
REVIEW ARTICLE

Beyond Picking Winners? Recent Writings on Australia's Industry Policy

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Jenny Stewart, The Lie of the Level Playing Field, The Text Publishing Company, Melbourne, 1994

Ian Marsh (ed.), Australian Business in the Asia Pacific Region: The Case for Strategic Policy, Longman Cheshire, Melbourne, 1994

P. J. Sheehan, Nick Pappas & Enjiang Cheng, The Rebirth of Australian Industry: Australian Trade in Elaborately Transformed Manufactures 1979-1993, Centre for Strategic Economic Studies, Victoria University, Melbourne, 1994

JUST when you thought the Australian industry policy debate was over, three recent contributions again call for a grand vision to create a viable manufacturing sector. But the nature of the debate has shifted. Debate over tariff protection is all but over. There is a consensus over the damage done to Australia by past protection, including the legacy of an inward-looking and uncompetitive manufacturing sector.

This consensus arose during the 1980s as several reports drew attention to the Australian economy's need for reform and greater international orientation. Apart from the pace of tariff reform, the point of departure between the so-called 'economic rationalists' and the 'interventionists' centred on what governments could best do to achieve sustained export competitiveness and growth. From the economic rationalist camp, the Hughes Committee (1989) highlighted the importance of macroeconomic policies consistent with the objective of improving Australia's export performance. Meanwhile the Garnaut Report (1989) argued for the continued internationalisation of the Australian economy, but was most widely quoted for advocating the removal of tariffs by 2000. The Industry Commission (1990) then

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questioned the relevance to Australia of looking towards the rapidly growing East Asian economies for examples of successful government targeting.

At the forefront of the interventionist camp was the Australian Manufacturing Council's (AMC) (1990) report, *The Global Challenge: Australian Manufacturing in the 1990s*. This report differed from the others in advocating the use of positive measures to create export firms in high value-added manufactures. All the three books under review share this theme. They argue that Australia should 'tilt the playing field' and adopt a strategic approach to 'create' export winners. This, it is claimed, represents the East Asian industrial experience.

It's All Down Hill From Here

According to Jenny Stewart's *The Lie of the Level Playing Field*, Australia is in economic decline. Since the mid-1970s, each recession has been a little worse, more prolonged than the last. Without an explicit, determined industry policy the country is doomed.

As deindustrialisation continues, young Australians will be forced to leave this country in search of work. When this happens the economic rationalists will no doubt identify yet another 'inevitable' trend, and wax lyrical over the new international mobility of labour. . . . The societies to which they will go are no luckier than Australia, except in one respect. They are not burdened by elites who find it difficult to concentrate on the main game, and then only from the distorted perspective of the level playing field. (p.13)

Such is the tone of this book: a call to arms to save manufacturing from the economic rationalists in the bureaucracy and academia. Like recent contributions of this *genre*, the term 'economic rationalist' is used consistently and pejoratively. Australian policy-makers, Stewart argues, have lacked any real sense of the importance of manufacturing to Australia's economic future. Canberra bureaucrats have had little understanding of the practical realities of manufacturing, with officials unlikely to even encounter a manufacturer. Meanwhile, the attitude of most of the intelligentsia towards profit-making business was one of slight disdain. 'After the old protectionists retired or were squeezed out, the new wave of conventionally trained economists often showed a deep-seated ambivalence about their role' (p.185). All of this is a 'hangover from the heady days of the 1970s when most Australians thought that they were, indeed, denizens of the lucky country' (p.186). Stewart apparently sees herself as a latterday Donald Horne. But whereas Donald Horne made an important contribution by tweaking a national nerve, Stewart's rhetorical attack on Australian 'elites' is somewhat dated and seem less likely to impinge on our national consciousness.

Beyond this, Jenny Stewart's main point is that a successful industry policy requires an implicit working partnership between business, government and unions. Both the public and the private sectors need to work actively to extract 'every ounce of opportunity from the changing circumstances of industrial, governmental and

working life'. The emphasis, says Stewart, is not so much on 'intervention' as on 'co-determination' based on the commingling of the resources of the public and the private sectors. This includes the adoption of policies (what Stewart calls 'dispersed responsibility') such as 'buy Australian' campaigns and government purchasing preferences, and more nebulous measures such as officials passing on word about contract opportunities or suggesting a partner in a grant application.

