Economists, Intra-Industry Trade and the Australian Car Industry

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A thesis submitted for the degree of Doctor of Philosophy of The Australian National University
Except as otherwise indicated, this thesis is my own work.

Nicholas Gruen
This dissertation is dedicated to my father.
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Preface

This dissertation is offered as part of conversations going on in several areas within the economics profession. Firstly there is a particularly Australian literature debating the merits or otherwise of 'economic rationalism'. Secondly, within the economics profession more generally there is a well developed literature which discusses the emphasis which modern economics gives to formal technique and the concomitant neglect of other disciplinary values. Given the polarised nature of contemporary attitudes to the discipline, both from within and without the profession itself, it is appropriate for me to offer some clarification of the relationship between this dissertation and these literatures.

Firstly, although it is critical of aspects of 'economic rationalism', this thesis does not argue, as do many critics of economic rationalism, that economists were wrongly located on some spectrum between faith in market forces and faith in state intervention. Indeed in the instances this dissertation examines, the very preoccupation with the market/state intervention dichotomy appears to be part of the problem. Preoccupation with the dichotomy between free markets and intervention displaced the more urgent and important task of choosing how one would move towards what was generally agreed to be desirable - freer trade. Preoccupation with the 'markets versus intervention' dichotomy also distorted the perceptions of participants in the debate. Economists tended to see certain innovations in trade policy as inherently 'interventionist' whereas, they could just as easily have been seen as instruments of trade liberalisation. In this sense, although the thesis is critical of aspects of early Australian economic rationalists in the seventies and early eighties, it takes pains to locate its critique from within essentially the same framework they adopted.

Secondly, it is appropriate to offer some comment on the relationship between this thesis and a growing unease with the positivism and formalism which has so dominated economics since World War II. Consistent with Popper's project to offer some methodological rules of demarcation between the scientific and the unscientific, post WWII economic methodology sought to 'legislate' what was and was not acceptable scientific practice for economists. Following the likes of Feyerabend and Rorty in the Philosophy of Science, McCloskey has argued that one cannot sensibly legislate for what is, and is not legitimate in scholarly debate: that the rules of Official Methodology are habitually broken by economic practitioners and that the only rules which can be
sensibly legislated are those which the participants of serious, conscientious conversation improvise and accept for themselves.

As the reader will discover, I have some sympathy with these points. But for me there remains a kind of remoteness with much writing in the methodology of economics which limits its practical usefulness in improving the quality of economic practice. Much methodological writing within economics today is practiced by methodological specialists and published in specialist books and journals as if it were a properly defined sub-discipline of the profession. This goes hand in hand with the idea that methodological reflection is something of a luxury - an interesting pastime, but not something of critical importance to the health of disciplinary practice. For all the sound and fury of McCloskey's denunciation of orthodox economic methodology, his ultimate conclusion - that "[e]conomics at present is . . . moderately well off" (see § 1.3.1) - is, amongst other things, a depreciation of the importance of his own methodological endeavours. For McCloskey, the economic practitioners will look after the health of economics themselves.

The methodological reflection in this dissertation is not primarily a response to current methodological literature. It is anchored in practice. It arises from pondering what I consider to be shortcomings of both academic and bureaucratic (policy advising) practice and has been integral to producing a diagnosis of these shortcomings. I have tried to drive this diagnosis home with careful expositions of the way in which unsatisfactory methodological values within the discipline harm economic reasoning in various ways; leading amongst other things to injudicious partialities of vision (§ 1.2.3), the waste of disciplinary resources on unpromising projects (§ 1.3.3) and the unnecessary polarisation of discourse and the irrational depreciation of important considerations in policy formulation (Chapters Three to Ten). For me there is a further anchor in practice. I would not have concluded that economic practice was deficient if I had not come to find some of their most dearly held convictions unconvincing. In this regard, my case for rethinking the discipline's stance toward unorthodox means of trade liberalisation is woven into the story as a central element.

**Notes on Sources**

My own circumstances changed considerably between the commencement and completion of this PhD thesis. I went from teaching at ANU, to advising the Treasurer, to being appointed by the Treasurer to the Industry Commission. The Commission was the institutional successor of the very body which was to be subjected to a 'case study' in the thesis! This provided me with a better feel for the difficulties which such an
organisation faced and with access to some of the people who had been in the organisation during the time under study. It also provided me with access to the IAC's archives. As the reader will note, I have made use of those archives and several things should be said about this. Firstly, many of the inadequacies of the Commission's work which the archive material permits one to elucidate in some detail - for instance the Commission's inability to measure cost disabilities accurately - were generally conceded in the Commission's published outputs. Thus while it has enabled a sharper focus and deeper analysis on a range of points, the essence of the case study of the IAC was not changed by access to the archives. Secondly I have been careful in my use of the archives. I have used them in the same way I would have used them had I been privy to them when directing an inquiry within the Industry Commission. I have not reported them in a way which would reveal any commercial in confidence information.

Given that the Commission is not a particularly secretive place and that it is certainly not so at Commissioner level, I was given free access to the archives without being required to gain anyone's permission to do so. Nevertheless I did inform the Chairman that I was working with the archives in the course of post graduate research. I would argue that the critique offered in this dissertation is essentially within the spirit of the Commission's original mission - that of subjecting competing claims about economic policy to critical and rational scrutiny using the resources of the discipline of economics. Nevertheless I am aware that it is likely to be taken by some as an attack upon the IAC - the predecessor of my current employer. Given my position there, public debate on the material contained herein is likely to pose difficulties both for me and the Commission. In these circumstances I have chosen to raise the kinds of issues I have raised in this thesis, within the Commission when appropriate, rather than in public debate.

Notes on Terminology

By 1970 the trade magazine Automotive Industry Matters had changed its car definitions. "Previously the car market was broken into three categories - light medium and luxury. This year there are four classes: light small; light medium; medium and luxury" (March, 17, 1970: 5). Henceforth this dissertation adopts these categories. It has been usual for car models to gradually increase in size as one model replaces another of the same name. In the early and mid 1970s Corollas were small light, Coronas were large light whilst Holdens and Falcons were medium and Fairlanes and Statesmans were upper medium. By the early 1980s the vehicle classes corresponding to the above model names were small, medium, upper medium and large. For the purposes of consistency, this dissertation adopts the former classification throughout the period under study.
notwithstanding the fact that by the early 1980s Holdens and Falcons were indeed large cars by most people's standards.

**Notes on Style and Length**

I have used standard Harvard style of referencing throughout with one modification. Where more than one reference has been cited for a single author in a single year, instead of distinguishing between references with letters - for instance Krugman, 1987a and Krugman, 1987b, I have taken a word or two from the titles of the referenced works to remove ambiguity. This has the advantage of minimising consequential changes in referencing, where a reference is discovered late in the day. It is also helps the reader remember to which reference I am referring on any given occasion.

Where I have added emphasis to a quotation I have always acknowledged this. Thus wherever emphasis appears in a quotation and such an acknowledgment does not appear, the emphasis was in the original.

Unless the context otherwise makes clear, references in parentheses to sections - eg § 1.3.2 - are references to sections and subsections of this thesis.

In cross referencing the dissertation I have used sub-section numbers rather than page numbers.

The dissertation is slightly under 100,000 words long. There are 274 pages and 103,846 words from the prologue to the end of Chapter Ten. However the word count includes citations, tables and chapter headings. On the basis of sampling twenty pages of the thesis, I estimate that just eliminating citations would reduce the count by at least 6 per cent.

**Acknowledgments**

In labouring over this work I have incurred a number of debts. I showed a small portion of Chapter One to David Henderson who responded with several comments for which I am grateful. Likewise I discussed ideas in this thesis with Neil de Marchi and Marina Bianci who were both very encouraging. Alan Lloyd read and commented encouragingly on substantial portions of the text.

Considerable debts are owed to my parents Ann and Fred. Both read the manuscript to detect flaws in reasoning and expression. I am grateful to them for this, and much else besides.
I am grateful also to my advisor Steve Dowrick who managed to read and discuss drafts of chapters despite his busy schedule. Bob Gregory also discussed aspects of the thesis with me and helped in other ways.

Rolf Geritsen was a particularly helpful supervisor always sparing the time to read and discuss material. He was also very encouraging.

My greatest debt is to Eva, whose forbearance enabled me to work most evenings and for most of each weekend for the period necessary to write the thesis.

It seemed like it would never end.
Abbreviations

AIA  Automotive Industry Authority
ASIC  Australian Standard Industrial Classification
BHP  Brake horse power
BMC  British Motor Corporation
CBU  Completely Built Up
cc  Cubic centimetre
CKD  Completely Knocked Down
CPD, HR  Commonwealth Parliamentary Debates, House of Representatives, Commonwealth Government Printer
f.o.b.  Free on Board
FAPM  Federation of Automotive Products Manufacturers
GDP  Gross domestic product
GMH  General Motors Holdens
HOS  Hecksher, Ohlin, Samuelson (A model of trade)
IAC  Industries Assistance Commission
IC  Industry Commission
JRA  Jaguar Rover Australia
MES  Minimum economic scale; also known as minimum efficient scale
MFN  Most Favoured Nation
NZAFTA  New Zealand-Australia Free Trade Agreement
oe  original equipment
PMV  Passenger motor vehicle
SIDCAI  Standing Interdepartmental Committee on Assistance to Industry
TCF  Textiles, clothing and footwear
# Abbreviations

## Commonly cited Journals and Newspapers

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>AFR</td>
<td>Australian Financial Review</td>
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<tr>
<td>AI</td>
<td>Automotive Industry</td>
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<tr>
<td>AIM</td>
<td>Automotive Industry Matters</td>
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<tr>
<td>CT</td>
<td>Canberra Times</td>
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<tr>
<td>EIU</td>
<td>The Economist Intelligence Unit</td>
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<td>MIP</td>
<td>Motor Industry Prospects</td>
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<td>SMH</td>
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Abstract

What are the trade policy implications of intra-industry trade and specialisation, particularly in the context of trade liberalisation?

This dissertation argues that where intra-industry trade is important, and protection is afforded by traditional 'inwardly oriented' instruments such as tariffs and quantitative restrictions, policy makers seeking to effect gradual trade liberalisation should consider introducing mechanisms which assist exports during the transition to free trade. Doing this allows one to liberalise intra-industry trade ahead of the achievement of complete free trade.

The dissertation provides a critical narrative detailing shortcomings in the way this issue was handled by economists and policy advisers during the decade in which economic rationalism first emerged as an institutional force in Australia - between the early 1970s and the early 1980s. I argue that there were serious shortcomings in the 'practical reason' of economic policy advisers and that many of these shortcomings stemmed from the culture of the economics profession. The dissertation focuses on the economics profession in general although there is a particular focus on the advice of the Industries Assistance Commission (IAC) and on the issues as thrown up by the automotive industry protection policy.

Chapter One introduces the themes of dissertation whilst Chapter Two outlines the state of the automotive industry and automotive industry policy up to the early 1970s.

Chapters Three to Five then examine the economics of trade liberalisation and particularly 'non-traditional' approaches to trade liberalisation which deviate from the approaches sanctioned by economic orthodoxy - equi-proportional across the board tariff reductions and top down reform (reducing the highest tariffs first). These chapters explore the case for 'non-traditional' trade liberalisation, particularly policies which facilitate the rapid expansion of intra-industry trade where the rate of tariff reform - and so the rate of inter-industry trade expansion - is more gradual.

Chapters Six to Nine provide a case study of the issues introduced in earlier chapters. They depict the extent to which economists were provided with material which would have enabled them to think through the normative
economics of trade liberalisation in the presence of intra-industry trade and the extent of their failure - one might even say their refusal - to do so.

Chapter Ten concludes with some further (and bolder) speculations on the nature of economic science as currently practiced, and the possibilities which might have been realised had the subjects of the study engaged more fully with the material before them.
He who knows only his own side of the case, knows little of that. . . . He must be able to hear the arguments of adversaries; . . . He must feel the whole force of the difficulty which the true view of the subject has to encounter and dispose of. . . . Ninety-nine in a hundred of what are called educated men [do not do this], even those who can argue fluently for their opinions. Their conclusion may be true, but it might be false for anything they know. They have never thrown themselves into the mental position of those who think differently from them, and considered what such persons may have to say, and consequently they do not, in any proper sense of the word, know the doctrine which they themselves profess.


In science, as in business, problems may be opportunities in disguise. They may offer new chances to demonstrate the power of our paradigms, if only we have the wit to see how.

Brian Loasby, 1976: 197
Prologue

The economist’s job is to say ‘this or that, not both. You can’t do both’.
Kenneth Arrow, 1970: 17

In the mid 1970s the Industries Assistance Commission - an incipient, but already prestigious bastion of economic expertise - advised the Federal Government on protection for the automotive industry.

The Commission was keen to reduce the absolute level of protection which had been accorded to many industries for many years and it was also keen to reduce the disparities of protection between different industries.

Preeminent amongst its ‘targets’ for reform was the automotive industry. Behind increasingly restrictive protection from imports afforded by both tariffs and local content schemes, Australia assembled small Japanese cars from imported components at effective rates of assistance which sometimes approached infinity!

Yet at the same time, a much larger sector of the industry manufactured medium (Holden) sized cars quite competitively. Medium sized cars were also achieving strong export growth. By the mid 1970s, over 15 per cent of medium sized car production was exported.

Over the 1960s, Australian domestic demand gradually swung towards smaller vehicles. Small Japanese cars became increasingly competitive and in the mid 1970s this trend dramatically accelerated as petrol prices surged. These circumstances provided the new Commission with some interesting challenges.

The Australian market had always offered limited scope to exploit the very significant economies of scale which characterised the industry. The new developments underscored the intuitive case for the industry to specialise, not only within Australia but in export markets. And by the early 70s export oriented development strategies had demonstrated their promise in countries such as Japan, Korea, Taiwan, Hong Kong and Singapore.

Free trade would have enabled the industry to specialise in its most competitive activity but this was not judged a likely possibility for a long time: the Commission’s terms of reference required recommendations consistent with the prosperity of the industry, and, apart from this, too rapid a rate of reform was likely to be politically impossible.
The Commission accordingly recommended that the industry receive significant assistance for at least the next decade. But what form should it take?

The Commission was keen to replace the local content plans with something simpler and more administratively transparent. A simple tariff regime would achieve these goals, but would discriminate against specialisation within the industry in two related ways.

It would continue to underwrite fragmentation of production for the domestic market as firms sought to 'cover the field' of domestic consumer demand to take advantage of tariff inflated domestic prices. But it would provide no equivalent assistance to automotive exports.

Also, where firms sought to increase their level of intra-industry trade, importing products so as to concentrate more fully on producing their most competitive products for both domestic and export markets, tariffs would tax them for so doing.

Given these considerations, two alternatives suggest themselves: direct production subsidies could have replaced tariffs, thus providing firms with the same level of assistance regardless of whether their output was destined for the domestic or export markets and regardless of the degree of intra-industry trade in which the industry engaged. Similar incentives would have been created by complementing tariff assistance with export assistance and/or tariff concessions to firms in proportion to their exports.

There was some evidence that had assistance been provided in a such a form, it might have been (politically) possible to provide it at a lower rate.

Subsidies were never seriously considered by governments, probably because of their budgetary cost. And the Commission feared that the latter course might open up a new front for rent seeking by Australia's powerful manufacturing lobby.

The Commission was placed in the paradigmatically economic dilemma of choosing between various evils. Yet although the choice was made - as choices inevitably are - it was made without properly weighing the potential costs and benefits of alternatives.

This dissertation illustrates the claims made above and tries to show how the situation described in the previous paragraph could have come to pass.
1 A Sketch of the Argument: Some Problems with Modern Economics

In a world where we are inevitably ignorant about some of the past and present, let alone the future, the co-ordination of activities is less important than the perception of new problems and opportunities, and adaptation to them.

Brian Loasby, 1976: 191-2

This thesis offers a contribution to the disciplines of economics and public policy in three related ways.

1) It offers an exposition of the economics of certain questions about which academic economists and policy makers deliberated in the period under study - the mid 1960s to the early 1980s - and which remain current today. In particular, what are the trade policy implications of intra-industry trade and specialisation, particularly in the context of trade liberalisation?

2) It offers a critical narrative detailing shortcomings in the way this issue was handled by economists and policy advisers. The focus is on the economics profession in general although there is a particular focus on the economists and policy advisers of the Australian Industries Assistance Commission (IAC) and on the issues as thrown up by the automotive industry during the period.

3) In the course of 2), an historical explanation-cum-methodological diagnosis of 'what went wrong' is developed.

Arguments 1) and 2) largely stand or fall together. Argument 3) on the other hand is more ambitious. Being more general it is less easily demonstrated. But if accepted, its conclusions have implications for the way economics is practiced generally. I hope that those who doubt it may, nevertheless, find some merit in the first two arguments. This chapter sketches the arguments. While the work as a whole must bear the burden of their demonstration, this chapter is intended not only to whet the reader's appetite but also to begin the process of demonstration and persuasion.
1.1 Choosing a Voice

A theory is not like an airline . . . timetable. We are not interested simply in the accuracy of its predictions. A theory also serves as a base for thinking. It helps us to understand what is going on by enabling us to organise our thoughts. Faced with a choice between a theory which predicts well but gives us little insight into how the system works and one which gives us this insight but predicts badly, I would choose the latter, and I am inclined to think that most economists would do the same.

Ronald Coase, 1988: 64

In a discipline in which disputants often understand one another according to where they 'fit' in fairly well understood spectrums of opinion (eg see Anderson et al 1993; Anderson, 1994), it is necessary to say what this thesis is not. This study is in fundamental sympathy with the IAC's conception of its intellectual, political and economic mission - that of winding back the excesses of 'protection all round'. It is also sympathetic to the fundamental inclinations of classical and neoclassical economics and political economy. But this is not because their picture of a perfectly competitive economy in general equilibrium more accurately describes the economy than do the alternatives. The frame of reference or 'appreciative system' we choose to inhabit will always be a compromise. It must correspond with reality sufficiently to guide action. It must also provide some coherent foundation for systematising our thought. And it must also be sufficiently shared by our fellows to mediate communication (eg see Coase quoted above and Vickers in Rein and Schön, 1993: 147).

1 I have not defined either classical or neoclassical economics precisely here - which, in any event, is impossible. The particular qualities of the two approaches which are taken to be distinctive are as follows. 'Classical economics' is taken to generally endorse the idea that Adam Smith's 'invisible hand' is a good descriptor of what happens in economies and accordingly a worthy model upon which to base positive and normative microeconomics. Neoclassical economics is perhaps pre-eminently associated with a certain formal technique. As Posner puts it:

In order to facilitate mathematical formulation and exposition, neoclassical economic theory routinely adopts what appears to be, and often are, from both a physical and psychological standpoint, highly unrealistic assumptions: that individuals and firms are rational maximisers, that information is costless, that demand curves facing firms are infinitely elastic, that inputs and outputs are infinitely divisible, that cost and revenue schedules are mathematically regular, and so forth (1993: 74).

Nevertheless, as Mirowski has pointed out (1986), formal mathematical analysis can be applied to economics in a variety of ways. The set of formal techniques which comprise neoclassical method have developed around the formal exploration of Classical themes relating to the efficiency of markets.
There are several reasons, therefore, that I have chosen to stick fairly closely to the neoclassical 'straight and narrow' in this dissertation. Firstly, it offers a reasonably coherent picture of how the economy works. If it is to rise above the crudely ad hoc, economic analysis requires some investigation of the net outcomes of interacting effects. Classical and neoclassical economics have done this by appealing to the concept of equilibrium - whether partial or general - and the assumptions which tend to produce equilibrium most easily are those of perfect competition. Imperfect competition, as outlined by Robinson and Chamberlain in the early 1930s, is a more encompassing - though in itself still very artificial - description of most markets than perfect competition. However imperfections in competition are immensely destructive of the possibilities of stable or unique equilibrium and hence of the kind of intuitive understanding of the likely effects of possible policies which Adam Smith's view of the invisible hand made possible. It was for these reasons that Keynes argued that it was impossible to think clearly about what today we call microeconomic questions without classical theory "as part of one's apparatus of thought" (1936: 340). Providing it avoids too great a violence to the truth, there are large pay-offs in 'making do' with classical/neoclassical conceptions of perfectly competitive general equilibrium, and conversely, significant obstacles to alternative frameworks. Hicks is quoted on this point shortly.

Secondly, the neoclassical framework provides a powerful and compelling language with which to communicate economic ideas to others. The simplicity of the classical/neoclassical schema offers a powerful conjunction between politics and economics. If one can assume that markets adjust to produce movement towards optimal resource allocation, one can retreat from a wide range of potential policy problems, solving them not with elaborate calculations and/or negotiations, but according to principle. And the principle invoked need not be some obscure economic precept, but a simple political one: in the absence of good reasons to the contrary, trade within and beyond a nation's borders should be free. It is not surprising that Adam Smith saw himself as uncovering an idea embedded in Nature itself! Nor is it surprising that almost from the time of Smith, the allure of this framework has sometimes led economists to a narrowness, and a trusting too well in the analytic elegance and ease which it provides. This is one of the pitfalls of economics (Groenewegen, 1994).

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2 One can make this true by definition if we make perfect competition a 'special case' of imperfect competition.
CHAPTER ONE

SKETCHING SOME PROBLEMS OF MODERN ECONOMICS

This dissertation offers no quibbles with the Commission's goal of uniformly low or zero protection in the absence of good reasons to the contrary. My focus is not on what kind of economics was applied but on the 'practical reason' with which it was applied. What is meant by 'practical reason' will become clear enough, but it may be defined here as the faculties and strategies used to mediate between 'theory' and 'practice'. I argue that there were serious deficiencies in the way economists applied their expertise. For this there are two broad explanators. The first is economists' conception of what and who their enemies were. This leads to what I call the 'anti-naturalistic' or 'anti-mercantilistic' orientation of professional economics. David Henderson has painted a perceptive portrait of professional economics battling popular economic misconceptions. In Henderson's schema, in democratic countries at least, good economic policy is forever at the mercy of what he calls the 'do-it-yourself economics' of everyman. Whilst I am in sympathy with his point, Henderson's own words introduce the problem commendably:

I have described the characteristic state of mind of do-it-yourself-economics as one of innocence, and I think this is just. But a significant number of my professional colleagues . . . might be disposed to remind me that in the Hans Anderson story it was precisely the innocence of the child which enabled him to see, and say out loud, that the emperor had no clothes (1986: 14).

Resisting the fallacies of 'do-it-yourself' economics was a central preoccupation of the economists under study. This was altogether appropriate given their mission. But this blinded them to the fruitful leads which were being proposed by businessmen, economic amateurs and even some professional economists. The second explanator is what might be called the positivist culture of economic expertise and the correspondingly poor quality of those aspects of human thought and dialogue which are undervalued or even deprecated within that culture. Both explanators are elaborated respectively in the subsequent two sections.

Before proceeding a disclaimer is in order. The project is an ambitious one. The subject deals with the policy predilections not just of a particular organisation - the IAC - but also with the economics profession at large. For that reason, the 'explanation' must be broad enough to encompass both, yet specific enough to shed light on what happened. As is often the case when seeking to explain human behaviour, neither explanator is offered as determinate, although in a given instance it may be decisive. That is, the explanation offered here seeks to help the story 'make sense', without suggesting that the various positions the actors took were predetermined. Indeed the piquancy of the
story lies precisely in all the 'might have beens': in the smallness of the intellectual changes which were necessary to arrive at better conclusions and the richness of the opportunities which the actors had to arrive at them.

1.2 'Dangerous Supplements': The Economist as Combatant

Classical economics was dedicated to the view that many propositions that appealed to the common sense of ordinary people, including quite sophisticated businesspersons, were wrong.

Richard Lipsey, 1993: 73

As soon as you get an equilibrium approach to life, suddenly you realise that a lot of what you'd thought was wrong.


Certain post-modernist scholars have argued that since the Enlightenment, Western political thought has been oriented around fundamental dualities - such as public and private, reason and desire, objective and subjective. In each case the strategy of 'modern' (i.e. Enlightenment) thought involves favouring one of the poles of the duality at the expense of the other. The disfavoured pole is described as the 'dangerous supplement' to its respective dominant pole because of its subversive, even anarchic, potential. The dangerous supplement is subversive firstly, because it is indispensable: each pole of a duality acquires definition in juxtaposition with the other. Secondly, because it is ever present, though subordinate, it remains a threat to the interpretive and normative standards which have been established around the favoured pole (cf Drahos and Parker, 1990: 35).

1.2.1 The Threat of Incoherence

This schema fits aspects of economics very well. In all science incoherence is the 'dangerous supplement' of coherence. And coherence in classical and neoclassical economics is usually won by appeal to the concept of equilibrium which helps ground both normative and positive economics. Disequilibrium is its dangerous supplement and

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3 Most particularly Derrida. I have deliberately chosen not to develop the idea from Derrida's primary source material because it may introduce extraneous elements of interpretation which detract more than they add in this context. I am working from the exposition of the framework as outlined in the secondary source cited at the end of this paragraph.
Chapter One

Sketching Some Problems of Modern Economics

is accordingly under-represented within the discipline.4 The following subsections explore the way in which, in positive and normative economics, imperfect competition stands as a dangerous supplement to perfect competition and how in normative economics 'second best' considerations are likewise a dangerous supplement to 'first best' ones. Note at the outset that the dangerousness - or at least the relative undesirability - of the dangerous supplements is already signaled in economic language. Given the myriad benefits of competition, who wants it to be 'imperfect'? And who wants to be second best?

1.2.1.1 Perfect and Imperfect Competition in Positive and Normative Economics

[In the presence of scale economies,] there must be something to stop the indefinite expansion of the firm, but it can just as well be stopped by the limitation of the market as by rising marginal costs. ... It is, I believe, only possible to salvage anything from this wreck - and it must be remembered that the threatened wreckage is that of the greater part of economic theory - if we can assume that the markets confronting most ... firms ... do not differ very greatly from perfectly competitive markets. ... At least this get-away seems well worth trying. We must be aware, however, that we are taking a dangerous step, and probably limiting to a serious extent the problems with which our subsequent analysis will be fitted to deal. Personally, however, I doubt if most of the problems we shall have to exclude for this reason are capable of much useful analysis by the methods of economic theory.

John Hicks, 1939: 84-5

The concepts of perfect and imperfect competition evolved together in the early decades of this century - each being defined in juxtaposition with the other as the various assumptions implicit in Marshall's system were made explicit. After considerable disciplinary turmoil, it turned out - perhaps somewhat to the participants' surprise - that imperfect competition threatened to wreak potentially critical damage on the coherence which Marshall had forged (Loasby, 1976, Chapter Ten). Imperfect competition was subversive of both the intellectual and political roles of perfect competition - that of providing stability in calculation and of legitimising the free market paradigm respectively.5 Its disciplinary status as a dangerous supplement was dramatically captured in Value and Capital, where John Hicks muses on the profound indeterminacy

4 As Lancaster puts it, "economists have virtually no theory of how individual decision-makers behave out of equilibrium" (1969: 3).

