A PLAN FOR INDUSTRY DEVELOPMENT

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This article is included in this issue of the journal with the intention of stimulating debate on current economic policy issues. It is a review article, focussing on the recent publication by the Metal Trades Unions, Policy for Industry Development and More Jobs, *August 1983. The article situates these proposals in the context of the broader debate on the Accord and industry policy*

INTRODUCTION

The role of industry policy in the management of the Australian economy is crucial. Industry policy is central to the "Accord" struck between the Federal government and the A.C.T.U., and it was an important aspect (albeit subsidiary to wages policy) in the agreement with employers and trade unions established at the "economic summit" in 1983. However, the development of a coherent industry development policy has yet to occur. Some piecemeal policies have been introduced to deal with acute problems in particular industries (eg. cars, steel) and some of the administrative apparatus necessary for consultation and development of tripartite agreements (eg. EPAC, Manufacturing Industry Council, industry councils) has been established. However, there is abundant evidence from statements made by government ministers and from other aspects of economic policy (eg. deregulation, floating the exchange rate, entry of foreign banks) that the government remains strongly influenced by the "economic rationalists" whose ideas derive primarily from orthodox economic views about the beneficial effects of free market forces. Meanwhile, restructuring of Australian industry continues in a manner which involves substantial job-displacement.

Not surprisingly, this situation has been of concern to Australia's largest union, the AMFSU. Its assistant national secretary, Laurie Carmichael, played a major role in the Accord through his position on the ACTU, and has long taken the view that unions should go beyond their traditional concerns with wages and working conditions and become involved in a more interventionist approach to a wide range of political/economic issues - hence the earlier campaigns around the development of the People's Economic Programme and the defence of the social wage. The Accord, from this viewpoint, provides an opportunity for the industrial wing of the labour movement to extend its influence into the policy arena, and an opportunity to move from a defensive, reactive position into a more positive position in the design of economic policy.

Consistent with this general philosophy, the Metalworkers commissioned a major study of how industry policies could be developed, particularly in regard to the heavy manufacturing sector of Australian industry. The study, published in August 1984 is based on quantitative analysis directed by Dr. Peter Brain of the National Institute of Economic and Industry Research, and also involved the work of a large number of people including many who have been associated with the Australian Political Economy Movement. The report (hereafter referred to as the Metalworkers' Plan) is a massive piece of work - some 273 pages including appendices - and currently in limited circulation.[1] A popular version of it is planned for production in early 1985, along the lines of the previous pamphlets, Australia Uprooted, Australia Ripped-off and Australia On The Rack. Meanwhile, the issues it raises deserve careful consideration. This article seeks to distill out those elements of the study likely to be of most interest to J.A.P.E. readers and to set it in the broader context of industry policy and overall economic management.

THE ROLE OF INDUSTRY POLICY IN THE ACCORD

Most discussions of the Accord have focussed on prices and incomes policy. Certainly, that is a central element, although it looks more like a wages policy in practice, and a fairly conservative one at that. The restraint on wages has not been matched by any corresponding control over non-wage incomes eg. from rents, interest, dividends, professional fees; and the extent of price control is minor even by comparison with the Prices Justification Tribunal introduced by the Whitlam government. But even if the prices and incomes policy turns out in practice to be little more than wage restraint, it nevertheless remains part of a broader "deal" involving improvements in the social wage, tax reform and policies to increase employment. It is in the latter respect that industry policy is particularly important.

The Accord states that "the paramount objective of economic policy is the attainment of full employment. Industry development policy should be integrated with macroeconomic policy to achieve this goal". This view was endorsed by the participants at the "national economic summit", whose communique included the following two paragraphs:

> "The Summit, understanding the enormity of inhibiting pressures on industry development at this time, supports the introduction of an active industrial development policy, including Government priority purchasing of Australian made goods and stimulatory fiscal policies which enable increased capital works and effective job creation schemes to be implemented."