Stewart is not advocating that governments pick winners, because, as she says, it is never really clear why certain industries should be singled out for special attention. But she then goes on to advocate selecting industries that are likely to generate links to other worthwhile activities. Governments can thus encourage and develop industry clusters. Evidence of such policies, Stewart suggests, are to be found in East Asia and most of the industrialised world. Japan is the pre-eminent practitioner. Although, Stewart says, we do not really know how these industry policies worked, it seems that they were devised with the needs of particular firms and chains of production in mind.

Stewart seems unaware of the considerable research effort undertaken on the East Asian development experience, of which Japan and Korea are the most studied cases. No clear consensus exists among Japan specialists on the effectiveness of Japan's industry policy. But a balanced view attributes Japan's success to a combination of MITI policy, market forces, and Japanese business leadership. MITI's record is by no means unblemished, extending well beyond the Honda case acknowledged by the interventionist literature as the only example of unsuccessful targeting the economists can find. Two trends are discernible in recent Japanese industry policy. Industry policy has become less important in overall government economy policy; and MITI's role as a major player has declined as it has placed greater emphasis on other aspects of industry policy. As Stewart acknowledges, Japanese industry policy during the 1980s has been most effective in dealing with industries in trouble and needing structural adjustment. Meanwhile, Korea is still paying a high price for its targeting of capital-intensive industries in the 1970s, a point usually conspicuously missing from accounts of Korea as an example of successful industry targeting. Its highly politicised industrial targeting has left a legacy of distorted credit markets, heavily indebted firms and a high concentration of industrial power.

Stewart's rhetoric portrays international trade and investment as a game of winners and losers. Trade liberalisation is viewed as a zero-sum game to which Australia has slavishly committed itself under the GATT. Although no evidence is presented as to why this is so, Stewart claims that Australia, 'would not be one whit worse off today had we never joined GATT' (p.12). Estimates of Australia's share of economic benefits stemming from the Uruguay Round differ, but the lowest estimate sees Australia benefiting by a minimum of \$2.5 billion by 2002 (DFAT, 1993). The Australian-led Cairns Group's insistence that the Round include an agreement on agriculture was rewarded by improved access for a wide range of Australian products. Increased market access will also accrue to Australian exporters of a wide range of manufactures.

While the trend within the Asia Pacific region is towards increasing economic integration and cooperation, Stewart says we should ignore the retaliatory consequences of attempting to 'resurrect and reconstruct' industries. Indeed,

[t]o weather this kind of (usually stage-managed) opprobrium requires a measure of national self-confidence, and the ability to apply policy by subterfuge where that is appropriate. Australia, like the rich kid on the block we used to be, tries to curry favour by buying presents for everybody and conspicuously being 'good'. Such behaviour is deeply confusing to older and wlier nations who are convinced it must disguise deeply duplicitous behaviour of some kind. (pp.40-1)

There is an emotional appeal in denying trading opportunities in retaliation against the distortions of others. If Australia were richer, we might be able to contemplate indulgence of this kind (Garnaut, 1991:30).

Stewart's mercantilist view is at odds with statements elsewhere in her book that, as trade barriers have fallen with increasing globalisation, assistance has taken the form of functional incentives such as training and know-how and new technology. This, says Stewart, helps keep firms at home and acts as a substitute trade policy by enabling firms to strengthen their competitiveness against imports. This is confused. Rather, increasingly globalisation of production, trade and investment creates what Jagdish Bhagwati (1991:16) calls a 'veritable spider's web', where everyone is now in everyone else's backyard. The trend of firms to share the burden of R&D or gain access to foreign markets through joint ventures and strategic alliances complicates any definition of national economic interest, weakening the role of government in industry policy. Stewart's prescriptions for greater local ownership and controls on foreign investment, allegedly crucial to industry policy in Europe and in Asia, seem equally flawed. Some of the most spectacular recent successes of East Asian development, such as in Malaysia and Thailand, have been led by export-oriented foreign direct investment from Japan and the newly industrialising economies. Foreign investment is being helped by increasingly liberal trade regimes, and in turn is creating pressures for further trade liberalisation.

Yet in other policy prescriptions, Stewart is probably more at home with the economist's view of the role of government in industry policy than she is willing to admit. Few would dispute Stewart's stated role for government in providing the macroeconomic and microeconomic conditions that firms need to prosper and grow. For example, in East Asia investment in education has been particularly well focused on the acquisition and mastery of technology.