5 The text proceeds to develop the former of these two claims. The latter, political aspect of imperfect competition was one of its main attractions to Joan Robinson (cf Robinson, 1969: x).
which imperfections in competition bring to microeconomic analysis. He then makes his celebrated 'getaway' into the world of perfect competition (see quote above).

Note how delicate is the quest for equilibrium, and so coherence in neoclassical theory. In Hicks' example, the assumptions allowed included perfect knowledge and foresight, static, homogenous technologies, costless government and transactions and all the other things which are brought to bear in generating a perfectly competitive equilibrium - except one. Yet once firms gain some discretion in setting prices, the analysis is engulfed by complexity. As Krugman explains, despite today's much greater mathematical sophistication, imperfect competition cannot be modelled without arbitrary - indeed "silly" - assumptions about tastes, technology, behaviour, or all three ("Counterrevolution", 1993: 20).

1.2.1.2 First Best and Second Best Perspectives in Normative Economics

\[
\text{[N]ecessary conditions are not very interesting. It is sufficient conditions for an improvement that we really want.}
\]

Ian Little, in Lipsey and Lancaster, 1956-57: 17

In normative economics, 'second best' principles and perspectives also stand as a dangerous supplement to 'first best' ones. The theory of the second best emerged formally towards the end of the 1950s. It showed that where one of the conditions of Pareto optimality was violated - by (say) some divergence between price and marginal cost in some market - it was in general no longer desirable to move in the direction of achieving other conditions of Pareto optimality. Again there was a good deal of disciplinary turmoil, about the implications of the new work and whether it should be interpreted as another 'impossibility' theorem à la Arrow (see Mishan, 1962: 205). The turmoil is hardly surprising. The world is constantly breaching the conditions of Pareto optimality. And even where one focuses on a single set of 'distortions' like trade barriers, as if they were the only obstacles to an optimum, where they cannot be removed immediately and totally, the theory of the second best threatens a fair amount of 'wreckage' for the coherence with which economists can think through the normative economics of gradual reform (cf Vousden, 1990: 203).

1.2.1.3 Coping with Theoretical Insufficiency: Disciplinary Collapse into Commonsense

According to the interpretation offered here, the content of dangerous supplements are not simply 'subjects' within the discipline. On the contrary, one would expect
approaches to them to mark the sites of strategic choices made - and battles fought - about how the discipline itself is practiced and what its social role might be - what it 'stands for'. But the 'dangerousness' of the supplements - their subversion of the coherence of the discipline - means that these choices are difficult indeed. And as Herbert Simon has remarked, difficult choices frequently mark the site of irrationality (1989: 34 and see below). The choices made by the discipline in the 1970s and 1980s make the backdrop for this study. The main focus is on choices made about 'second best' issues, although a different choice made about imperfect competition features as an interesting foil.

By the early 1970s, economics had dealt with the destructive tendencies of both imperfect competition and the theory of the second best in a similar way. The discipline continued to orient its thinking around its favoured poles - perfect competition and 'first best' normative principles - but it made pragmatic exceptions where the case for so doing seemed strongest. Thus for instance, Donald Winch commented in 1971 that "[t]he general conclusion about optimisation in an imperfect world is clear. . . . In the presence of imperfections, the best policy in any situation cannot be calculated with precision from available data. The rules of first-best optimality, coupled with the caveat of second-best, do however, constitute part of the fund of guidelines from which good, if not perfect, policy might be formulated. . . . This is a delicate business, lacking scientific precision" (1971: 116). *Mutatis mutandis*, this description of 'second best' reasoning in economics, aptly describes the role of imperfect competition, certainly in the economics of trade in the early 1970s. Many economists considered scale economies and imperfect competition to be an important engine of trade, including the man who engineered the 'getaway' from imperfect competition cited above - John Hicks! (*eg* see 1959: 183). Some systematic attempts had been made to accommodate scale economies into trade theory (*eg* see Linder 1961; and Drèze in Vernon, 1970: 176-7). Various economists, like Harry Johnson for instance, called for increased effort to accommodate imperfect competition into trade theory. But others like Bhagwati reflected the orthodox pessimism about the technical possibilities of moving very far beyond the existing position. Bhagwati called on Johnson to explain "precisely" what he had in mind (In Vernon, 1970: 24).

After the seventies the disciplinary status of these dangerous supplements diverged. After what one might call the 'repressive tolerance' of the 1970s, 'second best' principles were progressively marginalised over the 1970s and 1980s. This dissertation looks at how this happened and at some of the problems this raised for policy making. By contrast, during the same period economists attempted to storm the citadel of
imperfect competition in the interests of the 'realism' of their discipline. As the final section of this chapter illustrates, the results confirm the dangerousness of imperfect competition. In trade theory at least, as Paul Krugman now concedes, economists did not get far (see § 1.3.3). A decade on, the preeminent exponent of the new international economics of imperfect competition considered that we should stick to 'first best' approaches to trade - *ie* free trade - unless there are compelling reasons to do otherwise (Krugman quoted in AFR, 3rd May 1989: 14). We are back to the 1970s.

As Herbert Simon puts it, "a choice between undesirables is a dilemma, something to be avoided or evaded" (1989: 34). With both imperfect competition and 'second best' considerations for policy, choices were made, but they were made by default rather than design. As this dissertation seeks to demonstrate, the choice to marginalise 'second best' reasoning, was made largely by appeal to the fallacious notion that policy can generally choose between 'second best' policies and something better - 'first best' ones (see Chapters Three and Six to Ten). By contrast, the protagonists of reconstructing trade theory along imperfectly competitive lines proceeded to engage the dangerous supplement in apparent disregard of the costs of their quest for the robustness, generality and tractability of their results. In this regard, the methodological choices made by the discipline defied the axiomatic injunctions of the discipline itself! Where 'second best' normative principles were condemned by reference to their potential costs for policy (with insufficient regard for their potential benefits), so imperfect competition came to dominate the 'forefront' of the discipline largely by virtue of an appeal to its analytic benefits (realism) which took almost no account of its analytic costs! (robustness and generality) (see § 1.3.3).

1.2.2 The Threat of Subversion by Politics and 'Do-it-Yourself Economics'

To expect . . . that the freedom of trade should ever be entirely restored in Great Britain, is as absurd as to expect that an Oceana or Utopia should ever be established in it. Not only the prejudices of the public, but what is much more unconquerable, the private interests of many individuals irresistibly oppose it.

Adam Smith, 1776: 437-8

It is frequently argued that protection will provide general benefits to the public - or 'the nation' - in the process of providing particular advantages to its direct beneficiaries. Despite their plausibility to the lay public, such calls are typically either wholly or partly fallacious. The crudest forms of protectionism can be refuted by reference to the 'second round' or unintended consequences of policy. A typical refutation goes something like
this: impediments to imports raise domestic costs. These higher costs are passed onto
domestic consumers as higher prices, but exporters compete against international
competition and so cannot raise their prices. Export production becomes less profitable
and so exports fall. General equilibrium can only re-emerge once exports have fallen by
as much as protection has reduced imports. Thus ultimately protection does nothing to
affect the trade balance (which is fundamentally determined by other forces) but national
income falls as low productivity import replacement displaces higher productivity export
activity.

Here economists' intellectual and social roles come together with particular force. Their
critiques of public misconceptions protect the public from inefficiency whilst illustrating
the potency and importance of economic expertise (cf Krugman, 1993, "Arguments":
362, Henderson, 1986: 53). There is surely particular satisfaction involved in this
turning of the tables, in showing how the seemingly attractive expansion of an industry
is actually harmful, and how the seemingly harmful contraction of a protected industry is
beneficial.

The orientation of professional economics appears to have been influenced in important
though subtle ways by its role as a foil to the mercantilist fallacies of do-it-yourself
economics. If mercantilistic policies are typically motivated by their expansionary first
round effects on chosen industries, economic orthodoxy appears to have developed a
strongly anti-mercantilistic aesthetic of reform which emphasises the ultimately beneficial
effect of contractionary first round effects. For the methods of unilateral trade
liberalisation which have received easiest acceptance within orthodox economic theory
and political economy are 'top down' and 'across the board' tariff reductions. (Top
down reform involves cutting the highest tariffs first, then the next highest and so on.
Across the board reform involves reducing all tariffs by the same proportional amount.)
The immediate (first round) effect of both types of reform move is to contract protected
sectors as imports increase. The beneficial expansionary effects of reform only emerge
once the resources thus liberated are employed more productively elsewhere (IAC,

It might seem obvious that the simplest and most direct way to liberalise trade is to
remove existing trade barriers. But when trade liberalisation must be gradual, such
simplicities obscure important questions. While tariffs remain at whatever level, to what
extent should tariff concessions be provided to exporters? Should industry assistance
remain inwardly oriented until free trade is achieved? Tariff concessions and other forms
of assistance to exporters from traditionally protected sectors have some appeal to the
mercantilistic intuition of 'do-it-yourself' economics precisely because of their expansionary first round effects. And there is no logical reason why contraction should be the first effect of reform. The same effect can be achieved where less protected sectors expand and draw resources from the protected sectors.6

Suffice it to say here that economists deliberations on these issues reflected strong anti-mercantilist orientations. The issue of tariff concessions for exporters remained almost wholly unaddressed within the profession. And where the issue of facilitating or assisting the emergence of exports in the context of trade liberalisation was addressed, many in the profession were instinctively hostile towards policies which sought to improve Australia's industry structure by promoting or facilitating the development of particular industries (see Chapters Three and Ten). As demonstrated in the following section, the anti-mercantilistic orientation of the discipline also provides a possible key to aspects of economists' treatment of the normative economics of trade negotiation.

1.2.3 An Illustrative Digression: The Normative Economics of Trade Negotiation

In economists' discussion of trade liberalisation, unilateral trade liberalisation has generally occupied the 'high ground' with trade negotiation between countries being correspondingly deprecated as either wholly inexplicable or at least paradoxical from an economic point of view (see below). From a neoclassical perspective it is hard to understand why countries negotiate to open their markets to each other because they are trading 'concessions' which are unilaterally beneficial in their own right. And when it comes to trade negotiation, multilateralism has occupied the high ground against regionalism and bi-lateralism.7 There may be 'practical' wisdom in these rankings -

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6 The point made is a logical one. It will frequently be practically difficult to design policies to expand lightly or negatively assisted sectors in such a way that their expansion draws resources from the most protected sectors. The distinction remains however between what one might call a 'contractionary' reform path driven by contraction of the most protected sectors (with the subsequent deployment of liberated resources in more productive activities) and its converse - an 'expansionary' one in which less protected sectors expand (drawing resources from more protected sectors). In the typical exercise in comparative statics used to explore these scenarios, ceteris paribus the expansionary and contractionary reform paths to free trade would be welfare equivalent.

7 Those amongst the orthodoxy who tolerate regionalism tend to do so to the extent that it might complement multilateral trade liberalisation (see for example Johnson, 1968: 167). The preference for multilateralism is expressed in the following passage from the Australian daily press. "NAFTA is second best. It is trade liberalisation, but it is discriminatory liberalisation. . . . First best would
related to the domestic and international *political* tendencies of different approaches to liberalisation - but it is hard to justify them theoretically.

From a neoclassical perspective two effects should be taken into account in trade negotiation - a country's access to imports and the access its exporters enjoy in foreign markets. Other things being equal, unilateral trade liberalisation offers the best possible result with regard to the first of these objectives, and nothing with respect to the second. Both regional and multilateral trade negotiation may compromise the first of these objectives because paradoxically, in 'trading concessions' countries surrender to some extent their freedom to act unilaterally. (If other countries know a country will embrace its own interests unilaterally and remove its trade barriers in any event, this cannot be described as 'negotiation'). On the other hand, a country participating in regional and multilateral trade negotiations can often have some effect on its own access to foreign markets. The net result of these two effects in any scenario is an empirical question which has defied attempts to establish the 'in-principle' value of one approach over another (Wonnacott and Wonnacott, 1981; 1984). Yet these trade negotiation alternatives are not neutral in their appeal or lack thereof to the mercantilist intuition. For the gains from traditional unilateral trade liberalisation emerge only after the contraction of protected industries. These are the gains which are all but invisible to the lay public and which economists are trained to see. By contrast, the expansionary first round effects attending improved access to foreign markets are not only easily accessible to commonsense mercantilism, but highly influential in motivating it (Wonnacott and Wonnacott, 1981: 705).

Consistent with the hypothesis outlined above, the economics profession appears to have given considerably more attention to the effects which justify unilateral trade liberalisation and much less attention to the effects which justify trade negotiation. The

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8 This is particularly the case where the number of trade negotiators is small - where trade liberalisation is regional or bilateral - and the mercantilist logic of traded 'concessions' is most evident in the outcome because 'free riding' on others' concessions can be minimised.
benefits of access to foreign markets were recognised in various ways in the literature - such as Harry Johnson's exploration of trade wars using offer curves. Yet despite this, since the 1960s, it has been argued by many economists - including Johnson! - that the only economic motive for a country to engage in trade negotiation is to provide the domestic political circumstances to enable it to reduce its own trade barriers (Wonnacott, 1993: 18-20). As Ronald Wonnacott observes, despite occasional recognition of the importance of foreign tariffs "it is surprising how much life remains in the contrary 1960s-1970s view of free trade as being almost synonymous with unilateral elimination of [one's] own tariff" with reductions in foreign tariffs seldom in view. Thus in standard textbook treatments of trade liberalisation, for instance, there is much on the elimination of the triangular deadweight losses associated with tariffs on the import side but little if anything on the elimination of the analogous deadweight losses accruing to the domestic (exporting) country where its trading partners liberalise.9

As Wonnacott explains, this lacuna existed not just within economic pedagogy but even at the level of empirical estimation:

Thus those working in trade became split between those like Harris and Whalley who, in the course of their empirical estimation of issues such as the cost to developing countries of the multi-fibre agreement, recognised the importance of foreign trade barriers, and those who were silent on this issue. While most in the silent group were not working on empirical estimation, there were some in this group who were, such as those who were evaluating the various effects on a country of joining an economic union and were taking into account the cost of trade diversion on the import side but not the benefit of preferences acquired on the export side (Wonnacott, 1993: 18-20).10

9 Wonnacott goes on:
This is particularly surprising, since other things being equal, a country might expect to gain more from a reduction of a partner's tariffs on its own exports than from reducing its own tariff on its imports, because 1) the former involves a terms of trade gain while the latter involves a loss (with both generating efficiency gains) 2) in bilateral or plurilateral reciprocity in which preferences are created there is a special cost of own tariff elimination in the form of trade diversion, whereas there is a special benefit from partner's tariff elimination in the form of preferential treatments received in [the] partner's market.

10 Wonnacott goes on to outline a similar intellectual phenomenon with regard to the 'unilateral tariff reduction' (UTR) theorem which demonstrated the superiority of UTR over the formation of a customs union by assuming away the very thing which a customs union can provide which UTR cannot - terms of trade gains (p. 20) And see footnote 2 on p. 20 where Wonnacott details a similar 'double standard' in favour of the consideration of the import side advantages of UTR and, in analogous circumstances, against the consideration of the terms of trade benefits offered by foreign tariff reductions.
In apparent exasperation, Wonnacott asks rhetorically "How did this happen?" without providing a satisfying answer. Whether or not it provides a complete explanation, the facts certainly square with the anti-mercantilist orientation of economics as explored in this section.

### 1.3 Positivism and Practical Reason

It is a mark of the trained mind never to expect more precision in the treatment of any subject than the nature of that subject permits; for demanding logical demonstrations from a teacher of rhetoric is clearly about as reasonable as accepting mere plausibility from a mathematician.

Aristotle, 1976: I, iii, 65

This section argues that the culture of modern - post war - economic expertise is infused with the values of rational deduction and that this has had an important effect on the quality of economists' 'practical reason' and so the quality of their contribution to policy advice. My intention here is to juxtapose two approaches to thought itself which have gone under a variety of names through the ages and in different disciplines. They were contrasted as 'logic' and 'rhetoric' in the pre-modern Aristotelian tradition. Lindblom contrasts the methods of 'foundationalism' and 'immanent critique' (1990: 42-3), as earlier in the century he contrasted 'synoptic' and 'incrementalist' procedures of analysis (Braybrook and Lindblom, 1963). McCloskey contrasts 'positivism' and 'modernism'

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11 Because the thesis does not return to it, and because it makes a contribution - albeit tangentially - to the argument, it is noted here in passing that, when it came to trade negotiation, the IAC too, put considerable effort into developing an exclusively unilateralist focus which had countries 'negotiating' trade concessions by reference only to the "restructuring required to make [their] own domestic industries more competitive" rather than the foreign market concessions which could also contribute to domestic welfare (Mauldon, 1988: 131, and see generally IAC Annual Reports, 1984-5 and subsequent years). For instance, the IAC commented that:

> Reducing barriers to international trade does not guarantee, for individual participating nations, an improved domestic incentives structure. The international objective of lowering trade barriers is important. Its contribution to the domestic objective, of a less disparate environment of incentives and a more competitive industry structure, is paramount (IAC, Annual Report, 1984-5: 3).

Without supporting empirical evidence, the assertion that the domestic focus is "paramount" is arbitrary. Note however that in other contexts, the IAC did acknowledge the gains to Australia from other countries' trade liberalisation. (see eg Annual Report, 1974-5: 110; and also Rattigan and Carmichael, "GATT survival crucial for us", AFR, 13th December, 1993: 15).
with 'rhetoric'; persuasive or 'probable' argument with indubitable argument (1985, *passim*).

There is now a vast literature attaching to each of these terms proposing distinctions between them and consequent refinements. Like McCloskey, I am more concerned with the contrast between the two styles of thought and use terms referring to the same sides of the divide synonymously (McCloskey, 1983: 483). The particular concern here is with the pre-eminence of one mode of thought and with the way which, within economics, "probable argument" is so often made "entirely subservient to indubitable argument" (McCloskey, 1983: 483). Naturally the pre-eminent status accorded indubitable argument and formal technique in economics does not prevent economists from exercising the techniques of practical or 'probable' reason. The subjects of this study used their judgment and supported it with informal argumentation, as indeed they had to in order to design and advocate reform. I argue that the quality of this argument was inadequate.

1.3.1 The Practice of Economics and Policy Making: Positivist or Rhetorical Discourse

Let me make a confession. Back when I was 20 I could perceive the great progress that was being made in econometric methods. ... I expected that the new econometrics would enable us to narrow down the uncertainties of our economic theories. ... My confession is that this expectation has not worked out. ... It seems ... that there does not accumulate a convergent body of econometric findings convergent on a testable truth.

Paul Samuelson, 1986: 793

After the Second World War, the rational-deductive ideal dominated the philosophy of science and even social science for many years. Many social scientists dedicated their energies to transforming their own disciplines into 'sciences'. Nowhere was this tendency more pronounced than in economics, not least because so much of its subject matter was naturally quantified and quantifiable (cf Mirowski, 1988: 180ff). Throughout the period, dissenters both within and outside the mainstream have warned that such adulation of the rational-deductive ideal could come at the price of practical reason. Keynes, (the later) John Hicks and Marshall - and arguably Adam Smith.
argued as much while they were alive. Since the publication of Kuhn's *The Structure of Scientific Revolutions* (1962), the positivist understanding of the logic of scientific discovery and justification has been in retreat.

Recently Donald McCloskey has led the anti-positivist charge in economics, arguing that the discipline does not in fact follow the precepts laid down for it in its rational-deductive 'official methodology' and that, moreover, this is a good thing. Like the anti-foundationalist philosophers of science, such as Feyerabend and Rorty, McCloskey proposes that economists should appreciate that there are no indubitable foundations for their discipline: that in so far as one can describe or prescribe for what goes on in the discipline, one can only say that economics follows - or should follow - the rules of disciplined conversation. It should admit formal, deductive reasoning but in a spirit of pluralism rather than exclusion. Much good and important argument will appeal to criteria which are inadequately recognised in the positivist canon. It will appeal to authority, to aesthetic qualities and to elements which appeal to intuitive faculties such as 'judgment'. McCloskey describes such a discourse as 'rhetoric' not in its pejorative modern sense - as ornament or 'mere' rhetoric - but in its pre (and post!) modern sense - as "the art of discovering good reasons, finding what really warrants assent, because any reasonable person ought to be persuaded" (1983: 482).

Similar issues were explored in Herbert Simon's and Charles Lindblom's critique of 'decision making as optimisation' in the late 1950s. Policy making as optimisation sought to include all relevant information and to reduce the various dimensions of a policy problem into some form which could then be solved by objectively optimising some agreed welfare function. Even to describe this strategy is to be struck by how sensible it appears. But both Lindblom and Simon were concerned that this was a misleading description of what actual decision making was or could even aspire to be. Both were concerned with describing strategies for what Lindblom later termed "skillful incompleteness": strategies which found a place for the intuitive processes of judgment, exploration, redefinition and improvisation by which people seek to meet multiple objectives (Lindblom, 1982: 136).

Simon proposed 'satisficing' in which the decision maker sought satisfactorily to meet or exceed specified objectives without seeking a single, unique 'optimal' solution (Simon, 1987: 243). Lindblom's vision was similar, but where Simon envisaged an essentially unitary or hierarchical decision making organisation reaching a decision which would satisfy a plurality of objectives, Lindblom's 'disjointed incrementalism' was socially as well as analytically pluralistic. It placed value on the 'mutual adjustment' and
Chapter One: Sketching Some Problems of Modern Economics

accommodation of a plurality of values, viewpoints, social and economic interests and
decision procedures (including, where appropriate rational deductive methods of cost-
benefit analysis, operations research and so on).

Both Lindblom and McCloskey offer a critique of practitioners' self-understanding
which suggests that many are profoundly misunderstood about what they do, and
accordingly what they might reasonably aspire to do. At this point McCloskey's and
Lindblom's messages diverge. Despite arguing that the Official Methodology in
economics is hopelessly, indeed "scandalously" misguided, McCloskey concludes that
"[e]conomics at present is, in fact, moderately well off. It may be sleepwalking in its
rhetoric, but it seems to know in any case approximately where to step" (McCloskey,
'scandalously' bad methodology suggests of course that methodological reflection has
relatively meagre practical significance. On the other hand, the burden of Lindblom's
message has been to stress the way in which such misunderstanding can undermine
practical reason. It certainly seems plausible that argument which placed almost
exclusive value on formal analysis but which relied extensively on informal judgment,
might be informal argument of a relatively untutored and even disoriented kind. As
Lindblom has put it:

A [rational-deductive] (in aspiration) attempt to choose and justify the
location of a new public housing unit by an analysis of the entirety of a
city's land needs and potential development patterns always degenerates at
least into superficiality if not fraud. . . . The choice . . . is simply between
ill-considered, often accidental incompleteness on the one hand, and
deliberate, designed incompleteness on the other (1982: 129, 130).

The contents of this thesis support Lindblom's instincts in believing that the issue is an
important one for practice.

1.3.2 Some Intellectual Vices of the Rational/Deductive
Self Image

This section outlines several ways in which the intellectual culture of the economics
profession provides fertile soil for a variety of intellectual vices to grow. Of course not
every episode examined in subsequent chapters exhibits each of these vices.
Nevertheless given that each makes its appearance amply in the subject material under

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13 McCloskey's use of the expression "in fact" conceals a few rhetorical tricks of his own. It appears to
stand for the expression "in my opinion".
study, it seems worth the attempt to relate them to their intellectual 'root causes' where this can be done plausibly.

**1.3.2.1 Technical and Integrative Skill and the Need for Evaluative Judgment**

I just don't accept the . . . view that until you have a good, solid, theoretical explanation of a phenomenon you have to ignore the phenomenon.

Alan Blinder, cited in Hahn, 1986: 279

Section 1.1 argued that frameworks and so modes of discussion must seek to satisfy several objectives simultaneously. Those objectives include internal consistency, simplicity, 'realism' and the breadth of illumination offered by alternative approaches. Thus, to use Simon's terminology, choosing between them is an act of 'satisficing'. Greater formalism will typically improve the internal consistency of an argument. And by thus making way for "modification and qualification" (Samuelson, 1947: 92), it can sometimes contribute to better meeting other objectives. But often it will not (Loasby, 1976: 56-7, and see § 1.3.3 below). And in most acts of satisficing, better meeting one objective comes at the cost of others. The strictures of logical consistency can weigh down a discussion (see Blinder above and Keynes below § 1.3.2.2.2). As IAC modeller David Vincent commented, "[g]iven the time constraint under which staff operate, the initial model specification is crucial. . . . only minor modifications . . . can be implemented as the inquiry progresses" (Vincent, 1990: 299-300). Less formal approaches are less constrained in this way.

Economists appreciated this point in the first half of this century. As Dewey has explained, there were good reasons why an earlier generation of economists - preemminently Marshall - held back from formally defining competition. Such forbearance permitted them to organise their discussions flexibly: "The model of perfect competition could be introduced whenever it could usefully illuminate some important feature of reality. It could be laid aside whenever it got in the way of the study of other important features of reality" (Dewey, 1969: 7-8). Today's economics does not escape the dilemmas of inconsistency. As Loasby puts it, the methodological difficulties involved in reconciling current 'static' and 'dynamic' perspectives cannot be solved - only lived with (1976: 202). Indeed, they go back to the birth of Western Philosophy and Zeno's paradoxes about stasis and motion which have never been compellingly solved. 'Comparative statics' usually runs the gauntlet of these paradoxes by suggesting implicitly that one static state somehow 'becomes' another - without (alas) having solved the problem of how this takes place either within the strictures of the model or the world.
In contemporary practice the economist frequently switches the scenery - instantaneously as it were - with very little, if any, deliberation on how partial perspectives might be brought into some (albeit inadequate) coherence. In the IAC study discussed in Chapter Nine below, the IAC itself provides an example of formally inconsistent analyses brought to bear on the same problem. The IAC's ORANI analysis assumed imperfect substitution between imports and domestic production, whilst its assistance evaluation was done according to a standard procedure one of the implicit assumptions of which was perfect substitutability (IAC, PMVs, 1981, Appendix Nine and Appendix 12, and See Corden, 1971: 60). Yet there is little if any discussion of how the two frameworks might relate to one another. The approach of economists like Marshall - what Shackle has called "deliberate imprecision of argument" (1988: 143) - had the great advantage of emphasising the role of evaluative judgment and interpretive skill in integrating partial perspectives into an imperfect, but possibly useful whole.

