must be closely located to up-stream processing activities. It is quite possible to be an up-stream processor of a commodity while being relatively under-endowed with raw materials. The Japanese have managed to dominate many industrial sectors, despite relying on imported raw materials. Japan's comparative advantage initially lay in other resources such as an abundance of cheap, highly-trained and disciplined labour.

The most sophisticated economic arguments for interventionist industry policy are based on "strategic trade theories". Brander, one of the major exponents of strategic trade theories argues that it may be possible in certain circumstances to use tariffs and other targeted industry assistance measures to increase national welfare. He examines a situation where a domestic market is serviced by one foreign producer fearful of domestic entry and substitution. Here it is possible for an appropriately applied tariff to return an economic rent to the domestic government, provided that the tariff is pitched at a level that enables the foreign firm to absorb it without raising prices sufficiently to encourage a domestic entrant. The tariff acts as a tax on the foreign producer.

By transferring a proportion of the foreign firm's potential profits to the state treasury this tariff-cum-tax can increase the domestic nation's economic welfare at the expense of the foreign firm. In short, under certain circumstances, underlying international comparative advantage can be exploited through government action.

The views of the strategic trade theorists are economically plausible and much more sophisticated than those based on the value-added or linkages arguments examined above, because they are able to identify the market failure that government intervention is supposed to correct. It lies in imperfectly competitive international markets or advantages accruing to competitors for particular historical reasons.

Ironically, the strength of such theories is also their major weakness—they only hold true in limited circumstances and under fairly restrictive assumptions. The major problem with strategic trade theory and industrial targeting is to identify the sectors that ought to be targeted for special assistance.

The tradition of the labour movement requires that policies be formulated to deliver equality of opportunity and consideration for those in need. Interventionist industry policies are inconsistent with that approach on both counts. They are designed to favour one group over another and are ultimately funded by the average Australian worker either directly through taxation or by way of an impost on household consumption. Interventionist industry policies are thus anathema to the principles of labour, if not its historic practice. ■

MICHAEL COSTA is an organiser for the NSW Labor Council.

■ LEAVING THE BARRIER

On the one hand, protection has served Australia badly. On the other, its removal leaves us decidedly vulnerable. The dilemma leaves Sue McCreadie feeling uneasy.

The recent backlash against 'economic rationalism' has challenged our over-reliance on market forces to accomplish restructuring and the subordination of social goals to economic ones. In the commonsense of many on the left, tariff reductions belong in the litany of 'economic rationalist' sins allegedly committed by the Labor government over the 80s, alongside financial deregulation, the erosion of universal welfare provision, corporatisation, privatisation and, more recently, the shift away from centralised wage fixing.

But while the debate about tariffs is part of a wider debate about the power of the market to allocate resources effectively, not all those on the side of interventionism are in favour of protectionism. The recent debate over Australian industry policy was inaugurated by the Australian Manufacturing Council's (AMC) report *Global Challenge* and the *Garnaut Report* in 1990. In that debate, those who argued for government assistance to industry on the grounds of market failure and the unlevel character of the international playing field also generally insisted that protectionism was not the best way to assist industry and that highly protected industries