Stewart is at her best when writing on science policy, about which she displays detailed knowledge. She highlights past disparate approaches to science and technology policy development, and the need for greater priority to be given to technological development. Unlike in the mining and agricultural sectors, a considerable gap exists between the manufacturing sector and major research bodies such as the CSIRO. Stewart shows just how long this has been a problem, although there are

increasing moves to put relations between business and the scientific community on a more commercial basis.

Despite some interesting sections, Stewart's book is loaded with unsubstantiated and opinionated assertions. Academics, says Stewart (herself an academic), will not like her approach because she is 'cavalier with disciplinary boundaries and because she sees her task in Australian terms, rather than curating the opinions of British or American authors. . . . All this suggests to me that I have probably got it about right' (p.14). For this reviewer, the straddling of disciplines is the core weakness of her book. It contributes little to the literature on industry policy. It is not rigorously analytical in its policy prescriptions, and is too populist in its view of what economic theory has to say on the role of the state and especially on what lessons the East Asian industrial experience may hold for Australia. Too many sweeping assertions are presented as self-evidently true when they are not. The most sweeping one of all states:

As in individual life, a lack of confidence among a nation's citizens produces an undervaluation of collective assets. Non-Aboriginal Australians had (and many still have) a scant regard for animals and plants which are not European . . . The same attitude results in an undervaluation of home-produced goods as well, most noticeably by the so-called elite. Being run over by a Volvo is more likely on the campus of the Australian National University than just about anywhere in the world, yet Volvos have been justly described as the Holdens of Sweden. (p.273)

The book's contribution consists of a set of principles to guide policy-makers in formulating industry policy, many of which are already observed in daily government-business networks and dealings. Some readers (presumably economists and the 'elites' in academia and the bureaucracy) will find the continual swipes disparaging and tedious, especially in the final chapter. Alternative policies are too vaguely and rhetorically argued to be translated into action. But other readers will cheer in the stands.

Still Looking to East Asia

Like Jenny Stewart, some of the contributors to *Australian Business in the Asia Pacific Region* seem to feel they have been marginalised from the debate. For example, Colin Carter, a principal author of the Australian Manufacturing Council's *The Global Challenge*, is perturbed that since the release of the report neither he nor his coauthors have received a single phone call from the bureaucracy.

The book arises from a conference held by the Australian Graduate School of Management and the Committee for the Economic Development of Australia (CEDA) in 1994 and is part of a CEDA series on strategic issues in economic development and public policy. The first of three major sections is devoted to the quality of industry policy debate in Australia and alternative economic strategies to achieve competitiveness. The second section examines opportunities in selected

high-value-added service and industry sectors: telecommunications, health, education, processed foods and tourism. The final section focuses on implementation issues. The book is heavy going. It has some good contributions, but it perhaps tries to cover too much ground. The editor could have been a little more selective in deciding which conference papers to include.

The book's central theme is that Australia must adopt a strategic industry policy if it is to successfully enter markets for high-value-added goods and services. Ian Marsh contrasts the free market or 'neutral' approach based on economy-wide action by government with a strategic industry approach involving selective incentives designed to suit particular sectors. Competitiveness, Marsh argues, does not need to be achieved in every activity associated with the value chain of the targeted sector. 'Just as Japan maintains inefficient rice-growing or distribution in the interest of solidarity, equity and high levels of employment, so inefficiencies can be preserved in some sectors and for similar reasons' (p.xv).

In reviewing the industry policy debate in Australia, Colin Carter asks why Australian policy-makers dismiss evidence of successful selective industrial intervention in East Asian and other countries, usually, according to Ian Marsh in his introduction, 'with a morally charged slogan that impugns the motives, not the arguments, of proponents' (p.xx). This is somewhat exaggerated. The real reason why economists are not convinced by the interventionist literature on East Asia is that its proponents have not satisfactorily established the effectiveness of industrial policies. The majority of these authors (including the contributors here) do not seek to evaluate explicitly and quantitatively various forms of government assistance to specific industries. A common but simple-minded argument is that since Japan had a targeted industrial policy and a high growth rate, Japanese-style targeting must work. But strategy-centred interpretations of East Asian industrialisation must also demonstrate, rather than assume, that strategies matter. For example, Taiwan's policy in the early 1980s of promoting 'strategic' high-technology industries with financial and fiscal incentives was not what it seemed on paper: government actually protected industries with declining comparative advantage, not export winners (Smith, 1995).