As well as being massively complex, the economy is also forever evolving. Formal method has trouble with both complexity and evolution. Hicks has commented that the experimental sciences are "in the economic sense, 'static'". Their data is provided by experiments which, being replicable, provide data which has validity in some timeless sense. He argues that while there are economic problems which can be dealt with according to such a method, "there are not many of them":

The more characteristic problems are problems of change, of growth and regression and of fluctuation. The extent to which these can be reduced into scientific terms is rather limited; for at every stage in an economic process new things are happening, things which have not happened before - at the most they are rather like what has happened before. . . . As economics pushes on beyond 'statics' it becomes less like science and more like history (1979: x-xi, cf Cairncross in Henderson, 1986: 105).

To use Hicks' felicitously vague expression, the development of policy responses to emerging economic developments requires skill in comparing 'rather like' with 'rather like'. One will need skill in working with frequently seriously inadequate information. Formal modelling and statistical techniques may be of some use. But their usefulness will probably be strictly limited. Where economic developments and the ideas to interpret them are new, the data will rarely be available in a form which permits rigorous analysis (Coase, 1988: 71). For instance many of Keynes' arguments in the general theory were not formulated as statistically testable hypotheses until the early 1950s (McCloskey, 1983: 489). Throughout economics, but particularly where new phenomena and so new possibilities are emerging, adaptive, informal and 'probable' reasoning will be crucial.
Against the 'technical skill' with which practitioners manipulate formal identities one may compare the skill and the fruitfulness with which they exercise the less exact skill of judging when, whether and in what circumstances analogies and distinctions between 'rather like' and 'rather like' enlighten more than they mislead (cf Marshall, 1947: 774). This is the skill - I will call it 'integrative skill' - by which a practitioner will decide the worth of a particular piece of economic theory and whether and how to apply it in specific circumstances. On inspection it will be evident that technical skill is dependent upon integrative skill for its usefulness. For the technical manipulation of formal identities is of no scientific interest but for some judgement made that what is manipulated - say the formal conditions which specify perfect competition - bears some useful resemblance to (is 'rather like') empirical phenomena of interest. A simple, and so compelling, example of inadequate integrative skill is provided by the IAC's treatment of economies of scale in the automotive industry. As Chapters Seven to Nine demonstrate, IAC analysts devoted considerable resources to technically estimating minimum efficient scale (MES) in the automotive industry for various activities without even considering whether the particular textbook specification of MES they were using was appropriate in this instance. The IAC took MES to be the output at which a further doubling of output would lower average unit costs by less than two per cent (IAC, PMVs, 1974: 100). But why two per cent? Other textbooks have minimum economic scale being the point at which a doubling of output would lower average costs by five per cent! (eg see Fisher and Dornbusch, 1983: 167). In plenty of markets even a five per cent cost disability is not critical to viability. Indeed the automotive industry is such a market (see § 7.5.2.1).

Integrative skill also enables the practitioner to look at phenomena from several perspectives in search of what Stretton has called 'manipulative opportunities' (1969: 62). Thus, in positive economics, if two reasonable perspectives on a problem each highlight something as an explanator of observed behaviour, this adds to the confidence with which it can be identified as important. The normative implications of competing perspectives or models can be integrated in an analogous way. Where it is not possible to choose confidently between alternative models or perspectives, progress may

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14 An even more striking example of this kind of problem - of economists learning techniques which are then uncritically applied - is provided by McCloskey and Ziliak, 1996 who show how alarmingly often in economic practice, statistical significance is substituted for economic significance. Note that tests of statistical significance are technical exercises whereas assessments of economic significance require some evaluative judgement to be exercised (1996: 98).
nevertheless be facilitated by searching for areas in which the policy implications of one approach are not vitiated (or better still, supported) by alternative perspectives.

The following chapters outline a situation in which there was a range of perspectives on trade liberalisation and industrial development within the economic literature in the 1970s and 1980s. Each offered partial perspectives on a range of issues of some relevance to Australia's circumstances. During the period under study, Australia's industry structure was changing and new possibilities were emerging. In the automotive industry, after two decades of inwardly oriented growth and protection, domestic demand was becoming saturated by domestic production. At the same time opportunities were emerging to deploy Australia's industrial capability as an 'export base'. What was happening was, 'rather like' what had happened to America's manufacturers in the fifties - although of course it had its differences. What Raymond Vernon had just christened 'product cycle trade' was becoming possible for Australia's manufacturers (see Chapters Two and Three).

Australia's circumstances were also 'rather like' those confronting the firms and policy makers of North East Asia. The policy makers of Japan, Korea and Taiwan were aware of the limitations of inwardly oriented growth. They were thus keen to shift the focus of an increasingly competent industrial base towards export markets and keen to achieve technology transfer from foreign multinational enterprises (MNEs). In the early 1970s the formal micro-economics of these issues were in a relatively primitive state. As Dunning put it "the debate on the role of MNEs on trade and the transfer of technology and the location of production, is still in its infancy. It is an area hazardous and not altogether attractive for the academic economist; the issues are controversial; the concepts are elusive the data are not easily subject to quantitative manipulation and appraisal, and the standard of debate is often low" (1977: 413-4). The discipline of economics was not well endowed with insights into these issues.

Yet the appeal of policies to deliver industry assistance in ways which facilitated intra-industry trade enabling firms to specialise in existing or developing competitive strengths was amenable to commonsense, and the North East Asian countries used such policies extensively (see Chapters Three to Five below). By contrast, within the Australian IAC, the act of formalising the problems itself concealed the very phenomenon of intra-industry trade from view. Three of the four of the simplifying assumptions made by the IAC in its measurement of effective assistance were logically inconsistent with any level
of intra-industry trade and specialisation (Rattigan et al, 1989: 107-8).\textsuperscript{15} These assumptions were taken directly from the economics profession's trade theory of the day. Where Asian policy makers improvised a range of new instruments to expand trade "before it could be realised how beneficial the transformation of policy . . . would prove to be" (Taiwanese Minister Li, 1988: 135), economists in the IAC actively opposed similar instruments and indeed actively opposed any of the exploratory innovations in trade policy and trade liberalisation which had been so successfully deployed in North East Asia.

1.3.2.2 The Temper of Economic Discourse: Dichotomies and Impatience for Closure

Modernism has also had a profound effect on the 'temper' of economic discourse. The previous sub-section suggested that the technical skill, so prized by modernist methodology, could come at the cost of 'integrative skill'. The following sections explore how this is reinforced by a range of tendencies, which tend to militate against the prospect of mutually beneficial dialogue between those with differing perspectives.

\textsuperscript{15} The assumptions are:

- perfect substitutability between local and international goods
- In the absence of assistance, domestic prices are set by international prices
- "The direction of trade in the absence of assistance can be assessed. Unusually this is further simplified by assuming that import competing goods remain import competing and that goods exported continue to be exported [even given changes in the assistance structure]." (In fact it is further simplified by assuming that industries which are net importers do not export and that industries which export do not import. Thus, although the commission was aware of the point which its consultant Peter Lloyd had stressed - that there were wide disparities in both competitiveness and assistance level within as well as between industries - [see eg Annual Report 1973-4: 12; §82 and 22; §152] - this virtually never entered its formal analysis.)
- The production relationships between inputs, between outputs and between inputs and outputs for each activity remains unchanged by the structure of assistance
1.3.2.2.1 Preoccupation with Polarities: Inattention to Local Possibilities

We need to focus on how to deal with the transitional issues - it is less important whether you think that free trade or strategic trade is the ideal than how you get out of the mess you are in now.

Nancy Barry, 1989

In a recent book Lindblom offered an instructive contrast between two approaches to policy on euthanasia. Where a foundationalist approach might attempt to deduce appropriate policy from a principle about (say) the value of human life, the alternative approach would build from what was known to it asking "Who are the people for whom euthanasia is a possibility? What is their situation? What do they think about it and why? What do others think about it and why? Can I find relatively concrete persuasive reasons for agreeing or disagreeing with either? On what grounds might my line of thought then in turn be challenged? One method descends, the other ascends" (1990: 42). A foundationalist approach which orients itself around polarities can be counterproductive if it obscures more immediately relevant issues. Indeed, as Lindblom argued in the 1950s, it can serve to orient the discussion around concepts like 'competition', 'capitalism' 'planning' and 'socialism' which do not describe actual alternatives confronting policy makers:

Since all relevant real-world systems are combinations of these 'systems', what is at stake at any point of marginal policy adjustment is a 'systems mix'. Hence the general case for or against any of these pure systems, we find, is not a case for or against any actual policy choice that is in fact open (1958: 310).

This describes the texture of professional economic discussion of liberalisation well. Despite perennial preoccupation with the 'big questions' on free markets versus intervention and whether or not to liberalise, economics is frequently unhelpful on the smaller questions of system design and amelioration. Thus for instance, despite lengthy debate on the merits or otherwise of protectionism, Max Corden observed in 1968 that Australian economists had "until recently, offered very little guidance on what the structure of a tariff system should be, given the fact that a general argument for protection is accepted" (1968: 26). More recently Michaely commented in 1986 that while liberalisation was often "of primary importance" in improving efficiency and growth, investigating the desirable path of liberalisation constituted a serious gap in both
CHAPTER ONE  SKETCHING SOME PROBLEMS OF MODERN ECONOMICS

the empirical and analytical literature on liberalisation policy (1986: 41).16 The World Bank has put considerable effort into addressing 'transitional' issues since then. Even so, the emphasis has typically been at a very aggregated level which offers little guidance on the issues covered in this dissertation: "Which are the key markets to be liberalised and in what order?" (Donges et al 1991: 219). This thesis sketches a wide canvass of options for liberalising just one system of intervention - trade barriers - which has received scant attention from economists.

1.3.2.2.2 Science as Convergence Toward Truth: Burdens of Proof and the Disparagement of Dialogue

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\text{[O]ne does not go about identifying the weaknesses of what another person says in order to prove that one is always right, but one seeks instead as far as possible to strengthen the other's viewpoint so that what the other person has to say becomes illuminating. Such an attitude seems essential to me for any understanding at all to come about. This is nothing more than an observation. It has nothing to do with an 'appeal' and nothing at all to do with ethics. Even immoral beings try to understand one another.}
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Modernist discourse not only downplays the importance of 'probable' reasoning. Modernism often actively deprecates 'probable' reasoning and in so doing places upon it a burden of proof which, by its nature, it cannot discharge. Modernists concede that scientific discovery may require imagination. But where truth, or successively closer approximations to it, are presumed to emerge from the data, the logic of scientific justification becomes a matter of excluding the 'untrue' and the 'unscientific' (eg see Popper, 1986: 36ff; 89). As Brown puts it ... "No longer a collaborator in persuasive discourse", the reader "is now to be convinced by the force of facts and logic" (1987: 20). Or in Klamer's words, for modernists, "agreement is only a matter of time" (cited in de Marchi, 1988: 272). In this framework dialogue provides an engine for scientific consolidation. But this is dialogue as a contest in which the winner carries the day. Mutually exploratory and cooperative dialogue is less obviously valuable. Indeed it might even retard scientific consolidation by compromising the rigour of the struggle for survival in the marketplace of ideas. Integrative skill and judgement about the plausibility of alternative ideas is subservient to the technical skill which one can

\[\text{16 cf The World Bank:}
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The nature of a desirable path - the sequencing - of trade policy reforms, specifically those economic measures that lead to a contraction of effective rates of protection is a significant omission in research on trade policy (1984, pp. 55-6).
bring to 'letting the data speak'. Samuelson tilts at the standards of rhetoric - the appeal to persuasion, judgement and authority - when he declaims:

It is not elder statesmen's wisdom that kills off a young whippersnapper's foolishness, but rather another whippersnapper's regression data (1989: 97).

Dissenters from 'modernism' have generally been concerned with communication between those who see things differently. For them mutually exploratory and cooperative dialogue is indispensable to the progress of science. Thus some 'openness' of the texture of disciplinary discussion is seen not as an indulgence but rather a prerequisite of social reason. Towards the end of his labours over *The General Theory*, Keynes became fascinated with the way in which his own struggle towards new ideas was also a struggle to escape from old ones (1936: xxiii). Thus he insisted on the importance of communicating whole "bundles of ideas" with "a quasi-formal style" which, though it is imperfect, is the best means of communication available. Such a style relies on the interpretive intelligence and good will of readers, who might otherwise raise "a thousand futile, yet verbally legitimate" objections (cited in Moggeridge, 1976: 33-4). Keynes' view accords with Kuhn's description of paradigm change in science which is the result of a "conversion experience that cannot be forced" (1970: 151).

This issue is related to the polarisation of economic discourse. Just as formal economic theory is generally best at dealing with the kinds of limiting cases which typify the extremes of a situation - like perfect competition versus monopoly, competitive markets versus central planning - and far less powerful in the complex area between such poles, so the areas of common ground which emerge between those with fundamentally diverging interests or perspectives will often exist somewhere between the poles. Thus in Australia, after the mid-seventies, enormous effort was then, as it is today, exercised debating the relative merits of 'free trade' versus 'intervention', rather than attempting to generate as wide a consensus as possible in favour of worthwhile improvements in Australia's industry and policies (also see P. Lloyd, 1978: 288-90). There was remarkably little dialogue as cooperation although there was plenty to be had, if not

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17 See also Keynes' personal note repudiating Hayek's critique of his *Treatise on Money*:

Hayek has not read my book with that measure of 'good will' which an author is entitled to expect of a reader. Until he can do so, he will not see what I mean or know whether I am right (cited in Moggeridge, 1992: 534).
concerning whether to liberalise trade, then on how to optimise industrial development in the context of liberalising trade.

Not only is formalism frequently inhospitable to the formulation of new insights and to the integration of differing perspectives. Those who seek such integration are frequently required to meet an impossibly heavy burden of proof in convincing modernist doubters. Where those opposed to the modernist tradition have argued that each side of the debate bears a heavy burden of interpretation in order to understand and 'make the most of' the other (see Gadamer in head quotation above), the modernist tradition imagines that the problem may be solved (at least in-principle) with a shoot out in which the bullets are formal logic and/or statistical regressions. Modernists who are unpersuaded but not, in their own terms refuted, might all too easily assume that the problem lies with their opponents.

As Chapters Seven to Ten demonstrate, one of the chief means by which the IAC avoided engagement with those who differed with it was to impose upon them a burden of proof which it was effectively impossible for them to discharge - and indeed one, which on inspection, the Commission itself was also generally unable to meet. A brief foretaste may be provided here. In its 1966-67 Annual Report the Tariff Board announced that it would not recommend 'infant industry' protection for an industry unless its "prospects of operating with lower levels of assistance within a reasonable time" could be demonstrated "beyond reasonable doubt" (1966-7: 9). One need not, as this author does not, disagree with this scepticism about the 'infant industry' argument for protection - especially in Australia in the late 1960s - to observe nevertheless that the Board was proposing a standard of demonstration for its opponents which has traditionally been regarded as more suited to dealings with murderers than protectionists! And evidently such a test pre-empts any possibility of making policy recommendations around assessments of the probable costs, risks and benefits of a proposed policy alternative. Needless to say the IAC never found an industry worthy of infant industry protection.

1.3.2.2.3 Peremptory Rules or Meliorative Themes?

Perhaps the most important aspect of the mathematisation of any intellectual project is its sociological impact upon the membership of the discipline. It is only fairly recently that the issue could be seriously discussed.

Phillip Mirowski, 1986: 191

Phillip Mirowski has suggested that disciplinary traditions of mathematical formalism in economics lead to a very low professional threshold of toleration for any debate which
does not seem to be headed toward definitive conclusion (1986: 192). An important theme in anti-modernism has accordingly been the struggle to allow a discipline to be "more 'open minded' - more adaptable to circumstances" than modernist methodological predilections are likely to permit (Braybrooke and Lindblom, 1963: 155). In this regard, Braybrooke and Lindblom make a useful distinction between 'peremptory rules' and 'meliorative themes'. Peremptory rules constrain discussion. Meliorative themes may embody the same considerations as are reflected in rules, but they seek to force the debate towards mutual accommodation of alternative perspectives rather than the triumph of one perspective over the other.

To simplify Braybrooke's and Lindblom's discussion somewhat, they exemplify the two approaches in an (imagined) debate concerning the initiation of a pilot school dental service. Group one argues against the initiative according to the 'peremptory rule' that dental services are not part of the function of the school. Group two bring a range of 'meliorative themes' to bear. They argue that there are no alternative ways of bringing proper dental care to a significant proportion of the school population and they stress the inherent value of so doing. They also show ways in which their program might be seen to promote certain educational aims, for instance by educating children in dental hygiene. Finally, they concede (perhaps for the sake of argument) that the program might not be central to the school's educational function. But they seek to engage their opponents by proposing that their decision criterion be expressed so as to allow more 'room to move' - 'Would the pilot program interfere with the basic pedagogical functions of the school?' - to which they answer 'no'. Their reasoning is thus exploratory in a number of senses. It searches for common ground with its opponents, and it seeks to "trade one value against another in margin-dependent comparisons" (1963: 157). Braybrooke and Lindblom continue:

The freedom of maneuvre gained (or rather maintained) by working with themes rather than rules has been described as a freedom of maneuvre against other disputants, but [it] is not merely an asset in debate - it is a freedom of discovery as well. . . . Shifting and changing from one theme to another, the meliorative party discovers ways of looking at the proposed policy that would perhaps not have occurred to its members if they had confined themselves to insisting on a particular policy's connection with a certain rule (1963: 165).

As with the other issues in this introductory chapter, the burden of demonstration falls to subsequent chapters. Suffice it to say here that the subjects of this study display a certain intolerance towards exploratory discussion and a corresponding inclination to search for peremptory rules of policy. In searching for common ground between
perspectives as set out above, 'meliorative themes' are likely to offer much more room to make fruitful connections than peremptory rules. Given the history of Australian post war protectionism, one can sympathise with the Tariff Board's indication quoted above (§ 1.3.2.2.2) that it would be loath to recommend 'infant industry assistance'. Yet it might be important that this be expressed as a meliorative theme rather than a peremptory rule. For there might be circumstances where the infant industry argument is unpersuasive on its own but decisive in conjunction with other considerations. Whether or not the battle against protectionism was to be ultimately won or not, the inevitability of protection remaining at relatively high levels while it was gradually reduced raised secondary questions and the 'infant industry argument' had some relevance in this context.

For if significant assistance was to continue into the medium or long term, infant industry considerations had some relevance to the form in which assistance was offered. As the Commission suggested, the greatest assistance had tended to be provided to those manufacturing activities with the least export orientation (IAC, Annual Report, 1973-74: 16). Australia's most promising manufacturing infant industries might accordingly be those which had or would achieve a high degree of export orientation. In this context, 'infant industry' considerations suggest that restricting what assistance remained to tariff-only assistance was wasteful because it was least available to those firms whose superior export performance identified them as the most promising prospects within their industry. Other questions which arise from the gradualism of Australian trade liberalisation include: could its worst effects be mitigated relatively quickly even if more substantial trade liberalisation would take longer? Might some forms of industry assistance prepare industry for the ultimate withdrawal of protection better than others? And how might the relative successes of Asian trade and development programs affect the specification of sensible trade liberalisation for hitherto protectionist developed countries like Australia and New Zealand? Yet in the economic literature, as in the IAC's analysis, there was little effort given to this kind of exploration.
1.3.3 An Illustrative Digression: Increasing Returns in Trade Theory

It is rather obvious, that in an economic environment in which firms and industries operate under increasing returns to scale and exhibit non-competitive behaviour, there exists room for beneficial intervention.


This sub-section offers an illustrative digression which argues that progress in understanding trade has been hampered by the 'modernist' values of economics. This sub-section forms a companion piece to the sub-section 1.2.3 above, which illustrated how the anti-mercantilistic orientation of modern economics had likewise distorted its focus.

The imperfectly competitive phenomena about which debate had raged in the 1920s and 1930s were almost wholly marginalised in the neoclassical synthesis of the fifties and sixties (Groenewegen, 1984: 22). Given this, the recent rehabilitation of increasing returns in trade is fortunate. However the way in which increasing returns has been rehabilitated shows many of the disciplinary vices which were responsible for their previous eclipse. The official history of the rehabilitation of increasing returns offered by one of its prime movers - Paul Krugman - is one in which economists vision is tied to their technical powers. Increasing returns disappeared from view because they were difficult to model technically and economists took the "line of least mathematical resistance". Economists could only 'see' them again when models of imperfectly competitive phenomena were constructed (1988: 8, and see 1993 "Counterrevolution").

There is surely an unfortunate complacency in Krugman's account. It is clearly unacceptable for a discipline to simply ignore pervasive and important phenomena because it has difficulty formally modelling them. Hicks did not say that imperfectly competitive phenomena should be ignored by economists and did not ignore them himself (see § 1.2.1.3 above). But he did argue that there were virtually insurmountable difficulties in exploring the implications of imperfect competition by the methods of economic theory (see § 1.2.1.1 above). Given this disciplinary heritage, the challenge before those seeking to reconstruct trade theory around increasing returns (Krugman, 1993, "Arguments": 366) was to show how and why the concerns of Hicks and others could now be met. They did this poorly if at all.

Some of the new work has undoubtedly been useful. Despite Hicks' warnings, economists have built models of trade in the context of monopolistic competition which have elucidated some of the necessary properties of trade when firms face fixed costs.
Chapter One

Sketching Some Problems of Modern Economics

(Fixed costs are pervasive in the economy but strictly incompatible with perfect competition.) Helpman and Krugman showed how monopolistic competition could be brought within a general equilibrium HOS framework (see § 3.2.1) generating trade which was driven by both relative factor costs and product differentiation (Bensel and Emslie, 1992: 258). Harris and other Canadian economists extended this approach into empirical estimation with computable general equilibrium models in which economies of scale and the resulting monopolistic competition were embedded within a traditional HOS framework (1984). This permitted them to illustrate the way in which traditional HOS models might significantly underestimate the gains from trade. Even here, however, for the sake of tractability the model of competition in the presence of fixed costs was very abstracted, and it left many of the phenomena largely unexplained (Gray, 1988).

Another tack was to accept Hicks' point that once competitive imperfections entered, economic theoretic analysis was likely to be much more indeterminate and to adapt one's methods accordingly. Peter Gray has put it well since then:

To be able to embrace all of the various forces which act on IIT [intra-industry trade] \(^{18}\) in a single model which yields a precise solution, is impossible because the variables are too numerous and their effects can be inconsistent across cases and through time. Even if it were possible to produce a definitive treatment of IIT, the model would be so general and would not be operational in the sense of either being subject to empirical test or useful for policy prescription. . . . Such is the complexity of IIT that our understanding of this phenomenon will be better served by . . . a general 'loose and untidy' model than by a selectively precise or rigorous one (Gray, 1988: 223-4).

Both Linder's (1961) and Gray's (1976) consideration of trade in manufactures for instance are identifiably within the broad tradition of the discipline of economics and both set out aspects of their arguments formally. However their methods also hark back to the economics of the Marshallian period in their preparedness to situate elements of formal analysis in a relatively informal context or, in Gray's case, to offer a quite elaborate formal structure which is offered as an heuristic rather than a determinate framework, or - as he later put it - a "paradigm" rather than a model (1988: 224).

However such approaches were unappealing to the modernist canons of intellectual prestige within the discipline which, as Coats argues, elevates the formal methods of economic theory "preferably supplemented by rigorous measurements [to] the top of the

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\(^{18}\) Gray uses the expression IIT in a broad sense and his comments apply to virtually all trade in manufacturers which is not driven by relative factor costs.
pecking order" (1989: 345). Within the discipline the prestige and prominence did not go to works like Gray's, but to the explosion of ad hoc models which became 'strategic trade theory'. Strategic trade theory took its name from its exploration of the scope for competitors in scale sensitive industries to seek advantage through strategic behaviour. In this context, strategic actors could be firms within industries, or national governments seeking advantage for their own firms. Not surprisingly the literature demonstrated no limitation of instances in which such strategic behaviour would benefit the firm or country engaging in it. The motivation behind most strategic trade theory was to illustrate the logical possibility of successful, self-interested strategic behaviour in trade (cf Silvestre, 1993: 109), rather than to build up a more accurate picture of the complex industrial reality and the normative implications to which this might give rise. However, the scope for strategic interaction between firms and their host governments in scale sensitive industries was already intuitively clear (see head quotation above). Scale economies often generate scope for strategic behaviour and provide cost (and often additional strategic) advantages to larger firms over their competitors. Given that countries, and/or their governments are characteristically larger than virtually all domestic firms and subsidiaries of foreign firms domiciled within those countries, it is fairly obvious that if governments are committed and sufficiently well informed, they can advantage their own firms in their strategic interactions with foreign firms and that by so doing they can advantage national economic welfare.

Whether or not one takes exception to strategic trade theory itself, one must surely question the prominence it received. Krugman himself has subsequently described the work as "a virtually complete rethinking" of trade theory (1991: 7) and his work was celebrated at the time as "truly ground breaking stuff . . . asking, to what extent does the presence of imperfect competition invalidate the case (hitherto thought to be rock solid) for free trade" (The Economist, December 24, 1988: 97). As to the potential usefulness of strategic trade theory for forging robust practical approaches to policy formulation, two strategic trade theorists, Flam and Helpman, give the game away: "[A]lthough there potentially exists a case for industrial policy, its nature is as yet unknown; every policy has to be evaluated for each country separately, using detailed

19 The latter quoted comment is a thoroughly misleading description of the state of trade theory at the time. As McCulloch notes:

Throughout the 20th century, and even before, economists have probed not only the theoretical benefits of free trade but also the multitude of circumstances (eg. monopoly . . . increasing returns, externalities, labour market distortions) in which maximisation of national income requires policy intervention (1993: 368).
information about the structure of its industries, their interaction through factor markets, the nature of competition and the structure of preferences". One can add to this list of difficulties almost at will. It does not mention externalities, uncertainty, imperfect information, moral hazard and adverse selection problems involved in intervention and so on. Even without these additional complications Flam and Helpman conclude "To collect the necessary information and then to evaluate contemplated policies seems a formidable, if not impossible task" (1987: 95).

With hindsight Krugman laments that such "fundamental rethinking of theory can have such modest implications for policy" (1993, "Arguments": 366), but one might surely wonder how much of the disappointment might have been anticipated at the outset, or at least kept under review along the way. As he helped construct the new field, Krugman for instance, deprecated the "educated guesswork and suggestive analogy" (1983: 57), of prior treatments of the issues whilst at the same time proposing formal treatments which were, by his own admission "implausible" and which did not capture "any of the richness of detail involved in real decisions" (1993, "Counterrevolution": 20; 1983: 57, 72). Krugman's formalisations had the methodological benefit of rigour and precision. But they also had heavy methodological costs - in particular the partial and 'unrealistic' nature of their assumptions. His own descriptions of his project did not dwell on the possible costs and implied that, however contrived or ad hoc the assumptions of his models were, formal treatment of a problem had an inherent value which transcended these methodological compromises (see Krugman, 1983 particularly).