> "The Summit accepts the Government's commitment to retaining programs of protection in the current economic climate and the priority it is giving to matters of pressing relevance to the problems of particular industries, such as dumping and adjusting temporary assistance mechanisms. The Summit stresses the importance of these policies as part of a wider policy for industry reconstruction and development."[2]

Laurie Carmichael's foreword to the Metalworkers' Plan stresses the need to beef up these aspects of policy, arguing "that the employment objective should be achieved through a combination of policies including:

> expansionary macroeconomic strategies,
> redistribution, tax and wealth programmes,
> effective industry development strategies involving:
>
> (i) across-the-board manufacturing industry modernisation programmes,
>
> (ii) specific industrial expansion programmes for the key metals and engineering technology industries, based on a combination of import replacement and export expansion,
>
> (iii) an effective and well resourced consultative decision making framework involving government, industry and trade unions." (p.iii)

Actually, the Metalworkers' Plan goes out of its way to say some rather generous things about two aspects of the Accord already implemented by the Hawke government. First, an expansionary fiscal/monetary policy is credited with achieving rapid economic growth, creation of nearly ¼ million jobs between April 1983 and May 1984 and a reduction in inflation. Second, distributional objectives are said to have been effectively pursued through the tax cuts in the 84-5 budget and various programmes such as Medicare, expenditure on employment and training schemes, public housing and the first home buyers scheme, changes to social security arrangements, and so on. (p.viii-ix)

Lest this all sound too rosy, it is stressed that industry policy reamins a missing link in the economic policy. As is clearly stated in the Introduction to the Plan, "it has been of some considerable concern to the ACTU and to the Metal Trades Federation of Unions in particular that little has been done to integrate the Accord's industry development policy with macroeconomic policy and the management of competing industry claims" (p.ix). This is followed by a stern warning: "These and other issues have left workers and their unions with little confidence that the deindustrialisation of Australia is a central concern of Government. This in turn has led the union movement to question the commitment of Government to the Accord's industry policy prescriptions. Without such a commitment, union acceptance and support for other areas of the Accord could be diminished at a critical stage in the conomic upturn. (p.x, emphasis added)

The message is clear: the future of the Accord depends on the introduction of an effective industry policy.

THE CASE FOR INDUSTRY POLICY

Given the influence of orthodox economic ideas about the efficacy of "free markets", the onus is normally on those who would wish to argue for a more active role of government. Three aspects of the Metalworkers' Plan are notable in this respect: an attempted negation of conventional pro-market microeconomic analysis, a sophisticated use of macroeconomic modelling to show how industry policy can reduce constraints on economic growth in the rest of the decade, and a carefully argued case for selectivity in the application of industry policy.

(a) Microeconomic analysis

The pervasive effects of neoclassical economic analysis are clear. As the Metalworkers plan puts it: "arguments ... that rely on the implications of the perfectly competitive neoclassical model of economic behaviour suggest that industry development policies distort price and cost relativities and result in a sub-optimal distribution of resources (capital, labour and land). The result obtained from this model is that a greater proportion of resources are allocated to industries yielding a lower output per unit of resources input that would be the case in the absence of industry policies. Consequently, there is a lower overall real income per capita:" (p.1)

Three underlying assumptions are identified:

(i) that the proper pattern of resource allocation is the most important economic problem;

(ii) that diminishing returns operate (such that increases in any one factor of production will lead to disproportionately smaller increases in output) and that there are long-run constant returns to scale;

(iii) that there is substitutability between all inputs in the production process (and products in consumption).

In each case, it may be argued that the reverse assumption provides a more useful basis for analysis of contemporary capitalism, i.e.

(i) Resource allocation is less important in determining economic welfare than resource creation. Indeed, as Nicholas Kaldor has noted "when every change in the use of resources...creates the opportunity for a further change which would not have occurred otherwise, the notion of an 'optimum' allocation of resources... becomes a meaningless and contradictory notion."[3] The Metalworkers' Plan notes similarly that "the pattern of resource allocation at any given time should properly be seen as nothing more than one point in an extended sequence of industrial growth and development, a sequence in which changes in productivity, technological change and consumer tastes, etc., are, in sharp contrast to neoclassical theory, all determined endogenously by the development process itself." (p.4) The inference is clear: that industry policy can generate resource-creation in a way which is systematically ignored by the "economic rationalists".

(ii) Increasing returns are characteristic of modern industry. Conventional arguments about scale economies and the division of complex processes into routinised simple processes are supplemented by an interesting argument about the benefits of "learning by doing". If the optimum design for machines can only be achieved after years, or possibly decades, of experience, then there are dynamic advantages arising from safeguarding such industries from the volatility and unpredictability of free-market situations.

