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 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 upstream processing activities. It is quite possible to be an upstream 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.

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were not the best foundation for the future. Rather, they argued, Australia should find a niche in the international division of labour which is based on high value added traded goods and services.

While many critics of 'economic rationalism' warn that attempting to compete with lower wage/low tax countries in the region without protection will inevitably force down our own living standards, those advocating a strategic industry policy respond that we shouldn't even be trying to compete with low wage countries. But is this debate a helpful and realistic one? Perhaps it would be more helpful to couch the debate in terms of possible futures rather than inevitable outcomes and to concede that while protectionism in the past has had some negative outcomes, there are still good reasons for being sceptical about the intrinsic benefits of removing it.

There was little doubt that protection historically allowed an inward-looking culture to flourish behind high tariff walls and stifled innovation. It is undeniable too that protection has raised the costs of inputs to exporters and imposed costs on the consumer and hence the economy as a whole. However, prices are known to be downwardly 'sticky', not the least because of the oligopolistic power of retailers and importers who may be tempted to boost their own margins rather than reduce prices to their customers.

And in a situation of less than full employment of resources it is clear that moving labour and capital out of protected industries does not in itself lead to greater allocative efficiency while, at the same time, it clearly leads to losses of output, jobs and income, all of which has a multiplier effect at regional and national level. This being the case, it is more than possible that the negative income effects—direct and indirect losses of jobs and output—will outweigh any positive price effects.

The AMC's Global Challenge report, among others, argued that simply reducing protection will lead not to a level playing field, but an empty one, and that reductions must be coupled with microeconomic reform and positive assistance measures. Union support for reduced protection has been further contingent on adequate labour adjustment and regional adjustment policies. And while economic liberals believe that Australia will benefit from dropping out of trade barriers, irrespective of what happens elsewhere, unions have also noted the need for reciprocity of our trading partners and the observance of minimum labour standards in countries exporting to us.

The current economic dilemma is whether or not it is possible to find a niche in the new international division of labour which doesn't entail dismantling our arbitration system, undermining our welfare state and our living standards, and worsening social inequity.

There is no doubt that, since tariff reductions began, manufacturing exports have grown and a cultural shift has overtaken many firms who are now enthusiastically embracing 'international best practice'. However, many among the more recalcitrant have instead responded by moving into sub-contracting and outwork, and attempting to undermine award conditions. Again, the lure of export processing zones with tax holidays and weak unions has proved too strong for others who have simply packed up and gone offshore.

Our great dilemma is that neither governments nor unions have any significant control over corporate strategies. Of course, the role of industry policy is to nudge firms into making desirable restructuring decisions, and a range of positive assistance programs now offer export and investment incentives, advice on strategic planning and marketing, grants to encourage international best practice, and so on.

However, leaving aside the adequacy or otherwise of the industry assistance budget, there is nothing magical about the capacity of positive assistance—sometimes it has the desired effects, sometimes it doesn't. And while it is true that we relied too heavily on trade barriers in the past, it does not follow that there can be no role for this instrument in the future. A sensitive and sophisticated industry policy needs to include a mix of positive assistance measures as well as selective use of trade barriers. By 'trade barriers' I mean not just tariffs, but also various non-tariff barriers, including environmental and health standards and voluntary export restraints.

Commentators are now warning darkly that in the event of the Uruguay Round of GATT talks failing, the hand of protectionism could be strengthened. It is fashionable to talk of 'vested interests' and to hint at privilege, as if there were no vested interests on the side of liberalisation. It's worth noting that the latter side has been bolstered by the conversion to zero tariffs of at least one Australian 'multi-domestic'—Pacific Dunlop—which has staked a significant part of its future on offshore sourcing rather than local production.

Among those bearing the brunt of industrial restructuring at present are many of the least privileged members of the workforce, including many migrant women, older women, and those with little formal education. It is not adequate simply to dismiss this as an unfortunate side effect. Of course, the social inequities of tariff reductions could be lessened if we had much more generous income support arrangements for people who were displaced. The regional burden could be lessened if we had a coherent framework for regional economic development, rather than an expectation that displaced workers should pack up their belongings and move.

Although the direction of change in tariff policy may be right, the size of the March 1991 tariff reductions in particular went further than expected and the timing was socially irresponsible. In the current recession, there are strong grounds for slowing the pace of tariff reductions—whether through a straightforward pause through linking reductions to a reduction in the unemployment rate.
There is a strong case also for linking trade liberalisation to the development of trade union rights in countries exporting to us. While not without problems this approach is also not without precedent. The US has operated a social clause in its trading arrangements with the Caribbean. The EC Social Charter is a variation on this theme. During the Uruguay Round the EC and the US have strongly supported the establishment of a GATT Working Party to examine the social clause formula which would link market access to observation of minimum labour standards.

The government is fond of invoking our moral obligations to developing countries as part of its argument for trade liberalisation, but it seems remarkably disinterested in the fate of those workers who are drawn into the sweatshops of the Export Processing Zones. But does Australian industry and the Australian consumer have an inalienable right to cheaper products if this is a result of exploitation of labour or ruination of other countries' environments? A code of conduct for Australian companies investing and sourcing from abroad could be the foundation for a socially responsible policy on trade liberalisation.

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COMING, READY OR NOT

Industry policy is the workhorse of industrial dynamism. This axiom underpins the relationship between the market and the state in the life of national capitalist economies. The nature of an economist's training in the English-speaking world obliterates the comprehension of this simple truth, self-evident to anyone residing in Europe or Asia.

Behind the noisy debate on tariffs, a quiet revolution is occurring. Pockets of business practice in Australia are gradually being transformed. The change is embodied in the intangible aspects of business culture, of business strategy, of workplace organisation within firms and of relationships between firms. Some examples of these developments follow.

1. In 1984 the Victorian government set up an Industrial Supplies Office (ISO) under the auspices of the Employment Ministry. Despite major bureaucratic antagonism and corporate indifference the institution flourished. NSW copied the concept in 1985 and it has since spread to the other states (except WA, where it met with antagonism from the major resource companies). The ISOs provide to companies needing equipment information on the availability of supplies produced within Australia. The ISOs enhance the operation of the market because of massive information disjunctures, and because management and purchasing officers in many companies operate with conventional prejudices that imported equipment is either of superior quality to that produced locally, or is not available locally. It is estimated that the ISOs have been responsible for import replacement to the tune of $790m.

2. In 1985 the Victorian Department of Industry developed a scheme to assist heavy engineering firms in that state. It was pursued at state level partly because of fears that a plan mooted for the national level would never be approved by bureaucrats in Canberra. The Companies Development Scheme was an early pioneer in the development of bureaucratic support schemes to reconstruct business culture. Department personnel consulted in depth with management, arrived at mutual agreement on needs, and tailored a package to meet those needs. The scheme aimed (successfully) to entrench strategic planning in the target firms. It introduced a 'key persons' approach to try to redress the manifest deficiency in broad management skills; this subsidised the cost of recruiting and employing for one year a specialist in a particular field. The scheme cost a mere $5m, and dispensed about $30-50,000 to about 90 companies. While the Victoria Economic Development Corporation (VEDC) was dispensing considerable sums to companies without safeguards, this unheralded scheme was enhancing cheaply the integrity and dynamism of the heavy engineering industry.

3. More generally, business practices are being assisted by the National Industries Extension Service (NIES). NIES field officers are contract staff, all with technical and/or financial experience in industry. Considerable effort is expended in selecting and training field officers and in the accreditation proc-