Another architect of strategic trade theory, Gene Grossman, hoped aloud that, with imperfectly competitive phenomena receiving increasingly mathematical treatment, modern economics would one day come to an understanding of imperfectly competitive environments which matched its understanding of perfectly competitive ones (1985: 31). This aspiration is hard to fathom. Perfect competition is a 'limiting' case of imperfect competition in which competition so constrains firms that they have no discretion over the price they charge and indeed are technically and behaviorally identical. Imperfect markets are rather like Tolstoy's unhappy families in Anna Karenina. Each is imperfect after its own fashion. With firms being spared the burden of being and behaving identically, all manner of market structures are possible. And strategic interdependencies are not unlikely. And while game theory can yield insights into 'optimal' strategies for firms, game theory - indeed any formal treatment - has great difficulty dealing with 'adaptive' expectations and uncertainty about competitors' current or future moves (Arthur, 1994). Here we are in the world of history or perhaps as Arthur has suggested, the 'ecology' of economic agents (1994: 409).
Take the following example as an illustration of the way in which strategic trade theory absorbed itself in the formal demonstration of special cases which shed little useful light on the economics of trade - except perhaps as an antidote to the previous pervasive neglect of imperfect competition. In the mid 1980s Brander and Spencer showed that an industry-specific export subsidy could be beneficial for a nation which was host to a firm which was a Cournot competitor against a foreign firm (1985). (A Cournot duopolist seeks to maximise its profits by taking its competitor’s level of sales as given.) Krugman reports that this "idea" generated a "flurry of excitement" (1993, "Arguments": 363). I find it hard to see what was exciting about such an idea. Indeed, as Flam and Helpman indicate above, the scope for beneficial intervention in such circumstances seems intuitively clear. The next year Eaton and Grossman published an analogous model in which duopolists acted according to Bertrand rather than Cournot assumptions (1986). (A Bertrand duopolist maximises its profit by taking its competitor’s price as opposed to its output as given.) This change of assumption reverses the Brander and Spencer conclusion making the optimal policy an export tax! It is hard to know what to make of all this given that both Cournot and Bertrand assumptions about duopolists are themselves fairly crude mathematical makeshifts rather than plausible descriptions of commercial behaviour (Vousden, 1990: 138).

Note that even where it does not involve strategic interaction, the "innate complexity" of monopolistic competition "makes it necessary to resort to special assumptions" (Vousden, 1990: 153 also see Krugman, "Counterrevolution", 1993: 20). Accordingly even where models do not contain strategic interactions as, for instance, in the monopolistically competitive models mentioned above, results are typically sensitive to assumptions and robust conclusions from the literature are thin on the ground. After a decade of strategic trade theory, Ronald Wonnacott commented that it "may not yet have even scratched the surface. To identify one of the large number of possible new cases, all that is required is the combining of one of the many causes of market failure with one of the many mercantilist instruments that could then be used to increase welfare" (1993: 18).

Yet Krugman's recipe for improving development economics today, is the same as his recipe for improving trade theory in the 1980s - the translation of plainly evident phenomena into simple formal models so that economists can once again 'see' them (1993, "Counterrevolution"). As with strategic trade theory, Krugman emphasises the benefits of formalisation, without careful consideration of its possible costs. He comments that "there are, unfortunately, no general or even plausible tractable models of imperfect competition". This necessitates having "the courage to be silly, writing down
models that are implausible in the details in order to arrive at convincing higher-level insights" (Counterrevolution", 1993: 20). And the point of this? The principal higher level insight to which Krugman has so far treated us in his recent reworking of development economics is that it was foolhardy to disregard the claims of development economics simply because a lot of it was expounded verbally rather than mathematically. "The irony is that we can now see that high development theory made perfectly good sense after all" (1993, "Fall": 3).

Paul Romer has recently bemoaned economists' profligacy with evidence: their failure to admit important evidence where it "does not come with a t-statistic attached" (1994: 19-20). The burden of this chapter is that this is a small sub-set of the modern discipline's profligacy. Krugman recognises that development economics "anticipated in a number of ways the cutting edge of modern trade and growth theory" (1993, "Counterrevolution": 16). Yet in his telling of the story, its insights remained largely inaccessible to Western economists. By contrast, as Jayawardena observes in response to Krugman's view of the world, "[a]ny lack of rigour in articulating high development theory did not prevent its determined and fruitful application in East Asia, particularly in Japan and the Republic of Korea, whose planning models embodied its insights" (1993: 53). Krugman's production of "controlled silly models that illustrate key concepts" in development economics (1993, "Fall": 3), may have some value. Yet ignoring what has yet to be formalised and unambiguously 'proven' is surely an enormously profligate procedure - especially since, as strategic trade theory so clearly shows, formalisation may not usher in much new useful knowledge.

The 'strategic trade theory' episode illustrates the cost of marginalising judgement from the discipline and replacing it with the technical chatter of Samuelson's 'whippersnappers' (see § 1.3.2.2.2). In the story just told, the architects of strategic trade theory were all young 'whippersnappers'. And what warnings came that they might be wasting their time, often came from 'elder statesmen' such as Bhagwati and Ronald Wonnacott. Indeed as a concluding aside one may note that the 'whippersnapper' Krugman initially had trouble having his early work on trade and monopolistic competition published. Referees (who embodied the role of 'elder statesmen' if not literally, then institutionally) were unconvinced that an "understanding of these issues would be helped by writing down formal models". These comments are now offered as a suitable topic for mirth by Krugman and others (Gans and Shepherd, 1994: 170). One can concede that Krugman's referees' concerns might not justify refusing publication of Krugman's clever models - particularly the model of trade and monopolistic competition to which these comments applied. However their concerns
have, according to Krugman's own account of it, been largely vindicated. With hindsight they can be seen as a salutary warning that, in economics, technical facility should be regarded as a subordinate methodological value to anticipated usefulness.

1.4 The Structure of the Dissertation

The rest of this dissertation is structured as follows. Chapter Two introduces the automotive industry with a brief description of the industry's history and structure up to the early 1970s. Chapters Three to Five then examine the economics of trade liberalisation and particularly 'non-traditional' approaches to trade liberalisation which deviate from top down and across the board tariff reform sanctioned by neoclassical orthodoxy. The principal purpose of these chapters is to explore the case for 'non-traditional' trade liberalisation, particularly policies which facilitate the rapid expansion of intra-industry trade where the rate of tariff reform - and so the rate of inter-industry trade expansion is more gradual. Nevertheless at the same time, an attempt is made to show how a preoccupation with polarities, an absence of dialogue as co-operation and a lack of attention to 'meliorative' possibilities meant that these alternatives were inadequately explored in the economic corpus.

Chapters Six to Nine present a case study of the issues introduced in earlier chapters with particular regard to the IAC's advice on automotive tariff policy. Chapters Six to Eight deal with the Commission's formation, its first major automotive inquiry and some minor inquiries before 1979, whilst Chapter Nine discusses the Commission's 1979-81 automotive inquiry. These chapters depict the inadequacies of practical reason introduced above. In common with some of the earlier chapters, Chapter Six sketches the extent to which there was scope for some 'mutual adjustment' between perspectives which led towards the kinds of intra-industry trade facilitation policies discussed in earlier chapters. Chapter Seven shows how the Commission's approach foreclosed such possibilities. Chapter Eight sees the Commission archetypically participating in dialogue as contest and outlines the costs of such an approach. For although their contributions were rejected, the Commission's adversaries had much to contribute to the discussion. Indeed the Commission and some of those it saw as antagonists had skills and perspectives which were highly complementary. Chapter Nine, outlining the Commission's 1979-81 inquiry, shows a continuation of the patterns established earlier. In this case those proposing alternative views included traditional allies of the Commission in supporting tariff reform, but the Commission nevertheless failed to engage them. Chapters Seven to Nine all show how the Commission's formal quantitative work was either largely irrelevant to the issue of intra-industry trade
facilitation or actively obscured the issue from view. And they show how thoroughly the Commission failed to engage with the 'dangerous supplement' of the 'second best'. Chapter Ten concludes with some further speculations on the themes introduced in this chapter and illustrated in subsequent ones.
Problems and Opportunities in Australia's Automotive Industry: An Historical Introduction

The car market . . . is too restricted at present to provide an outlet for more than one modern large-scale factory. To allow several manufacturers to split the market, would inevitably mean over-capitalisation, with excessive overhead costs, and they could carry on only by agreeing to maintain an excessive price, which would need to be made effective by inordinately high tariff protection.

The Sydney Morning Herald editorial, 5th July, 1939

This chapter surveys the development of the Australian automotive industry in the fifties and sixties to acquaint the reader with the emerging economics and political economy of the industry in the early 1970s.

2.1 Introduction

Protection inflates domestic prices and thus assists local manufacturers to supply the domestic market. This can encourage fragmentation if it attracts more entrants to an industry than can be supported at economic scale. In Australia's post WWII automotive industry, this effect was greatly intensified by several factors. The 1960s saw a dramatic increase in the diversity of demand for automotive products. Consumers demanded cars and their derivatives - utilities and vans - in an increasing number of model configurations and sizes. This effect was powerfully reinforced not only by the dynamics of competition in the industry, which drove firms to imitate each others product offerings, but also by the political economy of post-war protectionism. Time and again protective arrangements were altered to favour new entrants in the industry frequently in ways which directly discriminated against incumbent firms. The result of course was even greater fragmentation of production. This chapter sketches this unfortunate conjunction of forces.

2.2 Economies of Scale, Product Differentiation, and Diversity of Automotive Demand

Even without tariffs, Australian automotive manufacturing was always likely to be unusually fragmented. Substantial natural protection was available to Australian automotive production. Transport costs were about 20 per cent of imported value in the early 1960s falling to about 15 per cent by the 1970s (IAC, PMVs, "Papers", 1974, Vol.
1, § 2.4.1.7; IAC, PMVs, 1974: 149). And economies of scale and scope were sufficiently important in the industry that they were of great significance even in much larger markets than Australia. GM's handling of these issues was one of the decisive events in its dominance of the American industry. In the 1920s and 1930s Ford (US) continued to pursue its initially successful strategy of cost reduction via standardisation and the resulting economies of scale to which this gave rise. By contrast, GM relied on product differentiation and economies of scope. It strove to increase the apparent diversity of its product range, whilst minimising the production cost of so doing. Instead of liquidating the marketing networks of the various firms absorbed into General Motors - Oldsmobile, Pontiac, Chevrolet, Buick and Cadillac - the huge conglomerate maintained their marketing identities and networks. These were used to market cars which were similar in technical specification, but differentiated in design (Sloan cited in Swan, 1972: 365).

In post World War II Australia, GMH did what Ford had done in America earlier in the century. It designed and built a single new car for the mass market and it focused on cost reduction through standardisation (AFR, 7th November, 1963: 4). Like Ford (US), it was massively successful - to begin with. In constant prices, the list price of Holden's standard model fell by approximately 40 per cent in the period between 1948 and 1960 as GMH concentrated almost all its production effort on increasing the scale and efficiency with which the Holden car line 20 was produced. GMH's annual production grew from just over 20,000 cars in 1949 to over 140,000 in 1960 (Swan, 1972: 504). Yet as time passed GMH's marketing and production strategy was progressively undermined both by growing consumer demand for variety and also by the largesse which governments heaped upon GMH's competitors. The following two sections explore these additional factors.

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20 The expression 'car line' is a useful piece of industry jargon meaning a line of cars or models which share basic mechanical features. Accordingly, to take an example from the current new car market, the Commodore Acclaim, and Calais are part of the same car line, although they are marketed as different 'models'. Likewise vehicles manufactured to either seem or perform very differently from the Commodore are likewise referred to as part of the same car line because they share major mechanical components with it. These include the Commodore Wagon, the Statesman and the Commodore Utility.
2.3 'Product Proliferation'

In recent years the passenger vehicle market has fragmented into a greater number of definitive categories than has been recognisable in the past.

Ford Representative to the Tariff Board, IAC, PMVs, 1974, Transcript: 1634

As the Australian industry matured, consumer demand for variety increased on several fronts. There was a growing demand for cars which were equipped more extensively and luxuriously and with new options such as disc brakes and automatic transmission. And, where the 1950s had seen demand concentrated strongly in medium (Holden sized) vehicles, the 1960s saw a drift towards smaller vehicles. The market share of 'small' vehicles, such as the Morris Minor and the Ford Cortina, went from 30 to 44 per cent in the decade to 1972 (MIP, August 1972: 10).21

Typically, new demands were first met from imports. Automatic transmissions and disc brakes for instance, were initially imported from countries with larger, more mature industries - particularly America (Stubbs, 1972: 80; SMH, 2nd, July, 1965: 20; CT, 15th September, 1962). Likewise, as demand for smaller cars grew, much of the increase in demand was met from imports. Thus Datsuns and Toyotas were imported from the early 1960s. When they were not assembled from CKD (completely knocked down) packs, they were imported CBU (completely built up) (Stubbs, 1972: 91). While, British Motor Corporation (BMC: later Leyland Australia), then Ford, and then GMH did supply the domestic market with small cars, they nevertheless made more extensive use of imported components than became usual in the medium car sector (IAC, PMVs, 1974, Appendix Seven: 22). Likewise Australian the market share of light commercial vehicles rose steadily throughout the 1960s and early 70s with much of the growth coming from imports (IAC, "Commercial Vehicles", 1974: 37; also see AIM, 22nd May 1973: 6).

21 Because the size of particular 'categories' of vehicles have a habit of changing over time, it is worth trying to standardise the terms with which this thesis discusses them. Accordingly I use the terms used by the IAC in 1974, despite the changes in size since then. Accordingly, Corolla, Escort, Gemini sized cars are referred to as 'small light'; Corona, Cortina and Torana sized cars are called 'large light', whilst Falcons and Holden Kingswoods and Commodores are called 'medium' sized cars. Fairlanes and Statesmans are 'upper medium' whilst very expensive (mainly European) imports are called 'luxury' cars (IAC, PMVs, 1974, Appendix 7: 18, Table A7.15). In my terminology the Corollas of today are still referred to as 'small light' even though today they are now closer to the size of the 1974 Corona or 'large light' vehicles with a smaller 'micro' class entering to fill the vacuum created by this gradual inflation.
'Product proliferation' also occurred in the medium car sector with Chrysler and Ford making major manufacturing investments towards the end of the 1950s to compete for Holden's lucrative medium car market. In an ironic reversal of their previous history in America, Ford (Australia) forced a somewhat reluctant GMH into progressively greater product differentiation in the sixties and seventies. The Holden received one minor facelift in the first seven years since its launch in 1948, and it retained the original engine for thirteen years (Swan, 1972: 485). By 1963, the Financial Review was contrasting GMH's strategy of "heavy concentration over a relatively small front" with Ford's strategy of "blanket[ing] the market with a large number of models" and "frequent model changes" (AFR, 7th November, 1963: 4). As Ford gained market share, Holden followed its lead in marketing. Five of the seven new Holden models introduced between 1948 and 1972 were introduced after Falcon's introduction in 1960 (Swan, 1972: 495). In addition, the American companies competed to extend the market reach of their medium car lines. Thus each introduced high powered V8 models, long wheelbase luxury limousines and sports coupés, all of which required substantial capital investment in design and tooling. By 1973, as the IAC observed, most manufacturers and assemblers marketed at least three car lines covering the three volume areas of the market. Small light, large light and medium passenger vehicles (IAC, PMVs, 1974: 36).

2.4 Ad Hoc Mercantilism: Protection from the 1950s to the 1970s

Even by the early 1950s the automotive industry was both relatively large and complex. Although increasingly self sufficient, it nevertheless continued to import much of its componentry and its financial, physical and 'human' capital. This had its effect on the politics and administration of automotive protectionism. Agmon and Hirsch argue that when negotiating its first large fixed investment in a foreign country, a multinational corporation (MNC) is in a very strong bargaining position. It has capital and know-how which will benefit the potential host country. But having not yet committed itself, it remains free to seek satisfaction elsewhere. As investment increases however, positions are reversed. With increasing sunk capital the MNC has progressively more to lose in negotiations with the host government; the host government progressively more to gain in exploiting its new found negotiating power (1979: 341-3). Australian automotive protection exemplifies the phenomenon almost perfectly. One after another, automotive MNCs were drawn into the web and, once they had become an incumbent, were discriminated against in favour of newcomers. First Ford and Chrysler were favoured against GMH. Then the British firms and Volkswagen were lured into increased
investment - ultimately in each case, disastrously. And in the 1960s it was the turn of the Japanese to receive the largesse of the Department of Trade.

The terms on which manufacturers or assemblers received access to imports were particularly crucial. Before World War II, minimal tariffs on 'chassis' and prohibitive tariffs on 'bodies' had virtually forced importers to assemble locally (Swan, 1972: 338, Stubbs: 1972: 10). Most 'chassis' parts, like engines for instance, were not manufactured in Australia and so were admitted at concessional levels of duty. GMH's investment in the late 1940s changed this. But although its manufacture of chassis products would ordinarily have triggered tariff increases to protect local production, tariffs were not increased on engines, perhaps because they were not a final product and the 'unfairness' to the local manufacturer was accordingly concealed. Thus from the outset, the most competitive firm in the Australian industry received significantly lower levels of effective assistance from the protective arrangements than its competitors, who could import engines duty free. After GMH had entered the market, McEwen and the Department of Trade continued to negotiate individual import access arrangements with newcomers. These arrangements, and the local content plans to which they ultimately led, exacerbated the problems inherent in the original arrangements.

Whilst originally manifested in various ad hoc arrangements, discrimination against incumbents became increasingly systematic. By the late 1950s the Department of Trade's administration of import licensing and the tariff by-law system had developed into a program of favours to those newcomers in the industry, such as Ford and Chrysler, whose local production plans it had 'approved' (Tariff Board, 1957: 9).\(^22\)

The Department of Trade and the major firms in the industry supported the superficially plausible proposition that "rates of duty should be highest on a completely assembled vehicle, which contributes nothing to the Australian economy, and lowest on the components imported by local manufacturers" (Tariff Board, 1957: 86, 7, 9 and see Transcript: 80).\(^23\) The evidence taken by the Tariff Board inquiries reporting in 1957

\(^22\) Before this time, GMH was discriminated against on at least one occasion more directly. In 1950, GMH sought to more than double annual Holden capacity from 20,000 to 50,000 units. The Government refused to permit the necessary import expenditure on capital equipment and components from the US on the grounds that it would deplete the Australia's scarce resources of US dollars. Soon afterward the Government approved an application from GMH's competitors which involved a greater call on US dollars for less than a third of the capacity expansion envisaged by GMH (Bennett, 1994: 21-2 and see also Swan, 1972: 480-1).

\(^23\) The wording is from Ford's submission though similar sentiments were either expressed or implicit in the recommendations/comments of the Department and GMH, Chrysler and the parts manufacturers.
and 1965 vividly illustrates the emerging political economy of automotive protectionism. Throughout the fifties and sixties, most manufacturers maintained a degree of solidarity with other manufacturers' claims for protection (Bell, 1993: 29). But the automotive industry was an exception (Tariff Board, 1957: 37). The complexity and multi-stage nature of automotive manufacturing meant that one man's meat was another's poison. Protection for component suppliers was an impost on assemblers. And many firms were both assemblers and importers of fully built up vehicles. An attractive solution to the economic and administrative problems produced by multi-stage production in a protected environment would have been uniform \textit{ad valorem} tariffs. Yet such a possibility was never in contention. For reasons which will become clear below, it was unpopular with virtually all interested parties.

The supplications of the various 'industry' representatives gravitated towards expanding production at the expense of government revenue rather than by way of structural change and adjustment within the industry. Firms with high levels of imported content in their cars could agree to increase local content where the cost of so doing would be underwritten by administrators providing cheaper access to those components which they continued to import. And those who currently imported built up vehicles could agree to assemble them locally where this would qualify them for discounted rates of duty on unassembled packs of components. Even those from outside the automotive industry who sought lower assistance argued from their own perspective as vehicle users. For them the final cost of automotive outputs was a more important consideration than the efficiency of resource allocation either within the automotive industry or the economy. Thus while farming lobbies tended to support lower tariff levels they were also keen to preserve duty concessions for automotive manufacturers. For they lowered the assembly cost and so price of automotive products to users (Tariff Board, 1957, Transcript: 498, 501-7).

The local content schemes institutionalised administrative practices and political dynamics which had been evident for some time (see McEwen, CPD, 24th May, 1965: 1894). Yet if the policy of the 1950s was ill-advised, the local content plans were folly indeed. They were introduced when demand for variety was growing strongly (see § 2.3 above). And at a time of full employment, the theory of effective protection demonstrated the costs of such arrangements on the efficiency of resource use within the industry and the economy. The first (1964) local content scheme sought to encourage increases in local content by imposing progressively stricter volume limits on the production of lower local content vehicles. Thus at 45, 50 and 60 per cent local content, 2,500, 5,000 and 7,500 units (per annum) of any car line respectively could be
assembled. If firms wished to locally assemble more cars than this, they were given five years to reach 95 per cent local content whereupon all restrictions on the volume of their output be lifted.

Not surprisingly this arrangement was unstable. For several manufacturers had small light and or large light vehicles for which they sought to achieve volumes greater than those allowed under the local content schemes, but which were unlikely to be viable at 95 local content given the then tariff rate of 35 per cent. As Volkswagen and BMC got into financial difficulty in the late 1960s, arrangements were changed to permit 25,000 units per annum production at 85 per cent local content (although this was insufficient to save Volkswagen which withdrew from local manufacture shortly afterwards). Even so, the plans continued to underwrite fragmentation of production. The plan rules defined models by their engine capacities. Accordingly firms were able to expand assembly production by assembling a certain model with more than one engine. Ford doubled production of its Capri entered in the 60 per cent plan by assembling it with two different engines. Renault spoke of increasing its market share by "adding one model after the other" (AIM, 15th November, 1970: 2).

Following a lengthy departmental review (AFR, 13th December, 1971: 5) the phasing out of the low local content plans was announced in December 1971. In part the phasing out of the small volume assembly plans demonstrated the learning of lessons. But the revised plan was full of the same ad hoc mercantilism which had characterised previous plans. As Max Walsh observed at the time, it was also "explicitly aimed at forcing Japanese car companies mainly making light cars, to move into local production with Australian made components" (AFR, 17th December, 1971: 1). It did this, not simply by phasing out tariff concessions on components imported for assembly, but also by making it prohibitively costly for a firm to import vehicles of the same 'class' as those it manufactured under the plan (IAC, PMVs, 1974, Appendix Six: 16; § 6(d)). Again firms with the least investment in Australia were rewarded. Amongst the Japanese firms the amendments effectively constrained the import plans of Nissan and Toyota, given their desire to continue production in Australia. By contrast importers like Mazda, who had stuck to importing built up cars, were untouched by the new restrictions.

The changes also showed the usual squeamishness about structural adjustment within the industry as the authorities sought to placate as many discordant interests as possible. Although the changes sought to protect manufacturers operating under the 95 and 85 per cent local content plans from the hitherto more highly assisted assemblers, the changes entrenched new forms of discrimination against the most established manufacturers. The
plans became a ratchet with which firms were perpetually pressured to increase their local commitment or, where they had already achieved high levels of local content, prevented from improving their efficiency by reducing it. Thus according to the new plans, participants in the 95 and 85 per cent local content plans were prevented from moving to a lower local content plan unless this was "satisfactory to the administering authority" (IAC, PMVs, 1974, Appendix Six: 10).

In both 95 and 85 per cent plans this new rule was to operate alongside the 'non-reversion rule', which required Australian manufacturers who had once bought local components not to 'revert' to importing the same components without consulting the Department of Trade (IAC, PMVs, 1974: 141, and Appendix Six: 10, 13). As GMH put it, for those who had invested in the industry in the past and built their local content to a high level, the 'no-reversion' rule was a "straight jacket" (IAC, PMVs, 1974, Transcript: 74). By contrast, favours done to newcomers continued. Duty free importation of components would be permitted on a gradually diminishing proportion of imported components for the next five to seven years depending on gradually increasing local content targets being met. (AIM, 18th January, 1972: 2; also see IAC, PMVs, 1974, Appendix Six: 5, 9, 12).

As the automotive consultancy Martec put it, the successive revisions of the plans throughout the 1960s were probably best construed as attempts to reconcile conflicting objectives and the "hesitant groping towards a more internationally relevant policy for automotive manufacture" (New Directions, 1972: 1.3). From an economic perspective there were two important signs of hope in the revisions of December 1971. The first was the seeds of what became the export facilitation scheme in the 1980s, according to which exports could be counted as local content and so earn 'credits' for the duty free importation of automotive products. Its emergence and the economics of such schemes are discussed below (Chapters Four and Five). The second was the Government's response to pressure from rural and other lobby groups. As a result of a change in opinion led by the new Chairman of the Tariff Board, Alf Rattigan, there were now powerful lobby groups in Australia who associated their own interests with tariff reform. The Government promised to submit the automotive industry to a Tariff Board review by 1974 (AFR, 7th March, 1972: 5).
2.5 Specialisation and Trade within the Australian Automotive Industry

2.5.1 The Pattern of Imports

When a new vehicle or set of vehicles comes in, some people would purchase them just because they were different. ... Some ... because they fill a slot ... a technical slot not fully filled by local production but again this is a limited field. ... Japanese vehicles ... have also filled a geographic advantage ... in supplying the Northern Territory and Queensland because they have freight advantages there.

Tariff Board Member, Boyer, Tariff Board, 1965, Transcript: 176

Trade was facilitating increasing specialisation in the Australian industry. Despite efforts to extend local vehicles' market coverage, imports predominated in the areas least well served by local manufacturers - small, luxury, sporting and commercial vehicles and relatively technically advanced or product-specific components. The Europeans imported many of the sporting and smaller luxury vehicles, the Americans the larger luxury vehicles, whilst the history of the Japanese industry saw it well placed to supply robust commercial vehicles and small cars (Tariff Board, 1965, Transcript: 42, 73, 193, 259, 362).

2.5.2 Automotive Exports in the 1950s and 60s

[The Holden] has been able to stand on its own cost/price/value relationships in overseas markets because of its indigenous design and character: there is no place in the world to buy that kind of a car, except from Australia. We would go so far as to speculate that given even moderate freedom from 95% local content, and reasonable shipping costs, the export Holden would become an even more outstanding export product for this country and a highly profitable element of GM's Australian activities.