(iii) Complementarity of industries is the order of the day. As the Metalworkers Plan puts it "In practice, sustained economic growth is characterised by the simultaneous evolution of a wide range of industries, bound together by a network of complementary purchases and sales." (p.4) Again the inference is clear: the performance of any one industry is closely tied up with the performance of related industries, and thus sustained growth depends on policies which safeguard the existence of such interdependent groups.

All this may sound like an unwarranted excusion into the realm of orthodox economic theory; indeed, readers of the Metalworkers' Plan might well be surprised to see material of this kind more obviously addressed to an academic audience than to bureaucrats and policy-makers. However, it does help to establish that the conventional wisdom about free markets rests on shaky theoretical foundations. The appropriate conclusion is not the rejection of the traditional concept of comparative advantage, but the recognition that comparative advantage can be created. In a sense, that has always been recognised in "infant industry" arguments for protection. What the Metalworkers' Plan does, quite properly, is to show that comparative advantage is not a static concept, as treated in neo-classical economics, dependent only on relative factor prices, but that "it can be created by industry development policies which lead to the development of sophisticated and highly differentiated production activities, perfectly consistent with the economy's underlying structure". (p.6).

(b) Macroeconomic analysis

The sterility of the general theoretical debate on free trade versus industry policy is emphasised when one introduces considerations of macroeconomic analysis. As the Metalworkers' Plan puts it, "the case for industry development policies is crucially dependent on the prevailing economic environment". (p.8). The most obvious aspect of this is the level of unemployment: as previous bodies such as the Crawford committee acknowledged, a programme of tariff reduction which might have beneficial effects at a time of full unemployment may be quite inappropriate when unemployment levels are high.

The Metalworkers' Plan incorporates the results of some econometric analysis, using a model which features four major contraints on economic growth:

(i) capital capacity constraint. The physical capacity of industry sets a limit, being the product of past investment decisions and depreciation. If demand expands beyond this limit, "either inflationary pressures will develop or the additional demand would be met from foreign sources". (p.8).

(ii) balance of payments constraint. If a significant part of any growth in domestic demand for goods and service involves increased expenditure on imports this is likely to generate a deterioration in the balance of payments. This problem, and the consequent tendency for governments to respond by the introduction of deflationary measures leading to a "stop-go" pattern of economic growth, has been a major reason why proponents of an Alternative Economic Strategy in the U.K. have advocated import controls.[4] More cautiously, the Metalworkers' Plan notes that "policy initiatives by any one economy to achieve a balance of payments advantage are likely to be met by retaliatory policy action which will either neutralise or more than offset the initial advantage" (p.11).

(iii) public sector borrowing requirements constraint. To the extent that economic growth involves growth in government expenditure, a problem may arise if domestic financial institutions have difficulty in absorbing government debt without increases in interest rates which would have the effect of curtailing private sector investment. This may be regarded as a rather uncritical acceptance of the "crowding out" argument, but its incorporation into the model may be regarded as an attempt to face up to all possible objections from more monetarist-oriented economists.

(iv) inflationary expectations constraint. It is acknowledged that investment depends on business expectations. (As a business representative at a recent Melbourne conference put it "investors are sensitive people who need frequent reassurance"!) In the words of the Metalworkers' Plan "producers will only secure markets, invest and employ labour if they expect a stable economic environment and, in particular, a stable inflationary environment to be maintained" (p.9).

Based on this model, projections for the period 1984-1989 indicate the limits of conventional policy instruments. What is indicated is that, while economic growth is certainly possible, it is unlikely to be such as to reduce unemployment below the projected level of 0.82 million people by 1988-9. (p.47). Enter industry policy. Such policy is a means of reducing the constraints and thereby reducing the expected level of unemployment.

How is this to be achieved? Surprisingly the Metalworkers' Plan does not spell out explicitly how industry policy operates on the four individual contraints. However, this may be deduced from subsequent argument and from general reasoning. Thus one may fairly readily infer that the capacity constraint is seen as being reduced by a programme of investment and modernisation, such as is later advocated in the report. (pp.243-256). Likewise, the balance of payments constraint would be reduced by a policy of import substitution and/or export promotion (pp.107-185). The public sector borrowing requirement constraint is more of a problem. To the extent that industry policy requires government expenditure, the constraint is increased in severity. However, to the extent that such a policy creates additional jobs, it raises tax revenues and reduces social security commitments. In effect, it could be seen as helping to reduce the cyclical component of the budgetary deficit by increasing its structural component. Unfortunately there are no estimates of the overall net effect on the public sector borrowing requirement. Regarding the fourth constraint the picture is more clear, though: to the extent that industry policy keeps the Accord in place, it helps prevent the emergence of an explosion of wage claims and consequent fears of rising inflation. In terms of orthodox economic analysis it keeps the Phillips curve (showing the unemployment/inflation trade-off) to the left, and thereby checks inflationary expectations. In term of a political deal: no industry policy, no wage restraint.