Given these concerns, claims by Ian Marsh, Bruce Scott and Colin Carter that strategic industry policy draws on actual practices in East Asia should be treated with caution. Rather, these contributors resemble certain American writers like James Fallows (1994) and Clyde Prestowitz (1988) who call for the adoption of strategic policies for industries with high growth potential, high added value, large linkage effects and rapid technology change. Paul Krugman, an author of earlier theoretical work on strategic trade theory, has recently debunked much of this line of thinking. Over the past ten years a massive international economic research program has explored the prospects for strategic trade theory, mainly in the context of industrial economies. According to Krugman (1994), several broad conclusions have emerged. First, it is very difficult to determine both the industries that should receive strategic promotion and the appropriate form of promotion. Second, the payoffs of even a successful strategic industry policy are likely to be modest. Third, the criteria advocated for picking strategic winners have little merit, since any indus-

try may exhibit one or more of the relevant characteristics. Advocates assume that 'high-value-added' industries involve high technology, which in turn is thought desirable. But this is typically not the case: for example, the steel and car industries add more value per worker than high-technology industries. As for 'linkages', these seem to refer to catalysts for the rest of the economy in the sense that one industry's output is in turn used as an input by a number of industries. But the fact that some industries produce inputs for other industries does not of itself provide evidence of market failure or indicate that markets underinvest in the relevant industries.

Much has been made of Michael Porter's *The Competitive Advantage of Nations* (1990). The chapter by Philip Yetton, Jane Craig, Jeremy Davis and Fred Hilmer shows why Porter's diagnostic framework is of limited use to public policy-making in small or resource-based economies like those of Australia, New Zealand and Canada. This chapter and Peter Warr's (1994) quite different discussion on how Porter and others (including contributors to this book) have confused the notion of comparative advantage and competitive advantage are two of the most rigorous critiques so far undertaken of Porter's framework.

The most interesting chapters are those that explore the opportunities in particular sectors, namely, telecommunications, health, tourism, education, food processing and resources. Not all of these sectoral case studies assign a major role to government incentives. Clem Doherty's contribution on the high-value specialist-treatment segment of the health sector and John Keniry's on the food-processing sector highlight the export opportunities for Australia in the Asia Pacific. Doherty argues that Australia has more and better quality health-care resources and is more cost competitive than any other country in the region. For example, an eleven-day hospital stay for open cardiac surgery in Australia costs half that of comparable treatment in the United States. Demand for high-quality health care will grow as the populations of the Asia Pacific age and become more affluent. But this potential is being constrained by frequent changes to health policy by successive federal and State Governments. This, says Doherty, makes the industry highly unstable and gives it a predominantly domestic rather than a regional focus.

Keniry likewise assesses opportunities in the processed food industry on the basis of growing per capita incomes of East Asia. Export opportunities, Keniry argues, will not be realised without an active role from government in the form of assisted export-market development. But there are more substantial obstacles: the traditional strong domestic focus of the industry; impediments in international markets; and impediments in the Australian business environment arising from assistance to other industries and from inefficiencies in transport and freight handling.

The conclusion of the sectoral chapters is that microeconomic reform is still what matters most. In 1994, the Hilmer Report produced a long list of reforms that would be required for the Australian economy to work to its full potential. It was clear that Australian businesses were at a disadvantage compared with their overseas rivals, mainly because of higher input costs, including transport, shipping, communications and wages. Many of these areas were tackled during the 1980s, but there

are still concerns that reforms have not occurred in many other sectors of the economy.

Now For Some Facts

The most informed assessment of Australia's manufacturing sector, past and present, is provided in Sheehan, Pappas and Cheng's *The Rebirth of Australian Industry*, which is described as the 'first report' of the New and Old Industries in Australia Project. Drawing on the resources of the International Economic Data Bank at The Australian National University, the authors document the growth in exports of Australia's high-value-added manufactures (elaborately transformed manufactures, ETMs) since 1985, and sift through the reasons for their strong performance, albeit from a low base.

Between 1985 and 1993 real ETM exports have grown by 14.3 per cent a year, compared with 1.9 per cent between 1980 and 1986. Improvement has been widespread, but the authors find that export growth has been highest in manufacturing sectors characterised by oligopolistic market structures, non-price competition, and industry-specific policies. These, predominantly high-technology, sectors are identified as pharmaceuticals, computing equipment, telecommunications equipment, transport equipment (particularly aerospace and shipbuilding), road vehicles and clothing. In 1985-93, real exports of this group (called policy ETMs) have grown by 21.7 per cent, nearly twice the rate of other ETMs.