Peter North, Managing Director of BMC, IAC, PMVs, 1974, Transcript: 1756

2.5.2.1 Exports and Attitudes from the War to the 1960s

Already in 1949, the first full year of its Holden production, GMH had its eye on potential export markets particularly New Zealand, South Africa, India and Indonesia; and the industry journal Automotive Industry noted the scope for export market development in former British colonies in South and South East Asia - India, Pakistan, Ceylon, Burma and Malaya. Australia's access to British trade preferences and its manufacture of right hand drive vehicles, were thought to give it unique advantages in these markets. Those countries then had a combined market of 311,000 units per annum
By the time of the first major post-war Tariff Board report in 1957, GMH was exporting nearly five per cent of its domestic sales volume (Table A2.1, Statistical Appendix). Yet compared with the attention given to import replacement, exports and the policy implications of automotive exporting were much more rarely mentioned by Australian politicians, opinion leaders and policy makers. Even where exports were considered, this was generally within the milieu of an 'industrial cringe' about Australia's capabilities and natural place in the world akin to the Australian cringe in matters cultural. Thus for instance, six years after negotiating the 1957 Australia-Japan trade treaty, McEwen confessed his "surprise" that the Australian industry had sought access to the Japanese market. "I think this is quite a remarkable achievement for the Australian industry" (CPD, HR, 16th October, 1963: 1838).

But why was it so remarkable? In 1957 Australia's automotive industry was much larger and more sophisticated than the Japanese one (Stubbs, 1972: 41; Tariff Board, 1965, Transcript: 297, 21st September, 1964). And both countries drove on the same side of the road. But McEwen's comment foreshadowed a tradition of similar perceptions from Australian commentators and policy makers, who likewise tagged the industry's export performance as "remarkable" and by so doing implicitly assumed what one journalist made explicit . . . "clearly export proportions like [Germany's and England's 48 and 42 per cent respectively] are just not in the realms of possibility" (eg see AFR, 26th January, 1961: 15; 2nd February, 1961: 43; also see 15th July, 1968: 1).

There were exceptions to this. As Deputy Leader of the Opposition, Gough Whitlam argued that the Australian industry's performance had not been very 'remarkable' by international standards. Yet, he argued, it was "the industry upon which we should rely more than on any other for export income if we ever are to get an export income from our manufactures".

There is no motor manufacturing country in the world, - we are among the first ten; possibly among the first seven - which exports such a small percentage of its production (CPD, 14th September 1961: 1185-7).

2.5.2.2 The Post War Tariff Board and Automotive Exports

The Tariff Board reports of 1957 and 1965 were in the tradition of the Australian 'industrial cringe'. There was remarkably little interest in the policy implications of exporting. Despite its explicit reference to the dangers of fragmentation in a small market, and the consequent limitations of import replacement, the Tariff Board's 1957 policy recommendations were designed to further import replacement while mitigating
the economic cost of so doing (1957: 64). In thirty pages of discussion and recommendations on the economics of the industry (1957: 36-66), there was no serious analysis of the economic or policy implications of export activity and no comment on the prospect of import protection directly increasing the costs of inputs to automotive exporters.

In 1957 these omissions were very typical of their time. But by the time of the 1965 report, various commentators saw exporting as crucial for the industry's development and for policy making. Gough Whitlam's 1961 comments have already been quoted. And a simple 1965 survey article for adult education in NSW called for the Government to "move beyond import replacement and into bigger export markets" and drew attention to the failure of local content schemes to promote exports (Crowley and Rorke, 1965: 138, 143). Likewise, in 1964 in an article presented in evidence to the Tariff Board, The Economist drew attention to the "increased costs" associated with the new local content schemes "just when the Australian industry was congratulating itself on the fact that vehicle exports . . . were going well" (The Economist, 9th May, 1964; Tariff Board, 1965, Transcript: 816).

Having left GMH, where he had masterminded the 'all Australian car' in the 1940s, Lawrence Hartnett had become an importer of Datsun cars. Nevertheless he remained a visionary for the Australian industry pointing out in Tariff Board hearings that the domestic sales of the Holden alone were greater than the total production of the eight vehicle builders of Japan until the early 1960s.24 Hartnett argued that exports would play an increasingly important role in the industry's development. He argued in his 1964 autobiography that Holden could not reduce its prices without taking up a 'monopolistic' share of the Australian domestic market which might contravene the Sherman Anti-trust laws in America.

What's the answer to these problems? . . . Part of the answer, I believe would be to increase exports of Holdens. GM-H could export up to

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Japanese Car Output</th>
<th>Holden</th>
</tr>
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<tbody>
<tr>
<td>1950</td>
<td>1,594</td>
<td>20,113</td>
</tr>
<tr>
<td>1953</td>
<td>8,789</td>
<td>44,175</td>
</tr>
<tr>
<td>1956</td>
<td>32,056</td>
<td>68,893</td>
</tr>
<tr>
<td>1959</td>
<td>78,598</td>
<td>115,308</td>
</tr>
<tr>
<td>1962</td>
<td>268,784</td>
<td>133,325</td>
</tr>
</tbody>
</table>

Source: Lawrence Hartnett's evidence to the Tariff Board (Tariff Board, 1965, Transcript: 44)

200,000 Holdens a year, for the export price could be reduced without any country challenging that the cars were being sold under cost (1964: 226).

Despite all this, the Tariff Board's 1965 report showed virtually no interest in automotive exports and made no comment on the policy implications of exporting. By 1973 when the Board received its next major reference on the automotive industry it had been transformed. Where the former Tariff Board had permitted itself to become a handmaiden of protectionism, its successor was a very different organisation committed to exposing the costs of protectionism and to proposing something more rational. But as subsequent chapters make clear, there was little discontinuity between the old Tariff Board's approach to manufactured exports and that of the new IAC.

2.5.2.3 'Identity Bias' and Automotive Industry Policy

Australian policy making and discussion was dominated by what Anne Krueger has subsequently dubbed 'identity bias' (1990). There was considerable interest indeed passion where import replacement was concerned. Automotive imports displacing local business were given considerable public attention. For instance in 1965, time in Parliamentary question time was taken up not once but twice with questions concerning the Government's purchase of 14 imported Toyota vehicles (CPD, 30th March, 1965: 413, and CPD, 13th May 1965: 1436).

By contrast there was virtual disregard of Australian exporting. Despite their promise, Australian automotive exports were being stymied at every turn by foreign protectionism. New Zealand and South Africa were developing their own industries and imposing progressively more draconian import restrictions. Likewise Asian markets were being spoiled by "high tariffs, severe import restrictions and in many cases, excessive tax-rates - often at discriminatory rates against six cylinder vehicles". India was substantially closed to automotive imports whether of built up cars or components (AFR, 26th January, 1961: 15). In 1961 Chrysler intended exporting about 100 Chrysler V8s to Japan but it canceled the whole operation after the Japanese suddenly imposed selective import restrictions (AFR, 2nd February, 1961: 43). Apart from occasional low key references in newspaper articles, automotive protectionism in countries which were actual or potential importers of Australian automotive products left virtually no trace on Australia's public record. There were no questions asked in Parliament and, judging from the public record, no diplomatic protests or public discussion of the issues it raised for Australian trade diplomacy.

Notwithstanding this, the largesse of 'protection all round' was extended to manufactured exports. In addition to export market development allowances, the
industry qualified for payroll tax relief on exports. With strong export growth in the early 1970s, the IAC reported that the industry received approximately $6 million in export assistance in 1970-71 by way of payroll tax rebates and export market development allowances (IAC, PMVs, 1974: 147). On an export turnover of approximately $60 million in 1970-71 (IAC, PMVs, 1974, Appendix Seven: 21) this produces a nominal rate of assistance of approximately 10 per cent. Nevertheless because the major form of assistance - payroll tax relief - was calculated on increases in export revenue, the industry continued to receive approximately the same dollar amount in export assistance (Working Paper B13: 2) despite nearly doubling its export earnings by the year 1972-73 (IAC, PMVs, 1974, Appendix Seven: 21). In December 1973 the Government announced a revised export incentive scheme to replace both payroll tax rebates and export market development allowances. It targeted small and medium sized firms and accordingly limited incentives to export to $100,000 per firm per annum (Working Paper B13: 2-3). As the Commission reported, this would see export assistance "greatly reduce[d]" (IAC, PMVs, 1974: 148), as the major vehicle manufacturers had accounted for the lion's share of the previous export assistance receiving several million dollars each (Working Paper B13: 2). As will be seen from what follows, at the same time the level of assistance to import replacement was progressively increasing.

2.5.2.4 The Evolution of Automotive Exports to the Early 1970s

Export is the end, not the beginning, of a typical market expansion path.
Staffan Burenstam Linder, 1961: 88

Automotive exports grew strongly and steadily after the mid 1950s. GMH's exports expanded as it gained technical maturity in the mid 1950s and, after 1960, exporting relatively sophisticated products became possible for firms other than GMH. Declining growth of, and increasing competition in, the domestic market may also have helped motivate firms to look to export markets. In 1961, the economist Linder suggested that product specific scale economies and product differentiation combined with local tastes and transport costs to influence the pattern of trade in manufactures (1961: 87ff). In particular, he suggested that countries domestically manufacture differentiated products which can be manufactured at economic scale because they appeal to majority home market tastes. At the same time they import products to meet minority tastes. Minority tastes cannot be efficiently served from local manufacture because low levels of demand prevent local manufacturers achieving scale economies. Where these products meet
majority tastes in other countries, they can be manufactured there at lower cost and then exported back to countries where they meet minority tastes. The resulting pattern of mass marketing at home and niche marketing abroad is well represented in many markets for manufacturers, not least the market for automobiles - particularly luxury European vehicles (see § 7.5.2.1 below).

The Australian market also fits Linder's description. The successful export products tended to be unique to Australia and were usually produced at relatively high volumes for Australia. As Ford developed its export markets, it did so with its Falcon, and not with vehicles which were manufactured in similar specifications elsewhere at vastly greater volume - Zephyrs, Anglias and Fairlanes. And as Stubbs observed, the strongest export performers - the Holden, Falcon/Fairmont and Valiant were also the three best selling domestic models (1972: 295). By the late 1960s the Holden and Falcon were unique Australian designs whilst the Valiant contained substantial Australian design input (Correspondence with GMH and Ford). Even where products were unique to Australia - as was the case with GMH's Torana of the late 1960s and early 1970s - the products with solid volume bases at home were generally more successful in export markets. By 1970, on the domestic market, GMH was selling one third as many Toranas as its traditional car line now named the 'Kingswood'. Yet the Torana accounted for about one tenth of GMH's exports (Correspondence with UAAI). In July 1972 the new industry magazine *Motor Industry Prospects* commented that the "overwhelming majority of car exports are Holden [ie: Kingswood], Falcon and Valiant models and derivatives" (July, 1972: 7, also see IAC, PMVs, 1974: 95).

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25 Note that at this time the Ford Fairlane was not a derivative of the Australian Falcon but rather assembled from American CKD Fairlane packs (personal communication with Ford). For volumes see Tariff Board, 1965, Table No. 7: 10. By 1963 over 40,000 Falcon registrations took place in Australia per annum - over 10% of the domestic market. Falcons were being produced with Australian pressed panels and were being rapidly further 'Australianised'. The Zephyrs, Anglias and Fairlanes received fewer than 2,500 registrations each and all achieved shares of less than 1% of the Australian market. As the *Financial Review* noted unsurprisingly, "this would seem to suggest that the Australian company cannot compete successfully with its fellow subsidiaries in the UK and Canada for the latter three models" (*AFR*, 2nd February, 1961: 43).

26 1,960 Toranas and 19,309 'other' exports - presumably almost exclusively Holden Kingswoods and variants thereof (UAAI supplied figures with similar relativities for the years 1971 and 1972).
2.5.2.5 Export Bases and 'Niche Marketing' from Australia

Australia is the hub of this area [the Asia-Pacific region].
Lee Iacocca, October 1973 in Mori, 1974: 30

A number of scholars have appealed to ideas similar to those of Linder in drawing attention to the possible importance of 'export bases' in the development of manufacturing industry (eg see, Porter, 1990: 19). From the mid fifties, Australia gradually became an automotive 'export base'. By the mid 1960s, Asia was growing strongly with a huge population and a comparatively tiny number of cars (AFR, 26th January, 1961: 15). In 1972 what Ford referred to as the Asia-Pacific market included more than 30 per cent of the world's population and had three per cent of the world's automobiles (Automotive Topics, May, 1972: 3). Australia had significant automotive manufacturing capabilities, a long tradition of political stability, relative economic prosperity and openness to direct foreign investment. It was located in a region in which the combination of these characteristics was hard if not impossible to come by. Even Japan's automotive industry was relatively unsophisticated until the 1970s, and the automotive industries of other Asian countries were literally decades away from maturity. Australia was also a base from which a non-British firm, could gain access to British Commonwealth trade preferences around the globe (AFR, 20th November, 1967: 23). As well as the efforts of Australian vehicle manufacturers, various Australian and foreign owned component manufacturers were speaking of ventures and joint ventures in Asia (eg see IAC, PMVs, 1974, Transcript: 1076, 1424, 2276).

In right hand drive Asian export markets Australian industry enjoyed advantages over both America and Europe because of geographical proximity and because Australia's domestic vehicles were right hand drive. Both General Motors and Ford had major investments in England. However these generally produced smaller, less sturdy vehicles for colder climates than those of much of Asia (Correspondence with GMH and Ford). Holden became a major export base for General Motors in right drive markets by the early 1960s by which time its export intensity by volume was over six per cent (see Table 2.1, Statistical Appendix). By 1967 both Chrysler and Ford had designated their Australian operations as their "world centre" for right hand drive versions of their Valiant and Falcon vehicles respectively (AFR, 20th November, 1967: 23). In 1970 The Australian correspondent commented that "Led by GMH the Australian motor industry is developing into a manufacturing base for markets in South-East Asia, the Pacific, New Zealand and especially South Africa" (9th June 1970: 3, also see Mori, 1974: 30). Product differentiation could be decisive even where it was minor. The British parent of
CHAPTER TWO PROBLEMS AND OPPORTUNITIES IN THE AUTOMOTIVE INDUSTRY

BMC Australia produced both left and right hand drive versions of most BMC vehicles, usually at much greater scale than the Australian subsidiary. The British parent also enjoyed British trade preferences (Crowley and Rorke, 1965: 142). Nevertheless the Australian market demanded significantly different characteristics which then became the foundation for export opportunities. The Mini-delux for example was exported from Australia because the Australian variant had wind up windows and a more powerful motor than its UK equivalent (AFR, 20th November, 1967: 23).

Australian cars were not being exported in large numbers to countries with developed automotive industries (CPD, 26th December, 1965: 2227; 16th August 1966: 79). Some Australian medium vehicles were manufactured at a similar cost to some European medium vehicles. However, their parent firms also had subsidiaries in Europe, and given tariff and transport costs into Europe, Australian vehicles would have been at a cost disadvantage there (see § 7.4.3.2 below). Had the Australian industry been less dominated by foreign equity it might have been more likely to have persevered in developed country markets seeking to find some profitable 'niche' market there in the way that Volvo of Sweden did in Australia - even given the Volvo's unsophisticated mechanical specifications and lack of price competitiveness with comparable Australian vehicles (see § 7.5.2.1 below). Even so, both Ford Australia and Chrysler Australia exported to Britain although neither was a major success. There was some scope for complementary specialisation however. By 1970 Chrysler had abandoned its low volume manufacture of six cylinder vehicles in Britain in favour of Australian Valiant exports (Stubbs, 1972: 285). Yet the features which detracted from the desirability of Australian cars in developed Northern Hemisphere markets were those which made them attractive elsewhere. Australian medium vehicles were large, powerful, sturdy and technically unsophisticated. As Ford's Bruce Burton explained to the Tariff Board, because the Falcon was engineered to withstand the Australian outback and poor roads, "it was soon found to be an ideal vehicle in New Zealand, South Africa, Asia, West Indies and the Pacific where similar conditions ... prevail" (IAC, PMVs, 1974, Transcript: 1610).

Having commenced the development of a left-hand drive Holden exclusively for export in 1960 (AFR, 26th January, 1961), by 1964-65 808 of the 5,000 built up Holdens exported went to left hand drive markets (CPD, 16th August 1966: 79). Together the Arab countries imported over 50 per cent of them. It seems reasonable to presume that Australian vehicles appealed because the Arab countries were relatively undeveloped, their road systems were poor, and their temperatures and levels of ultra-violet radiation were high. In 1970 the chairman of Chrysler was very optimistic about export growth.
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Asked if Chrysler were exporting left hand drive cars he replied "Not yet - But we hope to" (*AIM*, 21st April, 1970: 4). These developments are of significance not just as a pointer to the evolution of the industry, but also as a yardstick of the competitiveness of the industry in export markets. The United States was the most competitive producer of medium sized vehicles (see § 7.4.3.2 below). GMH and Chrysler could each have supplied the Middle East with American manufactured vehicles which were roughly comparable with Australian medium vehicles (on which the Australian vehicles had originally been based) and which were already tooled for left hand drive. Thus, although formal studies of cost competitiveness were fraught with practical problems (see § 7.4.3.1 below), the development and intended development of left hand drive vehicles in Australia, even with strong negative assistance from the local content schemes (see § 5.7.2) provides strong anecdotal evidence that Australian medium vehicle production was relatively competitive in the mid to late 1960s and may well have been viable at free trade.

2.5.2.5.1 Specialty Vehicles

In the early 1970s, Ford Australia participated alongside its parent in Dearborn Michigan and Ford Asia-Pacific (a separate office also located in Australia) in the design of the 'Fiera' - a vehicle for the developing markets of Asia. It was designed for the "rough terrain and difficult climates" of Asia (*Automotive Topics*, May, 1972: 3). Production was to commence with a pilot plant in the Philippines but Ford was also moving towards production in Taiwan and Thailand. The car was "conceived, designed and engineered" at Ford Australia and many of its parts would be sourced from Australian suppliers (IAC, PMVs, 1974, Transcript: 1585).

Ford was following BMC's example of the Mini-Moke - a small basic utility vehicle which shared mechanicals with the Mini-Minor. As *Automotive Topics* commented, the Moke was "ideally suited for the Asian market with rugged, simple construction, good ground clearance and great adaptability, as well as being much cheaper than conventional vehicles" (*Automotive Topics*, June 1972: 4). Intuitively one can imagine such arrangements as a excellent model of the mutually advantageous international integration of the Australian automotive industry. There was significant domestic demand for the Moke and capacity to manufacture it from components common to other Australian
manufactured vehicles. BMC began exporting the Moke from Australia in 1967. By the early 1970s Australia was the sole source of supply for built up Mokes to the world (Automotive Topics, June 1972: 4). And as will be seen, its export intensity was by far the greatest of any Australian vehicle of the period. As if to defy those quoted above who had claimed that Australia's industry could never match the export intensity of European industries, BMC consistently exported over 40 per cent of the Mokes it produced and in 1972 over 50 per cent of them went to export markets (personal communication with JRA, 1984).
3 The Economics of Trade and Trade Liberalisation

Does anyone consider autarchy realistic? Outside the confines of academe, who is interested in tests of the 'ultimate' determinants of observed trade patterns at a point in time? Policy makers work in the confusing real world of constant change, innumerable market imperfections and governmental interventions, both foreign and domestic. They are interested in the evolution of so called 'dynamic comparative advantage' and the sources of economic progress. They seek to utilise international exchange 'optimally' so as to foster development rather than simply to allocate efficiently in static terms.

Helleiner, 1990: 211

3.1 Introduction

As outlined above, this thesis argues that the economics profession's handling of certain issues was deficient and that this stemmed from the culture of the profession itself. Chapter One claimed that the profession's vision was too strongly oriented around its self styled role as a foil to popular mercantilistic biases. It claimed further that the culture of economic expertise placed inadequate weight on integrating insights from multiple perspectives, that it frequently placed an unreasonably high 'burden of proof' on heterodox views, and that it had a penchant for spelling out the normative implications of its analysis by way of 'peremptory rules' which narrowed the scope for dialogue. This and the next two chapters develop these arguments by reference to the handling of certain issues within the profession generally while subsequent chapters detail them further in a case study of the IAC's advice on Australia's automotive industry.

Of course to mount such an argument convincingly one must provide some glimpse of an alternative. Thus in the process of their critique, the following three chapters sketch out an alternative appreciation of the issues. It should be stressed that this alternative to orthodoxy is built from orthodoxy itself. That is, it does not embrace some 'key' to the economy which is hidden from orthodoxy - for example the Marxist theory of surplus value or 'structuralist' theories of economic growth and dependency. Instead it explores a range of perspectives - each of which was well regarded within economic orthodoxy.

Those perspectives include:

1) neoclassical trade theory, particularly the 'Hecksher-Ohlin-Samuelson' (HOS) framework;
2) technological theories of trade;
3) intra-industry trade in similar products; and
4) the emerging development consensus of the 1970s.

The following three chapters attempt to put those perspectives - the resources of orthodoxy - to more productive use than the orthodoxy put them during the period under study. Thus the 'engine' of improved productivity here is not some improvement in theory, technique or data but in the 'fitness' of the conversation to its normative purposes, in its sensitivity to context and its ability to make fruitful analogies between 'rather like' and 'rather like'.

Within economic orthodoxy, insights from the perspectives outlined above tended to be confined to particular areas of influence. Thus economists tended to confine the insights won in the 'new development consensus' to developing economies. Likewise the insights generated in the 'non-traditional' perspectives on trade - 2) and 3) above - had a limited influence on the normative economics of trade liberalisation. This was because the normative implications of these perspectives tended to be read within the polarity of 'free trade versus protection' and this was associated with a failure to explore the 'meliorative themes' which these literatures suggest.

The 'dangerous supplement' of 'second best' policies makes its first appearance in the final section of this chapter which explores Australia's 'tariff compensation' debate of the mid 1970s. The section outlines the ways in which the debate polarised around the dichotomy of whether to 'compensate or eliminate'. It will be argued that a crucial subtext of the debate was about the tone of normative economics - and in particular about whether normative economics should provide 'peremptory rules' for policy making or offer instead more fluid, context dependent 'meliorative themes'. Those who polarised the debate arguing for elimination rather than compensation were successful in their campaign although this chapter argues that their 'victory' in the debate was founded to a significant extent on theoretical confusion. In the upshot some of the more important 'meliorative' aspects of the tariff compensation issue were left largely unaddressed.
3.2 Positive Frameworks

Hufbauer’s study finds that the crude factor proportions theory performs surprisingly well. . . . But so, embarrassingly, does every other theory proposed by a competent observing economist.

Harry Johnson in Vernon, 1970: 15

This section introduces the various frameworks so as to throw light in passing on various themes of the dissertation. The frameworks are elaborated initially with regard to Australia’s automotive industry. The section argues that the profession was at its most useful not where it was most rigorous - within the context of the HOS framework - but rather where it was most pragmatically eclectic and meliorative - where it forged new ways of thinking about links between trade, technology and development.

3.2.1 Perfectly Competitive Frameworks

The Classical economist Ricardo had taken the comparative costs of production in different industries within countries as in some sense ‘given’, and had shown how trade could lower the cost of securing a given national income (Caves, 1960: 8). If relative costs determined trade patterns, Ricardo showed how this related to relative costs within each domestic market compared with relative costs within other domestic markets. Thus, even if England could produce both wine and cloth at lower absolute cost than Portugal, each country could still enjoy gains from trade by exchanging the product which they produced at comparatively lower cost (in which they were said to have a comparative advantage) for the one they produced at comparatively higher cost. The neoclassical re-interpretation of this story involved countries with perfectly competitive internal markets trading according to the competitive costs generated by their respective factor endowments. Given certain assumptions the neoclassical - Hecksher-Ohlin-Samuelson (HOS) framework - suggested that countries will be exporters of those products which embody factors which are domestically relatively cheap, and they will import goods embodying factors which are relatively costly.

Both classical and neoclassical approaches provide a useful starting point for appreciating the circumstances of the Australian automotive industry. Because of its factor endowment, Australia was strongly comparatively advantaged in the production of a variety of agricultural and mineral commodities and ipso facto it enjoyed a comparative disadvantage in other areas. The neoclassical framework also allows a useful distinction to be drawn between allocative or economic efficiency and technical efficiency. For a firm or industry may be very technically efficient in producing inputs from outputs, and
yet still be economically inefficient because other domestic industries can operate more advantageously given prevailing domestic factor prices.

For this reason, even if Australia had been relatively technically efficient at vehicle manufacture, the favourable factor prices faced by agriculture and mining, meant that automotive production was always likely to face comparatively worse factor prices and so to that extent be comparatively disadvantaged in international trade. Australia's status as a net importer of vehicles is thus well 'explained' by classical approaches to international trade. However, there are other characteristics of the industry which fit this framework poorly. For instance, although imports grew strongly in the 1960s, so too did exports.

3.2.2 Technological Theories of Trade

Where one nation has gotten the start of another in trade, it is very difficult for the latter to regain the ground it has lost; because of the superior industry and skill of the former, and the greater stocks, of which its merchants are possessed, ... which enable them to trade on so much smaller profits. But these advantages are compensated, in some measure, by the low price of labour in every nation which has not an extensive commerce.

David Hume, "Of Money", (1752), 1955: 34

As the above extract from David Hume indicates, the idea of innovation and technology influencing trade patterns is hardly new. Nevertheless 'technological' theories of trade have remained peripheral to mainstream economics until recently. Following Posner (1961), Vernon argued in 1966 that trade in manufactures was strongly influenced by the changing comparative costs emerging from the manufacturing 'product cycle' (1966). His schema refocuses on Adam Smith's concept of the division of labour casting it in a dynamic form in the context of international trade and development. Because innovation and improvisation are paramount when products are first developed, production is relatively unstandardised and so immobile between locations. However over time, production becomes more standardised and relatively stable industrial configurations emerge. This enables firms to relocate some or all of their production to locations with more favourable factor prices.

Frequently the home market will retain some production, finance and continuing research and development of products and processes. At a later stage in the product cycle, it may become economic for the 'follower' to export back to the innovating country. It will be producing relatively standardised products, sub-assemblies or components and may have the advantage of lower costs - particularly for labour. At this 'mature' stage, trade is
likely to flow in two directions. 'Innovators' will export 'know-how' or intellectual property, specialist or technology intensive capital equipment and/or components whilst the 'followers' will produce and/or assemble standardised products for local consumption and for export back to the innovator. At each stage of this process, trade is driven by the comparative costs and/or exigencies of production emerging from the product cycle.27

At this point the product cycle approach can offer an insight into evolving patterns of trade and development in the developed and developing world. As countries develop, their technological capabilities typically rise as do their wage rates. Accordingly the comparative advantage of original 'followers' will move away from labour intensive production to more capital and skill intensive production. By this stage, original innovators may have moved on. Original innovators will retain their lead in some aspects of the industry, particularly in 'leading edge' technology. But more sophisticated manufacture - and perhaps some research - can now be done most efficiently by the original 'follower'. And the original 'follower' is now engaged in product cycle trade with a later follower country which enjoys lower labour costs than the earlier follower and so on. This pattern has been lyrically captured in the image of countries as 'flying geese' continually 'catching up' to the geese in front, which, like them, move further still (Fukasaku, 1992: 22). It was this kind of 'catching up' which the Japanese and other East Asian countries appear to have made a cornerstone of their trade and industry development policies.