(c) Selectivity

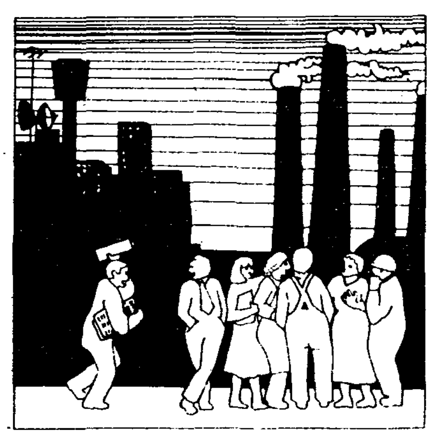
It is conceded that industry policy is not costless. In that it involves government expenditures, there are opportunity costs associated with other expenditures foregone. In that it involves protectionist measures: it imposes additional costs on consumers.[5] This is acknowledged by the Metalworkers' Plan (p.49). It is also emphasised that industries differ in their capacity to take advantage of industry assistance (p.50). Hence the need for selectivity.

This type of reasoning picks up a theme now well established among political economists in Australia, regarding the need to move away from the sterility of the "free trade versus generalised protection" debate to a more sophisticated consideration of how selective protectionist measures can be incorporated into a process of national economic planning. The general case for this "third way" was made over a decade ago by Jim Cairns in his book Tariffs or Planning and has been echoed more recently in this journal in the special issue on Alternative Economic Stragegies.[6] Peter Brain puts the point strongly in his personal preamble to the Metalworkers' Plan: "To continue to prolong the debate in terms of the simplistic dichotomy between free trade versus protection is to trivialise the fundamental issues and objectives associated with Government policy..." (p.xii).

If governments are to be selective in using a range of industry policy measures to control the process of restructuring, what criteria are to be applied? The first is growth potential. This can be considered in general terms in relation to the income elasticity of demand. It is

noted for example that, in world markets, such elasticities are higher for manufactured goods than for food and primary products (p.xxi). Of course, caution is needed in applying this sort of reasoning, because the simple conclusion that it is better to specialise in high elasticity products, on the assumption of growing per capita incomes in world markets, needs a host of qualifications. Our location relative to those markets and our domestic production capabilities are important constraints (p.56).

The second criterion, moving from demand to supply-side considerations, is technological advantage. "The selection of industries for assistance must take into account whether or not the development of an industry or class of industries will strengthen the overall technological base of the economy and, if so, to what extent" (p.58). Technological change is not exogeneous, as assumed in most economics textbooks, not "manna from heaven". Rather, the Metalworkers' Plan argues, it normally involves a process of diffusion beginning in key sectors such as the component and capital equipment industries: "therefore, the relative efficiency of the overall economy is ultimately dependent on the degree of specialisation in the component and capital equipment industries, hereinafter referred to as the technology industries" (p.57). This last proposition is clearly intended to lend support for the subsequent selection of the heavy engineering sector as one particularly appropriate for industry assistance. It is not wholly persuasive as it stands and would require considerable supporting evidence. What needs to be demonstrated is that this industry sector is a particularly powerful engine of growth, because of inter-industry linkages and multiplier effects, as well as the dynamic effects of technological change. These criteria for selection of industries deserve careful consideration. The arguments are not the same as those conventionally applied to "infant industries", but they are similar in that industry assistance is seen as an interim measure. The Metalworkers' Plan talks of three phases, the first of which involves increasing output based on a protected home market, then a period of export growth, followed by a period of withdrawal and reallocation of assistance to the next set of industries selected for development (p.xvi). The inference is clearly that the primary candidates for assistance are those capable of eventually standing on their own two feet, and likely to generate stimulatory secondary effects on other sectors of the economy, especially via the diffusion of technological innovation.



