

To: Automotive
Subject: Auto inquiry

This is a slightly revised version of a contribution I made to the Candobetter web site in December last. It is more impressionistic than rigorous, but is intended to place the auto industry in a historical and broader context than we usually hear.

The demise of the motor industry in Australia is the culmination of a long history of economic mismanagement by successive governments. The industry was established in the middle of last century, with on-going assistance in the form of tariffs, subsidies and other forms of protection, which were far too generous and were retained far too long, resulting in too many inefficient plants which were too small to reap the scale economies necessary in such a high tech industry as the motor industry. An Industry Assistance Commission report in the 1970s estimated that, for maximum efficiency, assembly plants should produce a minimum of 110,000 vehicles per annum, compared with the actual Australian average of 40,000 (spread over 12 plants), and well below current estimates.

The reforming Hawke/ Keating/ Button government eventually took the initiative to reduce protection levels (but not completely), and sensible rationalisation measures resulted in the closure of many of these inefficient plants. 'Effective rates of protection' for the motor industry were reduced from 119% in the 1970s to 36% or less by the mid 1990s.

Were there any valid arguments for protecting the industry? Two arguments stand out: firstly the *self-sufficiency* argument; namely that for industries of strategic importance we should not be too dependent on overseas sources in case supplies are cut off, especially in time of war. Secondly the *infant economy* argument, also called the *external economies* argument. This is a tricky one, but the argument goes something like this. As a country develops it will inevitably need to pass through a transition stage from an infant rural economy to a mature industrialized economy with a diversified manufacturing base. But because of the importance of external economies in the development of industries which are highly interdependent (e.g. motor assembly manufacturers and component parts manufacturers), some form of government planning or assistance is needed, but only for a limited period – perhaps a few decades.

With the benefit of hindsight, the motor industry may have been established too early in the transition stage, but by the end of the century it should have been well and truly bedded down. But then we then had a mining boom, which was allowed to merrily roll along with disastrous effects on the manufacturing sector, especially the internationally competitive motor industry. The market mechanism responsible for this was a rapid rise in the \$A due to a significant increase in overseas investment induced by very high export prices.

In effect, the mining boom represented a transition from the manufacturing sector to the mining sector, which undid much of the beneficial effects of previous government attempts to protect and develop the manufacturing sector, at enormous cost. It was painfully obvious a few years ago that the federal government should have introduced stronger measures to curb the mining boom, e.g. by preserving and increasing the resource rent tax and by discouraging the import of foreign labour which mining moguls claimed to be so necessary. Slowing the mining boom would also have

reduced or delayed the adverse environmental impacts of mining. Also, because the mining industry is very capital intensive, the exchange rate adjustment would, I expect, create fewer jobs than those displaced in manufacturing and other sectors, resulting in an overall increase in structural unemployment.

The above analysis may be an over-simplification, but it is frustrating when so much of public debate on economic policy waffles around peripheral issues instead of analysing central core fundamentals, or is distracted by shallow arguments of dubious logic, such as “other countries protect their motor industry so we should also”. If other countries subsidise the production of cars, do we not benefit from lower import prices? And if other countries prop up inefficient industries, is that a reason for us to also prop up inefficient industries? Maybe yes if self-sufficiency is the purpose, but the arguments need to be fully explained.

Another popular misconception is that the industry should be retained to maintain jobs. All structural change involves employment change, and we are dealing here with a long-term structural adjustment problem that requires long-term solutions. Unemployment is a short-term phenomenon requiring short-term solutions, and I expect the government will address these.

What next? The damage is done and our manufacturing base is weakened. Furthermore, if too much of the manufacturing sector is lost, I fear that the externalities argument could work in reverse, with a snowballing downward effect as industry interdependence links are weakened. The government clearly needs to draw up a long-term plan of where we are heading as a nation, free from short-term political expediency.

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