For all their differences, the product cycle and the HOS frameworks can be brought into a relatively easy intuitive compatibility and complementarity. The product cycle approach focuses on the imperfectly competitive dynamics of innovation and economic development and the management of indivisibilities in production. Where some 'shift' comes about in production and trade under this model, it does so as a result of the joint action of comparative costs and competition. Thus in a sense, the monopolistically competitive product cycle framework contains the perfectly competitive HOS framework within it. And each framework can merge into the other by virtue of appropriate re-definition. 'Factor' supplies can be specified at whatever level of disaggregation

27 For the sake of generality, where the product is unavailable from any other country or firm, this can be regarded as an infinite cost advantage. Note that this kind of trade can take place between firms at 'arms length', but it will often occur between 'parent' firms and their subsidiaries. In its original form the 'product cycle trade hypothesis' was intended to offer some explanation not just of trade but of foreign direct investment. However the main focus here is on trade patterns.
necessary to interpret phenomena consistently with the HOS framework. One could thus argue that America of the 1920s had a comparative factor cost advantage in the factor of 'automotive know-how' (cf Posner, 1961: 328). Likewise distinct activities in the production chain can be regarded as distinct industries or as integral to a single industry. If textile and apparel manufacture are regarded as two distinct industries the migration of apparel manufacture to low income countries is an instance of HOS trade. If the two activities are regarded as part of the same industry, the same phenomenon can be seen as product cycle trade (cf Johnson, in Vernon, 1970: 17-8). The 'flying geese' pattern of trade and development can likewise be 'derived' from the HOS model. (cf Krueger, 1977: 11, 25, and see Figure 1).

And of course both 'theories' are the acme of commonsense. One could read either or both into Hume's words at the head of this section. Illustrating the themes of Chapter One, within the economic literature the two approaches have frequently been juxtaposed as alternative hypotheses rather than as crystallisations of empirical tendencies the existence of which no-one should need convincing. Each 'hypothesis' enjoys significant support from the evidence - providing that some way is found to represent human capital as a factor within the HOS framework. As Johnson put it in 1970:

[T]he 'adversary procedure' of testing one hypothesis against another is a useful scientific procedure up to a point; but, when both hypotheses perform well and seem to be fairly evenly matched, it is not necessarily the best scientific procedure to send the challenger back to training camp with good advice on how to prepare for the next month. In the realm of ideas, a conflict of equally well (or equally imperfectly) supported hypotheses may be more fruitfully resolved by merger into a composite hypothesis (in Vernon, 1970: 17).

3.2.3 Intra-Industry Trade in Similar Products

The factor proportions account is only one of many. . . . It is important to realise this, or we shall not be able to get off the side track onto which we have, in effect, been shunted.

Staffan Burenstam Linder, 1961: 16-7

Cross trade in manufacturers has increasingly dominated world trade in modern times. In 1899 trade between industrial countries already accounted for over half of world trade in manufactures. Yet the elegant lure of Ricardian comparative advantage and its successor within economic orthodoxy - the HOS framework - have both dominated the profession, apparently inducing a degree of myopia. Until at least the 1940s, economic orthodoxy assumed that manufactures trade would fall as poorer countries gained
industrial know-how (Rayment, 1983: 1-3). Ironically, it was Bertil Ohlin - the "O" from the HOS framework - who, in the 1930s, drew attention to the "surprisingly large volume" of specialised manufactures trade between industrialised countries, suggesting that Marshall had underestimated the importance of economies of scale and specialisation. Yet his comments appear to have had little or no effect on empirical work and none on theoretical work until at least the late 1960s (Rayment, 1983: 4, and see Krugman, 1993, "Arguments": 363).

Economists Herbert Grubel and Peter Lloyd became interested in the phenomenon of cross trade in similar products in the late sixties, but were still able to report six years later that the phenomenon had yet to be seriously studied (1971; 1975: xiii). They listed a wide variety of causes of intra-industry trade all of which were generated by relaxations of the standard Heckscher-Ohlin assumptions. It is a testament to the untidiness of economic life that most of these kinds of intra-industry trade could be found in the Australian automotive industry by the early 1970s. Intra-industry trade can be driven by factor prices if, contrary to the standard HOS framework, industries contain other industries with differing factor usage. Thus the automotive industry 'contained' various industries which added value to Australian iron and steel and which may have gained traditional 'comparative advantage' from that fact. Both Holden and Ford exported body panels for assembly into cars to a wide variety of destinations throughout the sixties and seventies. Later in the seventies and 80s there would be considerable export specialisation within the industry in iron and aluminium castings. Trade in Australian automotive products also reflected transport costs with import penetration being greater in the northern states and territories which were closer to Japan and further from Australian production bases in the South-Eastern States. Likewise Australia's exports did best in markets within its region (see § 2.5.1 above).

Yet as Chapter Two demonstrated, much intra-automotive industry trade reflected indivisibilities in production and the resulting scale economies. Thus from the late 1950s on, Australia was a net exporter of the medium sized cars which were so successful domestically and a net importer of smaller vehicles in less domestic demand, with a similar pattern being reflected for components. Grubel and Lloyd suggested that this

28 Whilst Australia enjoyed a comparative advantage from the factor prices facing iron and steel making, trade in panels and engines reflected indivisibilities in production with Australia's sectoral trade balance in both reflecting Australia's specialisation in medium six cylinder vehicle production (IAC, PMVs, Papers, Volume 1, 1974, § 2.2.3.4ff). Australia was a net exporter of engines and panels for six cylinder cars and a net importer of the same commodities for four cylinder vehicles. In 1972 very few panels or engines for six cylinder cars were imported. About 5,000 six cylinder vehicles were assembled
kind of specialisation was the most quantitatively important source of intra-industry trade offering some plausible - though fairly sketchy - evidence for their assertion. Product differentiation was important in many large manufacturing industries. Trade in these products tended to be between countries with similar factor endowments. And while scale economies at the industry level were important, there appeared to be significant room for product differentiation, suggesting scale economies of equal or greater importance at the product level. The large industrial firms in Europe had not, by and large, decimated the small. Trade liberalisation within Europe had increased intra-industry specialisation much more than inter-industry specialisation (Grubel and Lloyd, 1975: 91; also see Balassa, 1966: 472).

In the 1980s, intra-industry trade received extensive professional attention. Today after several decades in obscurity, Ohlin's commonsensical explanation of intra-industry trade has been absorbed into textbook orthodoxy (Fischer and Dornbusch, 1983: 847; also see Harris, 1993: 768). And an extensive contemporary sub-literature is devoted largely to formal expositions of various themes of Ohlin. In 1975 Grubel and Lloyd also noted that "oligopolistic market structures" could also determine patterns of intra-industry trade and so could make their own story richer and more realistic. They neglected to model such factors explicitly largely because "these kinds of models are often indeterminate or based on particular assumptions, the validity of which is questionable" (Grubel and Lloyd, 1975: 92-3). Ten years later the gap they had left to intuition was partially filled, with various models in which oligopoly drove intra-industry trade in identical products (Brander, 1981; Brander and Krugman, 1983; Venables, 1985). At the same time their own insight about the usefulness of such work looked like being borne out as debate raged over the practical usefulness of similar models within 'strategic trade theory'.

from packs with imported panels and engines comprising Toyota Crowns, Triumph 2500s and Rambler Rebels and Hornets (IAC, PMV Papers, Volume 1, Table 2.4.5). By contrast panels and engines for smaller vehicles were imported in large numbers with all vehicles participating in low local content plans being manufactured largely from imported components including panels and engines. Four cylinder engines were not manufactured in Australia until after the mid 1970s (Interview, Bill Hartigan, 1991).
3.2.4 The 'New Development Consensus'

Instead of the chaotic selectivity of the incentive policies for 'import substitution' which seems to be the main focus of our trade-theoretic analysis, a more important inhibition on growth may in practice be the speed with which import substituting industrialisation is geared toward 'export promotion'. . . .

The key to success is not the absence of detailed, selective and target-oriented export promotion . . . . The distinguishing feature of superior export performance seems to be the pursuit of 'indiscriminate' and 'chaotic' but energetic policies to promote exports from industries which have been nurtured under protection in the first place.


The 'development economics' of the 1950s and 1960s emphasised the pervasiveness of market failure in developing economies, the difficulties they faced in achieving export growth, and the consequent need for extensive intervention including typically, trade protection to stimulate industrialisation and growth through import substitution (Edwards, 1993; Krugman, "Counterrevolution", 1993). In the 1970s this approach was challenged by a small number of major cross country studies into trade and development regimes in developing countries (Little, Skitovski and Scott, 1970; Balassa, 1971; Krueger, 1978; Bhagwati, 1978). The studies showed how high and how disparate protection had become in many developing countries. Protection might once have been justified for 'infant industries', but the 'infants' were all too often not the ones receiving protection (Balassa, 1971: 134). Industrialisation behind protectionist walls had generated high cost enterprises, excess capacity and production which was "rapidly coming up against the limits of the home market" (Little et al, 1970: xviii).

The studies dealt a considerable blow to export pessimism or at least provided striking counterexamples with which to refute any general export pessimism for developing countries. Taiwan for instance, had achieved phenomenal export growth in both manufactures and agricultural products (Little et al, 1970: 254-8). None of the studies denied the presence of extensive 'market failure' in developing countries. Nor did they reject the case for assistance to manufacturing and potential infant industries (Little et al: 158ff, Balassa, 1971: 99, Krueger, 1978: 284). Yet, following the logic of the 'optimal intervention' literature, (eg see Bhagwati and Srinivasan, 1969 and this chapter below) they argued that policies to correct market failure should act on it directly. This suggested industry promotion rather than protection (Little et al, 1970: 121ff).

Promotion might be in the form of wage subsidies where excessive industrial wages were the impediment to better development (Little et al, 1970: 145), or industrial output subsidies where there were positive 'externalities' to industrial production; though in
either case there was little to be said for excessive rates of subsidy (Little et al, 1970: 159; Balassa, 1971: 98-9).

Using the recently refined concept of effective protection, considerable effort was expended in searching for some link between developing country success and the absence of selective interventions in resource allocation (Bhagwati in Kenen, 1975: 513-4). Certainly there were successful (and somewhat unusual) countries such as Hong Kong and Singapore whose background as entrepôt ports had led them to very liberal trade regimes. But countries like Taiwan and Korea for instance, were clearly much more interventionist. As Bhagwati noted in 1973, "Korea shows as much variation in domestic resource costs as you could now expect to find among the import substituting industries in 'inward looking' countries" (Bhagwati in Kenen, 1975: 513-4). The new development consensus nevertheless steered a fruitful, if at times somewhat tendentious path through these difficulties in generalising from the variety of experiments in economic development against the backdrop of economic theory. Amongst other things, the new development consensus built on the importance which the old development economics gave to the value of foreign exchange in development. However where emphasis had previously been placed on discouraging the unnecessary use of foreign exchange the new approach focused on the importance of earning foreign exchange with exports - both traditional and 'non-traditional' (Little et al, 1970: xx).

Although some of the work was methodologically questionable (Edwards, 1993: 1373), the explanatory apparatus of the new literature was built around what Bhagwati calls a "mix of analytical insights, casual empiricism and econometric evidence" (cited in Milner, 1990: 17) which was both suggestive and persuasive. Krueger suggested that the observed superiority of export promotion could be attributed to two classes of influences. Firstly export promotion was more conducive to the achievement of economies associated with learning and scale (also see Balassa, 1971: 76-9). Secondly, some of the most distorting interventions associated with import replacement involve attempts to manipulate domestic demand rather than supply - for instance by banning imports over a certain level. Analogous kinds of interventions cannot be practiced in export markets. Governments seeking to expand export market share must do so by subsidising exporters (either implicitly or explicitly). In either case, export promotion must work "through pricing, rather than quantitative, interventions". In such circumstances the costs of policies are likely to be more transparent limiting both the magnitude and the duration of major policy mistakes (Krueger, 1978: 284).
To use some terminology introduced in Chapter One, the new approach melded aspects of the old development economics, the effective protection and optimal intervention literatures with 'integrative' and 'meliorative' skill. Riedel puts it well. "A free trade strategy works best of all in theory, but alas has rarely been tried in practice. The single case of it in recent times Hong Kong, is a phenomenal success, but is routinely dismissed as irrelevant because of the peculiarities of Hong Kong. . . . The case for export promotion is therefore a practical compromise between free trade strategy which looks good in theory but has not been practiced, and . . . import substitution . . . which looks bad in theory and worse in practice" (1990: 137). One need not decide the case for or against free trade to recognise that both theory and evidence were combining in a powerful case against inward orientation. In constructing their arguments in such a way, the new development economists made contributions both to the 'protectionist' and the 'free trade' camps: their fruitfulness was a direct result of their integrative 'mutual adjustment' between different perspectives.

3.3 The Normative Economics of Trade and Trade Liberalisation: Some Perspectives and Principles

This section suggests some conclusions which can be drawn from the corpus of normative economics and the frameworks discussed above, taken as far as possible, together.

3.3.1 Protection versus Promotion

During the 1950s the case for free or freer trade was at a discount in most of the less-developed countries. Laissez faire had failed to develop them, so it was argued; hence free trade had failed. In the [next] stage of thought the link between . . . free trade and . . . laissez-faire has been broken. One can believe that there are many reasons for the government to intervene in the economy . . . and yet one can also believe that, broadly speaking, 'free trade is best'. The point is simply that intervention in trade may not be the best way of [intervening].

Max Corden, 1974: 4

Where the search for good policy takes place as an exercise in 'mutual adjustment' between perspectives and objectives, and where the emphasis is on the plausible rather than the indubitable, some robust policy principles emerge from the literatures explored above. The conclusion which emerges most robustly from the four sub-disciplines above emerges from each of them. That conclusion is not about the merits of free trade
versus protection, but rather about what form industry assistance should take if provided. For if one assumes that protection seeks to increase the output of protected industries, the sub-disciplines all suggest that traditional protection imposes costs which are unnecessary to its policy objectives: that accordingly, if assistance is provided, it should promote rather than protect leaving firms to decide their own preferred level of intra-industry trade. A simple HOS model illustrates the costs which tariffs impose on consumption. These costs are avoided by subsidies. HOS models with multi-stage production, and models of intra-industry and product cycle trade suggest that tariffs also impose costs on producers where subsidies do not. And the latter approaches suggest that, as well as the allocative inefficiencies illustrated by the HOS framework (associated with sub-optimal factor usage), losses from protection will also include productive efficiencies (associated with the loss of scale economies).

These points were developed in the literature of the 1970s which relied to a considerable extent on informal reasoning (see § 3.2.4 above and eg Balassa, 1971: 76-9; Krueger, 1978: 284). By reference to both the 'optimal intervention' and 'new development' literatures, Max Corden's mid-1970s textbook on the normative economics of trade commented adversely on the unwanted distortions associated with protection, particularly the 'home market bias' which had become typical of protected industrial structures. He included Australia as one of the bad examples (1974: 24). Rattigan's Tariff Board commonsensically set out its appreciation of these issues in 1971. Responding to a reference emphasising the Government's desire to maintain the shipbuilding industry, it recommended reducing the rate of assistance and extending the existing bounty scheme to exports because it would improve both allocative and productive efficiency within the industry (1971: 21).

Some local yards producing small or special types of ships already have a useful export trade - mainly to areas adjacent to Australia. Subsidising exports would extend these markets and thus increase the efficiencies of these yards. Of greater importance is the fact that it would provide other local producers ... with more opportunities to exploit efficiencies of specialisation and economies of scale (1971: 21).

Here there were the makings of some consensus which would have been no less real for being partial. For essentially the same points were being made by those more sympathetic to protection. In 1971 the Australian Industries Development Association (AIDA) published a survey of industrial firms together with an analysis by economist Neville Norman. AIDA styled its role as integrative and ecumenical; as "bringing together information and opinion emanating from industry, government and academic economists" (Norman, 1971: v). When questioned about the effectiveness of existing
industry assistance schemes and whether or not industry assistance should be extended, two fifths of firms surveyed argued that assistance should be extended. Yet nearly all the firms were unhappy about the way in which assistance was being administered and nearly all made specific proposals for changing the form of assistance they enjoyed. In response to these comments, Norman then offered the benefits of his own expertise, by suggesting which kinds of proposals received from business were "soundly based" and which were fallacious or misguided (1971: 62). Although more sympathetic with protection than the Commission, Norman's position was far from crudely protectionist.

Norman invoked the principle of comparative advantage arguing that proposals for the extension of assistance on the simple ground of cost disability could not be justified in the national interest. Likewise he argued that it was difficult to justify an increase in general tariff levels given the burden this would place on consumers. Norman ignored several industry proposals to re-impose quantitative restrictions altogether. Accepting the traditional arguments that protection was consistent with the "primal economic objective" of supporting "a high rate of growth of population and expansion in the industrial base", Norman argued that assistance should not be reduced if this would lead to a reduction in the value added in tariff assisted industries. He concluded that "There is a strong case, though, for reducing the emphasis on the tariff in Australian policy towards industry" (1971: 62). Prompted by one executive's observations that "the same level of assistance in a different form" would reduce costs and create "the opportunity for expansion . . . large scale plants, frequently with export potential" (1971: 85), Norman advocated the gradual, and widespread, though not wholesale, replacement of tariffs by subsidies (1971: 63; 73).

3.3.2 Trade Liberalisation and the Two 'Rules' of Piecemeal Reform

The conditions outlined above augured well for the emergence of an approach to gradual trade liberalisation built around the specific circumstances of the Australian economy and insights from the contemporary professional literatures on trade and development. However as will be seen, as economists' vision of reform took hold through the 1970s and 80s, this never occurred. This was for two reasons which resonate with the themes introduced in Chapter One. Firstly, technical skill displaced integrative skill. Chapter One explained how economists paid little attention to context when applying a concept from the textbooks like 'minimum efficient scale' (see § 1.3.2.1). When it came to trade liberalisation, economists did something similar. They applied the top down and across the board tariff reform rules which had the sanction of economic theory and the
textbooks. And this displaced the attempt to adapt the perspectives explored above to Australia's circumstances. Secondly the traditional reform rules met the 'contractionist' aesthetic of orthodox reform (see § 1.2.2 above) while alternatives had a more expansionist and so 'second best' and 'mercantilist' flavour. These issues are addressed in turn below.

3.3.2.1 Were the Neoclassical Reform Rules Optimal?

A disposition against deviations from top down and across the board reform rules would have been less unfortunate had the rules themselves been what Corden took them to be - "optimal tariff dismantling" rules (1974: 366ff). But they were not. To use Simon's jargon introduced earlier, the rules do not optimise a single objective. The test they meet is a 'satisficing' one. They satisfy the following two objectives: firstly, if partial reform episodes are repeated sufficiently they ultimately sum to complete reform - free trade. Secondly, each and every partial reform episode is a step in the right direction - towards freer trade. These are worthwhile objectives. However their origin lies not in any considered ordering of the priorities facing policy makers but instead in the exigencies of formal proof within economic theory. In other words, there is no practical reason why a reform sequence should consist of identical moves all of which sum to the ultimate objective or only of moves each of which could in-principle do so. But this is a convenient way of formally specifying the search for a simple rule which can guide gradual trade liberalisation. Indeed, where policy makers are seeking to engineer trade liberalisation so as to optimise development and dynamic comparative advantage in the sense referred to at the head of this chapter by Helleiner, those conditions are curious constraints to place upon policy. If a particular policy will generate gains and liberalise trade in a particular circumstance - say cutting tariffs to the second most highly assisted industry or offering some assistance or tariff concessions to exporters - it seems perverse to rule it out on the grounds that in different circumstances a similar move might not be trade liberalising.

Although the above argument can be elaborated in an HOS framework, it becomes stronger when one considers 'post HOS' models of trade. Because of its construction

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29 In a sufficiently simple version of the HOS world - particularly one which does not allow for multi-stage production - a tariff to an import replacing industry has the same effect on production in that industry as a subsidy at the same effective rate. As a consequence, ignoring consumption effects, the strategy of trade liberalisation seems reasonably unproblematic and involves the removal of tariffs and/or quantitative restrictions at a greater or lesser rate. In principle however, even here a sufficient knowledge of the appropriate elasticities would enable policy to 'optimise' net trade creation in any trade
around perfectly competitive markets and their concomitant 'law of one price', the HOS framework cannot capture simultaneous imports and exports in differentiated products with similar factor proportions. The focus which both product cycle and intra-industry trade 'theories' place on indivisibilities in production also suggests that a 'critical mass' of production may be important - that supply may be very elastic at the margin of viability. They also suggest that intra-industry trade involves dynamic gains. A net importing industry which nevertheless exports enjoys the various informational privileges and 'demonstration effects' associated with exporting. And because product cycle trade occurs around the evolution of comparative advantage and technological 'catching up', it ought to facilitate various dynamic gains associated with technology transfer and 'learning by doing'. If these 'post HOS' perspectives are considered, trade liberalisation can be considered as having two objectives - facilitating HOS inter-industry trade (improving allocative efficiency) and 'post HOS' intra-industry trade (which will improve scale economies and so technical efficiency). Moreover, post HOS frameworks provide glimpses of something which, as Frank Hahn puts it, stares us in the face, even if neoclassical theory helps us not to see it: economic processes are often path dependent. If the economic structure which emerges in response to liberalisation can be path dependent (Hahn, in Hey, 1992: 48; Grubel and Lloyd, 1975: 96, 92; Falvey, 1992: 67; Krugman, 1991, "Geography": 9), then the case for at least considering variations on the neoclassical decision rules in the light of the development and trade expansion priorities and opportunities in particular circumstances seems compelling.

3.3.2 Heterodox Reform Options and the Aesthetics of Reform

It is possible to sketch an introductory taxonomy of trade liberalising possibilities which deviate from the two neoclassical rules of reform:

1) 'Anomalous reform' - reducing particular tariffs which are not the highest;
2) 'Concessional reform' - providing duty concessions (such as tariff concession orders or duty drawback for exports) on otherwise dutiable products;

As a liberalisation episode by 'targeting' reform - whether it be in the form of tariff reductions, concessions or 'compensatory' assistance - so as to produce the greatest trade creating demand and supply responses (cf Shone 1972: 84-5).

30 Under perfect competition and abstracting from transport costs, a good will have the same price - its production cost (including normal profit) - in all places. If it did not, some producer somewhere would be earning above normal returns which would attract entry by other competitors until prices were equalised.
3) 'Compensatory reform' - extending direct assistance or 'tariff compensation' to activities which would otherwise be penalised by trade barriers.

The profession's response to each different type of non-traditional reform varied considerably in ways which square with the interpretive framework proposed in Chapter One. Anomalous reform was accepted, with some discomfort, as indispensable to the exigencies of reform given Australia's institutional framework. Given that the IAC's advice almost invariably came in a 'piecemeal' form - in response to government references on specific industries - strict insistence on traditional reform would have prevented trade liberalising recommendations in any inquiries other than those into the most highly assisted activity (cf IAC, Annual Report, 1975-6: 111).31 One might suggest that 'anomalous reform' commanded disciplinary approval because it deviated least from traditional reform in form and appearance. It was confined to reducing tariffs - the only compromise being the order in which they were reduced. And where it resulted in reductions in assistance to highly assisted activities (even if they were not the most highly assisted) anomalous reform accorded with the contractionist aesthetics of traditional reform. Relatively high cost industries would contract liberating resources for relatively lower cost industries.32

By contrast, if they are to be trade liberalising, both concessional and compensatory reform achieve their effects by ameliorating the worst effects of tariffs - on the emergence of low cost exports - and in this sense can be seen not to address liberalisation 'directly'. In this form, concessional and compensatory reform also have a more immediately expansionist and so 'mercantilist' flavour. If they liberalise trade they will typically do so by initially expanding (predominantly) low cost activities and so

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31 The IAC accordingly reconciled itself to a degree of pragmatism and frequently endorsed 'anomalous reform'. It recommended reduced assistance to certain industries even though other industries would continue to receive even higher assistance at least until the IAC inquired into them. Its proposals to reduce assistance to the automotive industry were a case in point, for there were some apparel manufacturing sectors with even higher levels of assistance (IAC, Annual Report, 1973-74: 69).

32 For this and subsequent examples, it is possible to think of counterexamples. For instance it is possible to think of anomalous tariff reductions the initial effect of which is expansionist where for instance they have an immediately expansionary effect on the costs of a user industry. However economists' 'stories' of why trade liberalisation generates gains almost invariably envisage an initially contractionist schema (eg see IAC, Annual Report, 1973-4, §152: 22).
ultimately drawing resources from (predominantly) higher cost activities. Of the latter two non-traditional reform moves, concessional reform has a more ambiguously mercantilist appearance than compensatory reform. Typically concessional reform functions by *facilitating* the expansion of relatively low cost activities - by unburdening them of some of the negative assistance imposed by existing protection - whereas compensatory reform occurs by way of an unmistakable touchstone of mercantilistic political economy - direct assistance.

Consistently with the framework presented here, both concessional and compensatory reform received much less favourable consideration within the profession than anomalous reform. Concessional reform was largely ignored within the professional literature but often treated with instinctive hostility where economists considered it (see Chapter Four). In contrast, by directly engaging the 'dangerous supplement' of second best reasoning, 'compensatory' reform occupied centre stage in Australian trade policy discussion for the best part of a decade and was the focus of considerable hostility. Within economic orthodoxy at least, it was ultimately marginalised as a reform option. The issue is introduced in the remainder of this chapter which discusses the tariff compensation debate of the mid 1970s.

### 3.4 'Directness' of Reform and the 'Tariff Compensation' Debate

It is quite logical for persons engaged in our export industries to say that, if they cannot have their costs reduced by means of lower customs duties, the same measure of protection as is enjoyed by other industries should be enjoyed by them.


This section introduces some of the economic aspects of the 'tariff compensation' debate of the late sixties and seventies at the same time as arguing that the debate was marred by

33 It need hardly be said here that I am examining scenarios in which these heterodox reform options actually do liberalise trade. The normative perspective of the policy maker is assumed to be something similar to the IAC on the many occasions when it recommended anomalous tariff reduction: an understanding that cutting some tariffs 'anomalously' can worsen welfare and that cutting others can improve it together with a desire to use anomalous reform to improve rather than worsen welfare. To object that given certain circumstances one *can* choose kinds of heterodox reform moves which worsen welfare and to thus associate heterodox reform moves with welfare losses seems overly circumspect. It would for instance have prevented the IAC from recommending reducing assistance to any industries below the (exorbitant) level which was being enjoyed by the apparel industry.
a degree of theoretical confusion. In particular, it was rarely clear whether and at what stages participants were appealing to the theory of the second best and when they were appealing to a related literature with simpler normative implications - the optimal intervention literature. In this regard it was unclear who was defending the high ground of 'orthodox' top down and across the board reform. For the first shots in the tariff compensation debate were fired not in support of extending assistance to export industries but rather against lowering their assistance before the orthodox reform rules would sanction such a move - *i.e.* before assistance had been reduced to more highly assisted activities.