THE METALS AND ENGINEERING SECTOR

This industry grouping is said to be in dire need of policy assistance and to meet the criteria set out for such assistance. It comprises enterprises concerned with the production of a wide range of fabricated products with a high metal content. About half the output is supplied to other industries as inputs into the latter's current production.(pxvii) It is a major part of capital goods production in the Australian economy. In Marxian terms, it comprises much of Department I, although it also produces goods bought by final consumers (Department II).

Why is industry development assistance warranted? Four considerations stand out:

(i) Job losses. The severity of the decline in employment is indicated by the following statistic: a net loss of 152,000 jobs in the period 1974-1983. (p75)

(ii) Rising imports. Half of Australia's manufactured imports are made up of metals and engineering goods. Between 1966 and 1981, the share of imports in the total supply of manufactured goods increased by 32%. The metals and engineering import share increased by 41%, while for non-metals the increase was roughly 23%(p108).

(iii) Export potential. Between 1970 and 1979 OECD exports of capital goods increase in real terms at an annual average rate of 12.1%, compared with a general growth in trade of manufactures of 9.3% (p17). Economic growth in S.E. Asia and the Pacific Region offers particular opportunities for Australian industry.

(iv) Diffusion of technology. The workforce in the metals and engineering sector is very skill-intensive: in Victoria, for example, the industries are said to account for 8% of total employment, but 34% of professional mechanical engineers, 50% of engineering technicians and between 50 and 75% of all craft-skilled employment. (pp71-74). The industries "play an active role in the identification, transfer, adaptation and diffusion of technological opportunities for the whole economy" (pxxiii).

These considerations, some negative and some positive, may be seen as justifying an industry policy which protects jobs and provides temporary protection from international competition so as to secure growth in the domestic market, thereby strengthening the basis for export expansion and technological diffusion. The usual sort of objection made against this sort of view, of course, is that the short-run protection may have the reverse effect, undermining export potential and the dynamic technological impacts, because it reduces the stimulus to increase efficiency. This possibility is recognised by the Metalworkers' Plan (p6) but countered later in the report, by the proposition that modernisation and increased capacity to compete can be pursued through the particular form of industry assistance.

The implicit judgement is that net job creation would be positive. Specifically, the industry development proposals can be considered in four parts:

(i) Demand-stimulus and import-replacement. Bringing forward capital works programmes would be one direct means by which government expenditure could effect demand-stimulus. (p.157). It is explicitly stated that unions for their part would "reiterate their no extra claims commitment, their willingness to set up machinery to resolve demarcation disputes before they become a problem and to enter into discussions with employers and Government on inproving industrial relations practices" if such a policy were forthcoming (p.158). Another interesting proposal is for the establishment of an industrial supplies office, designed to give advance notice to Australian metals and engineering firms of the capital goods requirements of mining and manufacturing firms. Purchasing of equipment, it is noted, is often locked in 18 months to 3 years in advance, so such advance notification would give a distinct advantage to the Australian industry in tooling up to meet forthcoming demands. Various other proposals are also presented e.g. regarding protection from dumping. However, all in all, what is proposed is not a generalised increase in tariff protection but specific measures to deal with features of the market for heavy engineering goods which currently limit the expansion of the Australian producers.

(ii) Export expansion. Similarly, it is argued that, given the importance of a host of non-tariff restrictions on trade, policy should be directed to reducing the various impediments to improve export performance. Particular attention is paid to the effect of export franchise restrictions, whereby a firm prohibits its subsidiary or licensee from exporting certain products or permits exports to designated markets only. It is argued the foreign investment review procedures should be more strict in limiting these sort of operations (p.181). The matter had previously been considered by the Vernon Committee (1965) and the Jackson Committee (1975) but the problem remains. It has been estimated that, of 7000 exportable items with promising markets, 1000 are subject to export franchise restrictions (p.181). Other aspects of an export assistance package which are discussed include export finance, export promotion, foreign aid tied to the purchased of Australian exports, offset purchases, an overseas market information system, and renegociation of the Closer Economic Relations agreement to provide "improved access for Australian manufactures in the N.Z. market" (p.185).

These suggestions are tentative: in the spirit of consensus, it is said that the policy package "can only be constructed after consultation between exporters, unions and the Department of Trade". (p.184).