The success of policy ETMs exports since the mid-1980s is explained by a combination of cost reductions, a positive change in Australian attitudes to competitiveness and exporting, the success of a range of industry-specific policies targeting export growth, and the expansion of world import demand, especially from East Asia. In particular, the authors present empirical evidence that this growth is not easily explained by changes in world demand and relative prices. This, they claim, supports the hypothesis that a range of non-price factors may have played a significant role: factors such as industry policies, changes in the tariff regime and other factors influencing the basic structure of the economy.

If this strong growth continues for the rest of the decade, the improvement in Australia's current-account imbalance is expected to permit sustained growth of up to two percentage points of GDP higher than at present (growth in the order of 5 per cent of GDP a year, compared with the currently accepted maximum of about 3.5 per cent a year), accelerating the fall in unemployment. This assumes that all the other factors explaining past growth continue to operate. The authors conclude that specific policies to stimulate export growth in these areas have been, and will continue to be, central to the expansion of exports of policy ETMs and other ETMs.

The book is valuable as a discussion of structural change in the Australian economy since the mid-1980s and as a detailed and technical analysis of the structure and performance of Australia's exports. However, the authors' hypothesis linking industry policy initiatives and ETM export growth is not convincing. As they have not gone far enough in empirically establishing the relative contribution of each of

the factors that explain ETM growth since the mid-1980s, their conclusion that industry policy is a major factor is not robust. The problem is partly one of data, as the authors readily concede; it is difficult to identify the contribution of the factors in quantitative terms. But it seems reasonable to assume that more deep-seated structural forces are at work and that ETM exports have been responding in the expected manner to changes in competitiveness and attitudes. Growth has been too widespread across sectors to be attributable principally to industry incentive schemes. Other studies have argued that reductions in protection are the most prominent specific policy factor driving Australia's integration into the international economy and might be one of the explanations for the increase in both imports and exports over this period (see for example Bullock, Grenville & Heenan, 1993).

Perhaps the authors should have stressed that any boost to the competitiveness of export industries provided by the current systems of industry assistance would be quantitatively small in comparison with, for example, the combined reductions in inflation, interest rates and exchange rates. Moreover, the macroeconomic environment for tradable goods, continuing reductions in protection and other micro-economic reforms are also likely to be more important to the continuation of strong growth in exports of manufactured goods and services than the different forms of direct assistance.

Conclusion

All three books under review (but especially *The Lie of the Level Playing Field* and *Australian Business in the Asia Pacific Region*) focus on the question of what governments should do to create a competitive manufacturing sector. All draw on East Asian experience to support a more activist industry policy. But none really goes beyond a cursory discussion of East Asian policy outcomes. None gives sufficient weight to the central elements of East Asian success: macroeconomic stability, competitive exchange rates, and high rates of savings and investment, combined with judicious investment in human capital and infrastructure.

It is important to future living standards that Australia has a diversified export structure, which includes an internationally competitive manufacturing sector. But the preoccupation of all these studies with the manufacturing sector obscures the strong performance of Australia's services sector in recent years. Jenny Stewart acknowledges that the services sector exists, but says that by the beginning of the 1990s services growth was slowing and that the prospects for fully employing a still expanding labour force appeared increasingly remote. Really? Australia's service exports have been growing at about 7 per cent annually since 1983/84, and account for about 66 per cent of total domestic production, compared with manufacturing industry's 30 per cent. A recent study by the Bureau of Industry Economics (1995) found that in 1993/94 services absorbed 80 per cent of employment and 50 per cent of investment, and generated two-thirds of national output and a fifth of export earnings. Moreover, the services sector is expected to provide most of the jobs growth over the course of the 1990s. On what basis could we justify adding to the cost burdens of this increasingly important sector?

Past concerns over government's ability to pick winners remain valid. In 1990 the AMC's *The Global Challenge* report argued that Australia's best prospects lay in the automotive, computer and telecommunication equipment, aerospace and pharmaceutical industries because of linkage effects with other industries. In 1994, the best prospects were identified as being in telecommunications, health, education, tourism and food-processing sectors. Jenny Stewart would have government not 'target' but 'direct' (which in fact is the same thing) resources to manufacturing industries on the basis of high added value and linkages to other industries. Sheehan et al. would have government continue its programs in high-technology sectors, but cannot effectively establish whether exports of these sectors grew because of increased competitiveness from reductions in protection, or from government incentive schemes, or from a combination of these and other factors. None really makes a strong case for giving some sectors preferential treatment at the expense of the others.

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