Although 'tariff compensation' was a foundation stone of Australian Protectionism (see above quotation), the issue was raised again in 1968 by a leading advocate of trade liberalisation (Gruen, 1968). Although no stranger to economists' "crusade" of exposing the special pleading of interest groups, Fred Gruen cavilled at the "attitude . . . that anything any farm pressure group asked for was *ipso facto* unjustifiable" (1986: 16-7). The debate acquired central policy significance in 1974 when the Green Paper on Agricultural Policy embraced the tariff compensation argument as a far-reaching justification for agricultural assistance. Partly because of its own wording, but partly because of the 'polarising' tendencies of economic discourse (see Chapter One), the Green Paper and 'tariff compensation' came to stand for an 'alternative' - bottom up - approach to tariff reform which contrasted with the top down formula from the textbooks.

Notwithstanding his co-authorship of the Green Paper, Gruen later felt that it overstated its case (1986: 17) - a point with which this author agrees. Where it acquired the flavour of an *alternative* to tariff reform, the case against 'tariff compensation' was strong.34

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34 That case emerged from several considerations. They include:

- the low degree of substitutability in consumption and production of manufactured and agricultural goods, suggesting that compensation should be at low levels;
- the complexity of calculating the 'optimum second best' compensations;
- the multiplicity of assistance instruments used to assist agriculture many of which involved additional distortions;
- the difficulty of ensuring that, once calculated, tariff compensation policies would survive their political passage into policy; and
3.4.1 'Bestness', Optimal Intervention and the Theory of the Second Best

Engagement with the dangerous supplement of 'second best' issues created difficult dilemmas of principle and practice. Economists were understandably suspicious of 'second best' considerations given the role such considerations played in underpinning 'protection-all-round'. As subsequent chapters demonstrate, ultimately an in-principle choice against second best policies was made rather than one based on the merits of particular circumstances. And within a decade and a half, 'second best' considerations, at least in Australia's trade liberalisation debate, had been vanquished. Yet as protagonists of tariff compensation insisted, where reform was piecemeal, second best principles could be ruled out 'on principle' only at the peril of irrationality. Chapter One has already asserted that the difficult choices to be made in these circumstances were not faced up to, and so made by default rather than design. Below I illustrate how the difficult issues were avoided in large measure by way of theoretical confusion.

By the early seventies, the expression "second best" was often used to refer to the 'indirectness' of a policy in meeting its objectives. Policies which addressed their policy objective directly were 'first best'; those which did so at the cost of a 'by-product' distortion were 'second best', with each additional distortion taking a policy from nth to (n+1)th best (Corden, 1974: 29). This language is grounded in the 'domestic distortions and optimal intervention' literature, not the related but conceptually distinct theory of the second best. By contrast, the 'second bestness' invoked by the theory of the second best relates typically, not to the policy under consideration but to the policy making situation. Here constraints on policy force policy makers to choose between policies which achieve a second best optimum, and policies which do not. There is an unintended irony in Bhagwati's comment that "first best policies applied in second best contexts can be counterproductive" (in Kenen, 1975: 515). In the constrained circumstances presupposed by the theory of the second best, second best is the best one can do. Policies which we would today call 'first best' will generally be worse than second best policies - and they cannot improve on them!

The distance which economics has traversed in its use of the term 'second best' is striking. In the context of the optimal intervention literature the ranking of policies and the language of 'nth best' is, appropriately enough, tendentious. Policy should address its objectives as directly as possible. Adam Smith pointed out as much (Smith, 1937: 483). Who wants to be second best? By contrast James Meade's original mid-1950s terminology captures the very different analytics of the theory of the second best - policy
making in 'second best' situations. He does not juxtopose first and second best policies but "[u]topian versus second best solutions" (1955: 8). Who wants to be utopian? It says something about the resistance of modern economics to the impending anarchy and paralysis threatened by one of its 'dangerous supplements' that Meade's terminology has all but disappeared from use.

At different stages of the debate both sides made theoretical appeal to concepts from the theory of the second best and the optimal intervention literature without offering clarifications. Gruen's original work was grounded in the theory of the second best, and the Green Paper's case for tariff compensation was, by its own description a 'second best' one although its reference to tariff reform as 'first best' suggests an optimal intervention framework (Harris, et al, 1974: 42, § 3.64, cf Harris, 1975: 131).

References to the language of 'second best' suggested the technical difficulties of estimating the tariff compensation policies necessary to achieve a second best optimum and, as Peter Lloyd pointed out, even to the nightmarish spectre of a "sequential and gradual process of second best intervention" and optimisation (1975: 151).

Was all this necessary to the tariff compensation debate? Once the Green Paper had been interpreted as proposing tariff compensation as a partial or complete alternative to tariff reform, this was probably inevitable. The Green paper conceded that tariff compensation was a "second best course of action" (Harris et al, 1974: 42, § 3.64, emphasis added) implicitly framing the discussion within the optimal intervention framework which defies the 'second best' nature of the situation (of piecemeal reform) which Gruen had first sought to address. As Alan Lloyd insisted, the focus on tariff compensation and tariff reform as alternatives essentially "distorts the discussion. Clearly the choice is between both policies combined or the latter only".

Likewise he charged that the IAC's invocation of 'optimal intervention' principles; its argument that reform should be determined "directly" by the reform objectives rather than the need to compensate for previous interventions had a "nice ex cathedra ring to it". But it simply substituted an optimal intervention framework for the second best framework which was the only one which captured the analytics of the situation in which the IAC found itself as a piecemeal reformer. "[A]s I far as I can unravel it" Lloyd protested his bemusement, "it is merely an assertion which takes us back to square one" (A. Lloyd, 1975: 15). To a considerable extent, the case for tariff compensation could have been made without extensive reference to the theory of the second best and the complications it implied. Gruen wished principally to insist that policy makers departed from the top down or across the board reform orthodoxy at their peril. In the
circumstances of high rates of assistance elsewhere in the economy, Gruen asked "Can we really be sure that seven per cent [effective assistance then provided to the wheat industry] is economically unjustifiable?" (1968: 12).

3.4.2 Peremptory Rules versus Meliorative Themes

With hindsight, one may use the terms introduced in Chapter One to argue that what was really at stake in the tariff compensation debate was whether policy makers and economists would make their way from the corpus of the discipline to policy prescription by way of 'peremptory rules' (which disparaged tariff compensation as a matter of principle), or 'meliorative themes' (which introduced tariff compensation as one consideration to be balanced against a range of others). The Green Paper had accepted that there were legitimate reservations about tariff compensation 'all round' and proceeded to outline some of the circumstances which would strengthen the case for tariff compensation in specific instances. Likewise the IAC's treatment of the issue (IAC Annual Report 1973-74, Appendix 5.5) was a sufficiently skillful piece of writing to embrace the possibility of occasionally endorsing the tariff compensation rationale for assistance to low cost industries - which it seems was necessary to secure all Commissioners' agreement (A. Lloyd, 1975: 2) - whilst rehearsing a strong 'in-principle' case against tariff compensation which was widely interpreted as the essence of the IAC's position (A. Lloyd, 1975: 2).

Yet as Alan Lloyd insisted - though he did not himself use Braybrooke's and Lindblom's terminology - any peremptory rule banishing tariff compensation considerations from advice on industry assistance is a travesty of economic science, a contradiction of the "whole IAC philosophy" which sought to examine the worth of policy alternatives from an 'economy wide' perspective (1975: 15 and see § 6.2 below). Alan Lloyd was concerned more than anything that "IAC staff and Commissioners should not feel constrained, as a matter of policy to disavow the compensatory assistance argument", warning that any such disavowal was irrational (1975: 20, 5 emphasis added). He accordingly pressed the Commission to develop its aversion to tariff compensation in the context of a range of 'meliorative themes':

The questions which the [IAC's first] Annual Report did not seek to answer, but which must be answered, are: 'Bearing in mind the difficulties and counter-arguments, under which conditions would it be sensible to allow for compensatory assistance? (ie for what industries and in what circumstances?)'. 'How much compensatory assistance should be granted and in what circumstances?' (1975: 3).
In this context, both the Green Paper and Alan Lloyd pointed out the potential for different arguments for assistance to mutually support one another. If there were a strong case for assistance on tariff compensation grounds, then this would gain strength from any additional case for assistance which might be made out in the same circumstances on other grounds. In this regard the Green Paper argued that "it would make good economic sense, on both efficiency and welfare grounds" to use assistance countercyclically to distribute agricultural incomes "more evenly over time" (Harris, 1974: 45, § 3.79, 80). It is not clear whether it was proposing any new assistance in this section or merely exploring implications of this line of reasoning for existing schemes.

The suggestion that different objectives of policy might in certain circumstances each mutually reinforce the case for tariff compensation was beyond the pale for Peter Lloyd. He did not debate the economic merits of such an approach but argued that peremptory rules offered greater protection against the risks of political subversion. "This suggestion of using compensation for the dual purposes of improving resource allocation and stabilizing farm incomes is dangerous. It opens another door for disguised long-term assistance which is difficult to measure and control" (1975: 147). Peter Lloyd's concern with the political risks of tariff compensation was legitimate enough. But politics is more than a field of threat for good policy. It is the necessary medium through which economic ideas pass into policy. As such, it is a field of both risk and opportunity. To take the example used above, permitting a plurality of objectives might well involve risks of having assistance extended when conditions in agriculture were parlous. But the prospect of increased rural assistance when times are hard may be politically inevitable in any case. And if admitting the plurality of objectives does increase risk - it might also increase the risks for farmers of having their assistance reduced when times were good. More substantial examples of the potential gains from admitting the plurality of objectives are outlined in the subsequent sub-section and in Chapters Five and Ten. For when they are more fully sketched out, it is difficult to choose between different perspectives on the politics of tariff compensation.
3.4.3 Political Considerations: Second Best as a Field of Threat or a Field of Opportunity?

If the IAC is seen to be actively and directly doing something 'constructive' towards expanding low-cost industries (as distinct from the 'destructive' but immensely beneficial role of reducing high tariffs) its public image and influence will be strengthened.

Alan Lloyd, 1975: 20

Of course one can concede the case for tariff compensation in economic theory and still reject such a policy in the belief that it will complicate and so jeopardise the politics of reform. This sub-section briefly introduces political considerations. It seeks to expand and enrich the field of view, rather than argue a particular case. It provides material for a claim which will be elaborated further in Chapters Five and Ten: those who advanced 'political' arguments against 'compensatory' export assistance did so in a summary fashion without showing that alternative perspectives were inferior.

As Glezer puts it, for the IAC, tariff compensation cut to the heart of a central economic and strategic problem:

Giving rural groups compensation for manufacturers' tariffs, mainly in the form of export subsidies, would have strengthened the commitment of these groups to the IAC. However it also meant the creation of assistance which, in the long term, would prove difficult to remove and might even have led the compensated industries to support the high protection granted to some manufacturers. To compensate lightly protected industries was to endanger the policy of eliminating assistance as far as politically possible (1982: 124).

Glezer's analysis illustrates just how ambiguous and rich the politics of reform can be. For it suggests that, at least in the short to medium term, some tariff compensation would have promoted the cause for reform by politically galvanising its beneficiaries behind the IAC. And while Glezer's echoing of the IAC's depiction of the dangers for long term policy are plausible enough, so too are other possibilities. Had initial reform proceeded more smoothly and generated benefits more rapidly, this might have improved the political prospects of reform later. It could have done so both by promoting greater public support of reform and by moving the economy faster to freer trade from whence it would be a smaller and so politically easier step than otherwise to complete free trade (A. Lloyd, 1978: 12).

Also, it is a commonplace of neoclassical political economy that trade liberalisation is politically difficult because its costs are immediate and concentrated and visible whilst its gains emerge more slowly and are diffuse, and so much less visible (IAC, Annual
The politics of reform are further undermined by the popular mercantilistic appeal of protection and, as Alan Lloyd pointed out, impeding 'cheap imports' always had a certain xenophobic appeal. As a consequence, there was widespread popular suspicion of trade liberalisation in the early 1970s, and as jobs were lost in the 1974-75 recession, suspicion turned to strong hostility. Alan Lloyd argued that judiciously applied, tariff compensation offered to turn these conventional wisdoms of political economy on their head, improving the public image of reformers into the bargain. Export assistance for some activities would be direct and visible, whilst its indirect effects - subverting the protection provided by tariffs - would be much less so (1975). And - as Ross Garnaut argued over a decade after the tariff compensation debate - export assistance might promote liberalisation by permitting faster tariff reform than would otherwise be possible (1991: 30). These issues are explored further in Chapter Five, which considers the politics of export assistance to manufacturers and the forms in which it might be offered in order to maximise the chance of entrenching a virtuous political economy of trade liberalisation in which successful reform helps accelerate further reform.

3.5 Until Completed, the Most Direct (First Best?) Reform Paths usually Contain 'Second Best' Policies

Had the debate been less preoccupied with the dichotomy between 'compensating or eliminating' (see Warr in Kasper and Parry, 1978: 295-6), it might have proceeded to develop further some of the principles from the optimal intervention literature to which both parties appealed at different times. This task is now taken on here.

If trade barriers are the problem, then clearly removing them is the 'first best' or 'most direct' reform. And policies which allow them to remain and seek instead to offset their effects will be less 'best'. Yet (leaving practical matters of implementation aside for argument's sake) this logic does not hold where trade reform is partial - and thus where it is gradual. In one sense top down and across the board tariff reform are direct. Their focus is on the policy to be dismantled and they concentrate reform in areas of highest effective assistance - where existing policy deviates most from the ultimate ideal. Yet in another sense, they are not the most direct attack on the problem because they do not focus on the deleterious incentive effects of the unwanted policy, the disparities of assistance to which tariffs lead. If one wishes to reform these as directly as possible, one would focus on the two extremities at once, concentrating reform where positive
assistance rates are highest and lowest (most negative). In principle at least, these considerations suggest a path of 'symmetrical' tariff dismantling in which top down or across the board tariff reform is complemented with tariff compensation focused on the most negatively assisted activities until the rates of tariff and tariff compensation assistance converge. Beyond this point, tariff and tariff compensation rates would be lowered until free trade was reached. In this sense, 'compensatory assistance' instruments play a necessary role in a 'symmetrical' - i.e. the most direct - approach to gradual tariff reform. From this perspective, immediate free trade is 'first best', symmetrical partial tariff reform is next best and asymmetrical partial tariff reform is next best again. And if theoretical considerations suggest symmetrical concertina tariff reform, so it seems would the empirical work associated with the 'new development consensus' where - it will be recalled - export assistance was taken to complement other liberalisation measures and accelerate the transition to outward orientation. These and other points will be revisited in Chapter Five.

35 Although both tops down and across the board trade reform will typically reduce the negativity of the most negative rates of assistance, they do so indirectly - that is as a by-product of reducing the highest positive rates of assistance. Thus they do not necessarily concentrate reform in the areas experiencing the greatest disparities from the average. Where the most highly assisted industry does not produce inputs for the most negatively assisted industry or to industries supplying it, the first round of 'tops down' reform will generate little relief for the most negatively assisted industry. Because across the board reform replaces 'tops only' reform with 'tops mostly' reform or reform which is most concentrated at the top, analogous arguments apply to it mutatis mutandis.

36 Corden refers to 'tops down' reform as the "concertina method" (1974: 369) and the symmetrical path mooted here is also more consistent with this imagery of the concertina!

37 Note the analogy with Corden (1974: 29) where he provides an illustrative list of interventions to deal with overpriced labour to manufacturing in a less-developed country. A subsidy to manufacturing labour is 'first best', a production subsidy to manufacturing next best, a tariff plus an export subsidy is next best with a tariff only regime coming in last.
4 'Intra-Industry Trade Policy' in the Sixties and Seventies: Policy Makers, Economists and the Accommodation of Intra-industry Trade

[W]e are looking for an institutional arrangement between two or more countries which would promote competitive specialisation and at the same time hinder, or at least limit, complementary specialisation. Describing the task in these terms already suggests the solution.

Peter Elkan, 1965: 52-5

4.1 Introduction

Amongst economists, both in the 1970s and today, considerable attention has been focused on the implications of intra-industry trade for the old debate between free trade and mercantilism (Grubel and Lloyd, 1975: 150-1; Lancaster, 1991). But there are a range of issues which the ubiquity of intra-industry trade raises for trade policy which are less fundamental, but, on account of that, perhaps of greater immediate significance.

In particular - accepting for the sake of the argument that some protection exists because it is 'politically' imposed, economically desirable, or because trade liberalisation, though desirable must be gradual - how can protection's intra-industry trade suppressing effects be ameliorated? This chapter explores the way in which both economists and policy makers responded by improvising new policy instruments to address these issues. The chapter continues the argument begun in Chapter One that the energies of the economics profession were marshalled very imperfectly to addressing such 'meliorative' themes. Because the automotive industry was one of the pre-eminent cases in which intra-industry trade confronted policy makers, and because some of the important contributions were Australian, the story about the theory and practice of 'intra-industry trade policy' and the story about policy making in the Australian automotive industry merge in these sections.

A few economists raised a range of 'meliorative' possibilities; however, their individual contributions were not taken up within the literature and so the discipline failed to build towards any systematic insights or growing consensus in the area. Some economists like Kiyoshi Kojima and Peter Drysdale offered pragmatic contributions addressed to particular circumstances. These fell from view relatively quickly and very little attempt was made within the discipline to deal with the issues they raised more generally. Only
one economist sought to consider the normative economics of intra-industry trade and protection more generally. This was Peter Elkan who proposed systematic institutional adaptations of traditional protection and customs union instruments in the mid 1960s. His work offered the prospect of a fertile beginning to a disciplinary conversation which, alas, never really got started. Elkan's work provoked very little response at all from economists. As this chapter outlines, what response it did engender smacked of several typical vices of 'poor conversation'. This foreclosed prospects for improved disciplinary insight. Following a discussion of this failure of disciplinary dialogue, the chapter briefly considers ways in which the new development consensus was also pointing towards the usefulness of what I call intra-industry trade policy, although again it failed to explore the area systematically.

4.2 *Ad Hoc* Proposals to Facilitate Intra-Industry Trade

Whilst some were pointing out the ways in which intra-industry trade might affect the choice between traditional trade liberalisation instruments (eg Grubel, 1967: 384), a number of economists suggested variations on customs unions to capture complementarities between industries in different countries. Japanese economist Dr Kiyoshi Kojima asked "[w]hat kind of adjustment is desirable and needed for the future expansion of Japan's trade?" (1965: 118). He argued that Japan should expand intra-industry trade. He suggested the formation of a preferential tariff area between developed countries in the Pacific to facilitate each country producing "sophisticated manufactures" at increased scale "reciprocally furnishing each other's markets" (1965: 119; also see Kojima, 1964: 57). He believed that the multilateralism of the Kennedy Round of GATT negotiations might not sufficiently meet the interests of Japan. While a large trade block was both unrealistic and undesirable for Japan, "some sectoral integration in heavy and chemical industries among Japan, the United States, Canada and Australia and New Zealand might be desirable" (1965: 119-20). But Kojima was short on the specifics of such arrangements.

ANU economist Peter Drysdale was an enthusiast for some of Kojima's ideas (*The Bulletin*, 8th August 1964: 56), and a few years later took them up again. He pointed out in 1969 that the Japanese and Australian automotive industries were highly complementary. Eighty two per cent of Japan's car output was in vehicles of less than 1.5 litres with the bulk of Australian production being concentrated in vehicles of over 2,200 cc capacity (1969: 333). Drysdale concluded that there was "considerable scope for more effective specialisation in motor-car production within the western Pacific
region, with Japan specialising in the production and export of small and small medium sized passenger cars, and Australia in the production and export of medium sized cars" (1969: 334). The resulting increases in production scale would lower costs and strengthen each industry in third country markets (1969: 334).

Drysdale added that until demand for medium cars in Japan and small cars in Australia had grown sufficiently to justify local production, it seemed "quite irrational" for each to cover the field of production "when the viability of the important section of the industry in each country is well established" (1969: 334). He suggested that a bilateral arrangement between Japan and Australia in motor vehicles could be attractive to both parties and that the (possibly) necessary GATT waiver ought to be available, given the GATT waiver for a the US-Canada auto pact of 1965 (see § 4.4.2 below).

4.3 Intra-Industry Trade Facilitation Policy: 'Customs Drawback Unions'

The idea that intra-industry trade might require essentially new economic institutions and approaches to protection and/or to trade liberalisation figured very little in the literature. Peter Elkan's work was an exception. Elkan, considered the policy issues arising from intra-industry trade and specialisation over a decade before interest in them increased dramatically in the economics profession in the late 1970s. He was one of the few economists of the early and mid sixties to draw attention to the likelihood that economies of scale were becoming increasing important to industrial development and to make this an important focus for his policy thinking (eg see Elkan, 1965: 47 and Elkan, 1972).

Without doubting that protection was the correct policy for New Zealand, Elkan anticipated the new development consensus in his concern that inward orientation would rob a small country's protected sector of important economies of scale (1965: 45). He was particularly concerned with what he called the "problem of assortment". Many economies of scale were product specific, when a good deal of thinking about them had assumed homogeneity of output within an industry and so had thought about scale economies at the industry level. His focus on the "outlet for every narrowly specified product" led him to conclude that "if local sales of any particular item do not reach the minimum scale at which it can be manufactured efficiently, its production necessarily entails either a permanent acceptance of low efficiency . . . or the practicability of exports in significant volume" (1965: 45).

Like many economists at the time, Elkan suspected that for small and/or underdeveloped countries, increasing inter-industry specialisation in primary products would lead to a
syndrome of underdevelopment in which the skills and so productivity of the labour force stagnated and the country had difficulty expanding export volumes without depressing export prices. On the other hand an increase in what he called 'competitive' trade specialisation "that is, . . . the international exchange of goods belonging to the same broad class, is practically always highly desirable" because it allowed specialisation and access to economies of scale in production not otherwise available without the offsetting costs which increased inter industry specialisation might entail (1965: 52).

Elkan accordingly went in search of institutional arrangements which would foster the desirable whilst limiting the undesirable (see quote at head of this chapter). In seeking an institution which would "abolish tariffs conditionally" for those imports which were matched by exports from the same broad commodity class, Elkan turned naturally to the existing institution of customs drawback.

Under existing export drawback arrangements, an exporter received a rebate of tariffs paid on imports if they were physically incorporated into products and then re-exported. Elkan proposed to modify the condition under which drawback was granted so that drawback on imports would be allowed in proportion to the extent of exports from the same broad commodity class irrespective of whether or not the imports were incorporated into exports. An importer would receive a receipt on payment of duty which could be drawn back by those exporting goods from the same broad commodity class. The duty paid receipts which could be redeemed by exporters were to be freely transferable to ensure that they went to their highest value uses (1965: 53). The economics of such instruments are explored more fully in Chapter Five below.

Perhaps because he was particularly concerned with New Zealand's trade arrangements with Australia, and with customs unions as instruments of development, Elkan's focus in outlining his proposals was regional rather than unilateral or multilateral. The drawback arrangements he proposed were to operate vis a vis trade between individual countries which had elected to join what he dubbed a 'customs-drawback-union'. Nevertheless he observed in a footnote the "logical possibility" that the arrangements he was proposing could also be introduced unilaterally by a country with respect to its trade in all directions (1965: 53). A variation on this 'logical possibility' was to find its way into the actual policy making of automotive protectionists in Australia in the automotive local content plans within six years of Elkan's article. Some years later a more liberal and thoroughgoing import/export link called the export facilitation scheme was introduced into the industry.
CHAPTER FOUR 'INTRA-INDUSTRY TRADE POLICY' IN THE SIXTIES AND SEVENTIES

Ironically, as interest in the phenomenon of intra-industry trade grew within the economics profession, and as a number of countries such as Canada, Australia and the ASEAN countries explored variations on Elkan's proposals (see below), professional interest waned in the kind of intra-industry trade facilitation policy which Elkan had proposed. Virtually nothing of Elkan's proposals survived in the literature. Elkan's name was never mentioned by those participating in inquiries which considered export facilitation for the automotive industry - effectively a unilateral 'customs drawback union' in Elkan's terminology - and no-one cited any body of work devoted to the economic analysis of these kinds of instruments - for there was none. Despite, or perhaps because of its growing technical sophistication, the discipline never focused systematically on the meliorative themes suggested by Elkan's work. Some speculations as to why this could have been so are offered below.

4.4 Experience with Intra-Industry Trade Facilitation Policies

The fundamental obstacle to production efficiency is the diseconomy of scale associated with production oriented to internal markets of limited size. Adjustment models must seek to overcome the scale disadvantage ... through extending the size of the market. ... [This] may be achieved through regionalism or specialized production for world markets.

World Bank Staff Occasional Paper, Baranson, 1969: 69

The following sub-sections explore various instruments used in the 1960s and 1970s to facilitate intra-industry-cum-intra-regional trade. The first four sub-sections explore intra-industry trade facilitation policies which were implemented at the regional level. The final section deals with the prominence of intra-industry trade facilitation in the successful developing countries whose experience inspired the new development consensus.

4.4.1 The Swedish Automotive Industry

The Swedish automotive industry had integrated itself with the European industry by virtue of its arrangements within the European Free Trade Area (EFTA). Like Australia, Sweden's automotive exports were negligible in 1950. But Sweden's exports had risen to 123,000 vehicles by 1967, or over 64 per cent of production (Rhys, 1972: 205). Most Swedish automotive exports went to Europe but nearly a third went to the United States (Swedish Embassy, 1994). Volvos and Saabs were successful on world markets because they were marketed into specific 'niches' where they held and/or could develop
competitive advantages, and also because Sweden's free trade with Europe and its relatively low tariffs on imports from elsewhere enabled it to impose strong price and quality disciplines on its suppliers (Rhys, 1972: 205). In the early 1970s Volvo's imported content was between 35 and 40 per cent of total vehicle costs (Rhys, 1972: 205).

4.4.2 The Bladen Plan and the Canada-US Auto Pact

[B]ilateralism between Canada and the United States may disappoint free traders, but it is a great improvement upon the narrow unilateralism that can so easily prevail.
Stubbs, 1972: 289

The relative success of Canadian automotive industry policy is of particular interest in comparison with Australian policy. Their industry, like the Australian industry was predominantly foreign owned and controlled. Their arrangements appear to be no less 'interventionist' in form than Australia's plethora of plans. In 1961 Dean Bladen - constituting a one person Royal Commission - proposed a range of policy measures for the industry which embodied many of the themes which were a hallmark of automotive protectionism in Australia. As Australia was to do a few years later greater assembly activity would be encouraged by allowing assemblers limited volume access to imported components. As in Australia this effectively discriminated in favour of assemblers and against high local content producers who were less import intensive and so enjoyed less concessional treatment (Johnson, 1963, passim). The major difference between the Canadian and Australian local content plans was that the Canadians embraced an innovation which Commissioner Bladen had called 'extended content'. This permitted the 'local content' requirements of the plan to be met by production for export as well as by production for the domestic market. Because local content entitled producers to access to duty free imports the arrangements amount to the unilateral variant of those proposed by Elkan.