(iii) Modernisation. A major sector of the report is devoted to proposals for modernisation (pp243-282). Emphasis is placed on existing problems regarding "out of date equipment [which] tends to become progressively more susceptible to breakdowns", and the implications of "the increasing average age of the industry's capital stock ... for the industry's overall efficiency, costs and hence profitability" (p. 245). Strangely though, the report at this stage meanders at length through the academic literature on economic development (Hicks, Hahn, Chenery, Hirschman, Young, Rosenstein - Rodan, Nurske, old uncle Nicky Kaldor an' all...) and some general considerations of relationships between small and large firms. To be sure, the key role of technologically advanced sectors in the economic development process is worth establishing, but one might have expected more specific proposals about what, where and when as well as why modernisation is needed.

(iv) Consultative Machinery. Finally, the Metalworkers' Plan includes an extensive discussion of possible machinery for the implementation of industry development assistance policies, and the principles to be applied (pp287-309). The concept of an Industrial Development Agreement is introduced, involving union and workforce participation in the decision - making processes of firms. This is justified on the grounds that successful industry development programmes would often require changes in functions, locations, skills and possibly number of employees, particularly where technolgical change is involved.

RESPONSES.

The response from the Federal Government has not been encouraging. The Minister for Industry and Commerce said at the ALP National Conference that the best form of assistance would be to encourage the development of resource projects, thereby indirectly stimulating potential domestic demand for the output of the heavy engineering industry. The Prime Minister has since emphasised the "futility" of "often ill-conceived" solutions to industry problems, arguing that increased protection from imports and higher public expenditure on the output of the industry are not warranted.
"Such palliatives could have the opposite effect of what is intended.

They would raise costs faced by other industries and the community at large. In this way the national strategy for general economic recovery would be put at risk". Rather, the Prime Minister's view is that the government's policies have provided the type of enviornment the heavy engineering industry needs for growth.[6] A report on the appropriate short-term and long-term policy measures has been requested from the Industries Assistance Commission, notorious for its consistent application of the very economic orthodoxies systematically criticised in the Metalworkers' Plan.

Of course, what is involved is not merely an academic debate but a political struggle. The continued rejection of the proposals could be expected to lead to a growing confrontation with the AMFSU which would have the support of employers for at least some aspects of the proposals. What is involved is a key economic sector, and a trade union whose stance is very significant to the future of the Accord. That union has previously demonstrated both its militancy and its willingness to work within agreements established both at the industry and national level. Its latest initiative is an example of how to move from a defensive posture to a more positive policy-oriented position, and to use the Accord as an avenue for the pursuit of the objectives of sections of the labour movement. Of course, it remains to be seen whether the industry policy element within the Accord can be used as a basis for the development of systematic economic planning involving the participation of organised labour. The Metalworkers Plan is a test case.

The proposals deserve careful consideration by all who are interested in the current employment problems in Australia. It can be anticipated that they will be criticised from an environmentalist perspective (because of the major problems of pollution often associated with heavy industry) and from a feminist perspective (because of the lack of consideration given to the differential impact of the proposals on the employment of men and women). However, as an analysis of industry development problems and policies, the Metalworkers' Plan is a sophisticated, quantitative and carefully reasoned piece of research. If nothing else, it would certainly come as something of a shock to those who think of trade union activities focussing primarily on "strikes, violence, intimidation and the destruction of private property".[8]

FOOTNOTES

1. Metal Trades Union, Policy for Industry Development and More jobs, August 1984.
2. National Economic Summit Conference, April 1983, Communique, paras 35 and 38.
3. N. Kaldor, "The Irrelevance of Equilibrium Economics", The Economic Journal, December 1972, cited in Metal Trades Unions, op.cit. p.5
4. See, for example, CSE London Working Group, The Alternative Economic Strategy, CSE Books, London, 1980 Chapter 8.
5. See D. Peetz, Protection and the Labour Movement, The Journal of Australian Political Economy, No. 12/13, June 1982.
6. J.F. Cairns, Tariffs or Planning?, Lansdowne Press Melbourne, 1971; A. Hopkins & R. Curtain, The Labour Movement and the Protection versus Restructuring Debate: A Proposal, The Journal of Australian Political Economy, No. 12/13, June 1982
7. Sydney Morning Herald 18.9.84 "Hawke takes hard line on help for heavy industry".
8. Sydney Morning Herald 14.8.72, Editorial