The US-Canada Auto Pact replaced the Bladen plan in 1965. Although some details of the previous plan were changed, the extended content arrangements of the earlier plan were essentially retained although they took on a bi-lateral form (Fuss and Waverman, 1987: 218). In addition the producers committed to a 'safety net' for the Canadian industry according to which certain minimum production levels were guaranteed. Given that these were expressed in nominal terms (Maxcy, 1981: 246-7), inflation and economic growth would erode their significance as constraints. While hardly embracing a 'laissez faire' spirit, the arrangements did not subject firms' rationalisation programs to
ad hoc administrative assessment. As Fuss and Waverman put it, the arrangements "allowed for (but did not mandate) the rationalization of North American production facilities" (1987: 219-20, also see Helleiner, 1981: 84). Accordingly, Canadian firms were free to plan cost reduction and intra-industry integration, subject to global constraints on the extent to which they could reduce total Canadian activity in the process. As Maxcy comments, "The effect on trade was spectacular" (1981: 249 see Table 4.1 below).

Table 4.1 US-Canadian Automotive Trade: Selected Years 1961-1975 (Millions of Canadian Dollars)

<table>
<thead>
<tr>
<th>Year</th>
<th>CBUs from US</th>
<th>Components from US</th>
<th>Total US-Canada Trade</th>
</tr>
</thead>
<tbody>
<tr>
<td>1961</td>
<td>65.5</td>
<td>0.4</td>
<td>367</td>
</tr>
<tr>
<td></td>
<td>292</td>
<td>8.8</td>
<td></td>
</tr>
<tr>
<td></td>
<td>357.5</td>
<td>9.2</td>
<td></td>
</tr>
<tr>
<td>1965</td>
<td>153.5</td>
<td>80.6</td>
<td>1,182</td>
</tr>
<tr>
<td></td>
<td>797.9</td>
<td>150.2</td>
<td></td>
</tr>
<tr>
<td></td>
<td>951.4</td>
<td>230.8</td>
<td></td>
</tr>
<tr>
<td>1973</td>
<td>2,082</td>
<td>3,060</td>
<td>10,866</td>
</tr>
<tr>
<td></td>
<td>3,553</td>
<td>2,171</td>
<td></td>
</tr>
<tr>
<td></td>
<td>5,635</td>
<td>5,231</td>
<td></td>
</tr>
<tr>
<td>1975</td>
<td>3,126</td>
<td>3,790</td>
<td>13,483</td>
</tr>
<tr>
<td></td>
<td>4,522</td>
<td>2,045</td>
<td></td>
</tr>
<tr>
<td></td>
<td>7,648</td>
<td>5,835</td>
<td></td>
</tr>
</tbody>
</table>

Source: Fuss and Waverman, 1987: 221

Despite criticisms of both the interventionism of the Canadian schemes and their export subsidy implicit in 'extended content' (Johnson, 1963: 226), the inclusion of duty remission conditional on intra-industry trade appears to have significantly reduced the cost of what other interventions were pursued. As intra-industry trade increased between the two countries, from an exchange of 37,000 units in 1964 to 1,694 million by 1973, the firms also rationalised their production. GM, Ford and Chrysler all moved from producing several car-lines, to producing one (Fuss and Waverman, 1987: 222). Before tax, Canadian prices moved from being approximately 10 per cent above American prices in the early 1960s to being roughly equivalent to American prices. At the same time Canadian auto-workers' wages caught up with those of their American

88
counterparts (Maxcy, 1981: 249). More recent and more careful analysis has yielded a somewhat more pessimistic assessment. Fuss and Waverman conclude that there was a reduction in relative unit costs in Canada of seven per cent relative to the United States "due primarily to exploitation of economics of scale". On the other hand they found that the productivity gap between the two countries had not been closed, perhaps because of inadequate competitive pressure (Fuss and Waverman, 1992, 203). (Japanese imports were subject to voluntary export restraint while the Canadian firms were subsidiaries of American firms.) Even so, one may ask what would have happened without the auto pact. For the policy alternative in Canada at the time was not unilateral free trade in automobiles. While the Bladen plan and the auto pact were 'messy' and their objectives 'protectionist' from the Canadian perspective (Fuss and Waverman, 1987: 218), the 'extended content' arrangements common to both meant that protectionist objectives were achieved at what one may assume was a substantially lower cost than would otherwise have been the case.

4.4.3 The ASEAN Complementation Plan

In 1969 the United Nations Team Report on ASEAN proposed that ASEAN nations embrace 'regional complementation' or the duty free facilitation of intra-automotive-industry trade between member countries, a suggestion which was taken up by a meeting of private interests in the automotive industry within ASEAN in October 1971 (Soldium and Meow, 1987: 1). Proposals for an "ASEAN car" were initially given a euphoric reception. However, like previous attempts at regional integration between developing countries, they were the source of continuing disappointment. An earlier attempt at regional complementation under the aegis of the Latin American Free Trade Area (LAFTA) was already experiencing difficulties. Public officials were involved in managing trade liberalisation and co-ordinating the terms on which complementation would take place. ASEAN's original complementation scheme encountered serious difficulties for two reasons. Firstly the arrangements allowed for substantial bureaucratic oversight of the complementation decisions taken by firms, and countries within the scheme continued to pursue national rather than regional objectives. With different countries' automotive industries at different stages of development, countries with relatively backward automotive industries were suspicious of the extent to which intra-industry trade complementation might further concentrate development of the higher skill sectors of the industry in the more advanced countries (Hoppe, 1979: 13).

Also there was the problem of conflict between government objectives and perceptions and the corporate strategies of, and logistic possibilities open to, the trans-national
corporations. The motivating vision of ASEAN complementation was provided by the idea of an "ASEAN car", which would require a high degree of co-ordination between firms which were otherwise fierce competitors. It envisaged that if, for instance, Toyota sought to invest in the market, it would produce (say) panels for Ford. The transnational corporations operating within ASEAN were far more capable of making arrangements involving rationalisation of activities within their own international networks than they were of participating in the inter-firm integration contemplated by ASEAN policy makers. Thus, for instance, the Philippines designated itself as a source for panels. This meant that, although Ford might earn credits by exporting Cortina panels from the Philippines, it could not use them to import complementary commercial vehicle panels from Thailand (Hoppe, 1979: 15). As time passed and disappointment set in, this 'part to part' complementation was gradually transformed into a moderately more successful 'brand to brand' complementation scheme which permitted intra-firm specialisation of various kinds, but again, generally subject to extensive bureaucratic oversight (Economist Intelligence Unit, 1985: 71).

4.4.4 Article 3.7 of NZAFTA

Although almost comprehensively ignored by academic economists, Elkan's work influenced the design of the New Zealand-Australia Free Trade Agreement (NZAFTA). Elkan's ideas were enshrined in Article 3.7 of NZAFTA which allowed each country to permit concessions on duty and quantitative restrictions to the other for cross trade (Templeton, 1969: 3). As Elkan had proposed, concessions were not restricted to trade within narrow industry categories. Nevertheless, and contrary to Elkan's proposals, approval was granted by government officials on a case by case basis. All the major Australian vehicle manufacturers participated under the arrangements. They typically used the concessions for trade within the automotive industry (IAC, PMVs, 1974: 213), however GMH was also able to use the scheme to facilitate white goods exports to Australia from its investments in New Zealand in return for vehicle exports from Australia to New Zealand (IAC, PMVs, 1974: 214).

Seventy projects had been approved by 1969, although the value of cross trade remained modest at an estimated NZ$6.6 million (Templeton, 1969: 3). Cross trade in automotive products under Article 3.7 grew strongly thereafter, to reach $22 million in 1973-4. Not surprisingly, given the concrete projects which could be identified as benefiting from the arrangement, it received the enthusiastic support of Ministers Anthony, McEwen and Cairns. Nevertheless correspondence on IAC files indicates that the arrangements were not seen by firms as providing security of market access (IAC archives 3/3/21). And as
one might expect, on occasion Article 3.7 proved vulnerable to domestic political lobbying. Thus in 1980 Australian officials refused to allow concessional entry to aluminium wheels from New Zealand under apparent political pressure from Australian wheel manufacturers (AFR, 17th July, 1980: 14).

4.5 The Australian Automotive Industry and Intra-Industry Trade Facilitation

4.5.1 Regional Complementation and Australia's Automotive Industry

Given the importance of economies of scale it is not surprising that multinational corporations in the automotive industry considered the idea of 'world-wide sourcing' as early as 1960 (Stubbs, 1972: 79). Ironically Stubbs' narrative of the introduction of the local content plans suggests that the local content scheme may have been partly in response to the 'threat' of imports which world wide sourcing provided (1972: 79).

The early seventies saw increasing interest in regional intra-industry trade for Ford's and GM's Asia-Pacific bases in Australia. In early 1971 GMH's Marketing Director, John Bagshaw, suggested that he did not think that a dilution of the 95 per cent local content requirement was necessary or desirable. "But I think this will be the area where industry discussions will have to take place otherwise we won't be able to maximise our exports into some of the developing areas" (AIM, 6th April, 1971: 6). Bagshaw commented further that GMH was receiving a variety of requests such as the Singaporean request for GMH to import more Singaporean components to earn licences to import more vehicles for assembly in Singapore. (Singapore was using an import/export link to give export orientation to its [then] protected automotive industry and to influence the sourcing decisions of foreign firms.) "There's going to be more and more . . . 'parts swapping'" commented Bagshaw (AIM, 6th April, 1971: 6). In mid 1972 it appeared that the ASEAN countries were exploring the possibility of participating with Australia, New Zealand, Taiwan and South Korea in automotive manufacture and complementation (AFR, 19th April, 1972: 1).

4.5.2 Ford Proposes Regional Complementation

An important participant in the development of the Australian export credit scheme was William (Bill) Hartigan - an Australian who had gone from customs administration to Ford (Australia) in 1963 and had since been an executive within Ford at various locations around the world. In 1971 he was Staff Director, Business Development
within the then newly formed Ford Asia-Pacific and South Africa Inc, the Ford Motor Company's Australian based regional headquarters. He wrote what the trade magazine *Automotive Industry Matters* called a "very significant" paper proposing the establishment of a 'common market' in automotive products within the Asian region (26th October, 1971: 2). He suggested that "[W]ith labour intensive industries established in Asia, they should be given free access to the Australian market, in exchange for preferential access to the developing countries' markets to the extent of the foreign exchange generated" (*Australia International*, January 1971: 9). He argued that Australia was ideally placed to initiate action towards the implementation of such an approach: "[T]he circumstances and timing could not be better" (*AIM*, 26th October, 1971: 2). He was proposing intra-regional intra-industry trade liberalisation via a regional import/export link - precisely what Elkan had suggested.

When Anthony's export credit scheme was announced at the end of 1971 (see § 2.4 above) trade sources gave Bill Hartigan much of the credit (*Automotive Industry Matters*, 18th January 1972: 2). For the brief duration of its first incarnation - from 1972 till 1976 - the usefulness of the new approach was profoundly retarded by the nature of its parentage. The administrative detail of the export credit scheme placed it well and truly within the tradition of Australian protectionism. The scheme expanded the administrators' armory of weapons to entice industry participants to increase their local investment at the same time as avoiding any concomitant structural adjustment within the industry. The export credit plan was touted as something which was "aimed at long term rationalisation and the maximisation of through-put from capital intensive facilities and the fostering of regional trade" (IAC, PMVs, 1974: Appendix Six: 26, § 8{1}). Yet it was hemmed in with the same policy intent implicit in the non-reversion rule and similar rules which encouraged firms to increase their local content but all but forbade them from ever decreasing it.38 As Michael Aiken from *Automotive Industry Matters* put it,

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38 Credits were to be available "only to approved new export projects of a continuing beneficial nature". They were not available for "short-term commercial trade or for exports of an established nature" (Motor Vehicle Plans, Appendix Six of IAC, PMVs, 1974: 26, §8 {1}). The scheme applied to intra-industry trade only within the region (Martec, 1976, § 4.6: 1). Where vehicles were exported they were required to have an acceptable level of local content (IAC, PMVs, 1974, Appendix 6, §8 {2} {b}). Credits could only be used to import for the purposes of meeting local content under the 95% and 85% local content plans (§8 {2} {c}). The local content benefit to accrue would be limited to 10% subject to review from time to time (§8 {2} {d}). Proposals for export projects were required to be "set out in full detail and [were] to outline the resulting implications for sourcing of components and purchases from local suppliers" (§8 {2} {f}). Those proposals would be approved or rejected on a "case by case" basis, (§8 {2}
"protection of the supply status quo is more important than exports . . . Rationalisation on an international scale is apparently viewed by the Government to be a rather dangerous experiment" (AIM, 30th May, 1972: 2).

4.6 Intra-Industry Trade, Intra-Industry Trade Facilitation and the Corpus of Normative Economics

Ward detects a tendency in modern 'formalist' economics to judge the merit of a particular piece of work by the cleverness of its technique and not the social value, nor even [its] intrinsic scientific value. . . . Students absorb this standard of professional quality and the accompanying definition of what constitutes a good research topic. They look for theorems, not solutions to problems. There is much truth in that observation. I know of no serious attempt to understand why it happens and how one could move to something better.

Robert Solow, cited in Samuels, 1980: 93

This section argues that important leads for policy were ignored by economists and makes some suggestions as to how this might have happened. Certainly Solow's observations above seem borne out. Yet even before the rise of formalism in intra-industry trade theory in the 1980s, economic reputations were gained by those focusing on the classic themes of economics - particularly the free trade versus intervention dichotomy - even though these scholars seem to have been inattentive to the possibilities being presented in the empirical detail. In addition it seems that those participants in the debate more inclined to free trade may have suffered from 'anti-mercantilistic bias' (cf § 1.2.2 above). Peter Lloyd seems to have dismissed Elkan's proposals in large part because of their protectionist motivation and because Elkan's elaboration of them appeared to Lloyd to embrace an elementary mercantilist fallacy. As a consequence liberal economists such as Lloyd tended to talk past those proposing innovations. They thus avoided the opportunity which discussion posed for mutual adjustment - and of course mutual benefit. By way of introductory caveat however, it should be stressed that if people ignore something sufficiently comprehensively, it will often be difficult to

(e)) and would "not be approved if not insubstantial injury to established local component suppliers would be likely to result from such an approval" (§8 {2} {g}). These restrictions and the rule in the December 1971 plan revisions which prevented vehicle manufacturers from reducing the local content of their major (highest local content) car line meant that the benefits of the export credit scheme were limited to manufacturers with more than one model in local manufacture, through the option to transfer credits to another model" (Martec, 1972: § 3.15).
detect from their utterances their reasons for so doing. The public record offers only a few clues as to why the opportunity for theorising intra-industry trade policy was not seized. Therefore explaining the cause of disciplinary failure can only be done much more tentatively than expounding what that failure was.

4.6.1 Why was Elkan Ignored?

It is nice to know that, after a delay of almost thirty years, someone has discovered my work. I am not writing 'rediscovered', because my paper attracted no attention whatever at the time. And this was the case with all my writings. On the whole I had no undue difficulty in getting my articles accepted by reputable journals, but once published they seemed to sink without trace: they were never quoted and never discussed, . . . [the] comment of Lloyd which you mentioned being the only exception known to me. . . . I can only guess as to the reason why.

Peter Elkan, Personal Correspondence with the author, 14th March 1994

Elkan's proposals disappeared more because of neglect than satisfactory challenge. Peter Lloyd offered the only response to Elkan's proposals which appeared in the literature. Given the brevity of Lloyd's comments - spanning only a few sentences - it is a little unfair to subject him to extensive critique. Nevertheless, it is worth dwelling on Lloyd's few words because they provide clues as to why Elkan's proposals lacked appeal to his professional peers. And they provide an insight into a lost opportunity in economics, a vignette of the way in which, as argued in Chapter One, poor conversation produces poor science and poor policy. Lloyd strongly disagreed with Elkan's pessimism about the prospects for manufactured exports from small countries (Lloyd, 1968: 107). In this, history has probably vindicated Lloyd. Yet Lloyd's preoccupation with resisting Elkan's protectionist motives foreclosed more exploratory discussion about how Elkan's innovations might be used for liberal purposes. Had Lloyd engaged less adversarially with Elkan he might have developed his own objections more fully, and in the process contributed to improving Elkan's ideas - and of course, his own.

Lloyd argued that Elkan's proposals were cumbersome, that their "conditional nature" would increase uncertainty, and that his proposals envisaged "balanced bilateral trade for commodity groups" (Lloyd, 1968: 117). Lloyd's points are taken in turn below. Australian experience with export facilitation demonstrates that, certainly in their unilateralist form, Elkan's proposals were not cumbersome to administer. Export facilitation is administratively simple - dramatically more so than traditional export drawback. Where traditional export drawback arrangements consume significant resources in policing the requirement that imports be physically incorporated into exports
(IAC, "Concessions", 1987: 12), an import/export link operates solely on information available as goods pass through customs. For a large vehicle manufacturer the existing import/export link for the Australian automotive industry has administrative costs of approximately .02 per cent of revenue foregone and less than .01 per cent of turnover for both government administrators and major exporters.39

The regional discrimination of Elkan's principal proposals may have added to their complexity, although it is not clear that this would have created significant problems. In contemporary practice, customs services routinely, and one presumes relatively inexpensively, discriminate between imports depending on their country of origin to provide developing country preferences and to give effect to obligations under various international agreements such as the GATT. Elkan's proposals required customs services in participating countries to discriminate not only between imports from different origins, but also between exports to different destinations. It would be easier to accept Lloyd's suggestion that Elkan's arrangements were 'cumbersome' had he deliberated on the matter in this way and come to a reasoned conclusion.

Lloyd's argument that Elkan's proposals increased uncertainty by making duty remissions 'conditional' is also hard to accept. Duty drawback on exports is also 'conditional' but it is hard to see how this conditionality increases uncertainty. Lloyd may have envisaged that duty remissions would be subject to administrative discretion which would have increased uncertainty, although this was not suggested by Elkan. Alternatively, Lloyd may have been considering the fact that Elkan envisaged a market developing in export credits. This may have generated some uncertainty, but that uncertainty is analogous to the price uncertainty inherent in most markets. Given that the market for export credits would have been relatively deep - because it operated over broad commodity classes - it is unlikely that it would have been intolerably volatile. As a matter of fact, the price of export credits under the current Australian automotive export facilitation scheme has been stable since the scheme was substantially deregulated in 1991 (personal communication with officer of the AIA).

The last of Lloyd's arguments offers a casual refutation of the commonsensical naïveté of proposing "balanced bilateral trade for commodity groups" by pointing out that countries and policy makers may have a legitimate interest in the state of the overall trade balance, but not in the balance of trade within industries. In his apparent eagerness to

39 Calculations from figures provided in personal communication with Australian Customs officials in the Automotive Plan Administration Section in Melbourne, and a major Australian vehicle manufacturer, 23rd March 1994.
puncture the fallacy in this piece of economic naturalism, Lloyd fails to notice that Elkan does not advocate it. Elkan does point out that, under certain assumptions his system "could be expected to produce . . . pressures towards the maintenance of balance in the exports and imports of each member country in each major commodity class", and he clearly regards this as healthy in the context of the article (1965: 57 emphasis added). Elkan does illustrate his proposals with an example which is offered approvingly of bilateral trade balance within a customs-drawback-union. But it is far from clear that he is advocating that balanced bilateral trade either within commodity classes or more widely be mandated within customs-drawback-unions.

Lloyd may have been right to have been skeptical of Elkan's concern about the potential of traditional trade liberalisation to generate increasing and immiserising inter-industry trade specialisation for small countries. He may even have been right to have interpreted Elkan to be advocating balanced trade within commodity classes - although I think it unlikely. But neither objection exhausts the relevance of Elkan's innovations. Whatever the motivations of their originator, the arrangements offered an administrative tool with which one could systematically discriminate between intra-industry and inter-industry trade expansion and liberalisation with a view to optimising trade creation wherever it was desired/possible according to the opportunities or constraints one faced. Lloyd was in substantial agreement with Elkan that, for small countries, "[g]ains from increased specialisation within plants and industries when a customs union increases the size of the market . . . could be substantial" (Lloyd, 1968: 110). As he conceded, Elkan's innovations provided a means by which these gains could be enjoyed (1968: 117). And although Elkan's objective was to "hinder, or at least limit" inter-industry trade, as Elkan himself pointed out, his instruments could be tailored to operate in the presence of any degree of inter-industry trade (1965: 57-8).

Like a number of critiques of similar proposals to be encountered in subsequent chapters, Lloyd's critique offers a powerful illustration of profligacy of dialogue as contest. It forecloses the degree of openness which is so often necessary to grasp the manipulative opportunities which good science and good policy require. As Elkan was at some pains to demonstrate, his ideas were offered in a protean form with meliorative and so fluid rather than peremptory intent. But Lloyd's critique oriented itself around its disagreements with Elkan and so forsook the opportunities which would have been available from dialogue as cooperation. Lloyd appears anxious that Elkan proposed to introduce a constraint on trade liberalisation - namely a constraint on the extent of inter-
industry trade liberalisation involved in a customs union; yet this is not intrinsic to the proposals.\textsuperscript{40}

However Lloyd's concern invests Elkan's proposals with the protectionism of their author when this is doubly unnecessary. Firstly, it is unnecessary because, for all instruments of partial trade liberalisation, whether they liberalise trade sufficiently is in the eye of the beholder. By providing the means to administratively separate intra-industry and inter-industry trade liberalisation, Elkan's proposals might provide the means to expand trade far more than would otherwise be the case - where for instance there were political or other obstacles to greater inter-industry trade liberalisation. Secondly, it is unnecessary because Elkan's proposals are essentially independent of inter-industry trade liberalisation which, as Elkan pointed out,\textsuperscript{41} can proceed alongside his proposals. Nothing prevents them being combined with greater inter-industry trade liberalisation by way of traditional trade liberalisation measures. Indeed Elkan devoted an entire section to "accommodating complementary [inter-industry] trade". Here he explained that his preceding exegesis of the workings and argued benefits of his proposals assumed that, before the customs-drawback-union was formed, "the composition of the mutual exports of the member countries was fairly similar and the problem was to prevent its becoming dissimilar in the future". As this assumption is relaxed, Elkan explains that the arrangements can be tailored to suit specific circumstances. They can be tailored to suit some members' continuing high levels of complementary specialisation in primary products, either on a temporary or permanent basis, as they can be tailored to other priorities including progressive trade liberalisation (1965: 57-8).

\textsuperscript{40} As part of his critique of Elkan's proposals, Lloyd cites Balassa's criticism of customs unions in Latin America. The arrangements criticised by Balassa appear to have required trade to balance between individual members of a customs union in the interests of "reciprocity". As Balassa pointed out that "the emphasis on equilibrium in inter-area trade appears to be misdirected, however, since it puts an additional constraint on the flow of international trade. As long as each nation's balance-of-payments with all other countries, taken together, is in equilibrium, it matters little whether they have a surplus or a deficit in intra-area trade" (Balassa, 1965: 120).

\textsuperscript{41} Elkan points this out with regard to further liberalisation towards customs unions (1965: 58) as this was the principal subject of his paper, but the same is clearly true of further unilateral trade liberalisation by way of tariff cuts.
Elkan's ideas were sufficiently good that it was necessary to re-invent them. Ironically one of the re-inventors was Peter Lloyd. Nevertheless when re-invention occurred, the clarity which Elkan had offered about policy design was absent. Commentators were more explicit about the kind of economic development they felt should be facilitated than they were about the actual policy instruments necessary to facilitate such an outcome. In 1975 Grubel and Lloyd deliberated briefly on "Development Strategies" in their book on Intra-Industry Trade. Noting that import substitution often severely limited the size of the market in developing countries, they approvingly noted proposals to establish "regional production facilities" such that countries in a region could each host some such facilities which would then swap their produce assisted by "duty free access of the industry's output in all countries of the region" (1975: 145). They continued that the "concrete policies" implied by their analysis suggested that countries should develop capabilities in narrow product lines of specific style and performance characteristics "while permitting the import free, or under much lower protection, of other commodities of the same industries" (1975: 147). Grubel and Lloyd also suggested automotive industry policies which encouraged specialisation within global networks rather than the more usual aspirations towards domestic sectoral self sufficiency (Grubel and Lloyd, 1975: 146-7).

Despite their promise to spell out "concrete policies" - the institutional arrangements which might facilitate such development and trade - Grubel and Lloyd offered nothing further. It is therefore unclear precisely how they proposed to realise the intra-industry trade facilitation of which they spoke. However the most systematic attempt to do so had already been offered a decade before by Elkan. His proposals offered the means with which to systematise - both intellectually and operationally - intra-industry trade facilitation/liberalisation in the presence of continuing protective arrangements. Elkan had shown how his own arrangements would produce precisely the kind of intra-industry trade and specialisation to which Grubel and Lloyd were referring - indeed they had been devised largely with this in mind. One of his illustrative examples showed
how his arrangements would facilitate precisely the kind of intra-industry specialisation in automotive production of which Grubel and Lloyd later spoke (Elkan, 1965: 55). But after Lloyd's dismissal of Elkan's ideas in 1968, neither Elkan's name nor his proposals were ever mentioned again in academic discussion, even for the purpose of disputing their worth (see head quotation § 4.6.1).

4.6.3 'Intra-Industry Trade Policy', Trade Liberalisation and 'Lessons' from Developing Countries

The ground for the 1960s transformation to export orientation was broken some five to six years earlier - that is, before it could be realised how beneficial the transformation of policy begun with the customs rebate would prove to be. When the liberalisation efforts were made, no one had any inkling that a more prosperous growth epoch was in the making. The early efforts were not ideologically motivated by any clear vision of the advantages of externally oriented growth, and there was only a vague awareness of the benefits of comparative advantage. The late 1950s reform measures were adopted for a pragmatic reason, namely to reduce reliance on American aid and to solve the problems of unemployment and foreign exchange shortages.

Taiwanese Minister Li, 1988: 135

The instruments which appear to facilitate intra-industry trade and specialisation within industries have existed for many years. The new development literature documented the fact that policy to ameliorate the intra-industry trade suppressing effects of traditional protection was widespread in developing countries. Little et al noted the dramatic expansion of Taiwanese exports "based largely on imported materials" and the accompanying system of rebating import duties on inputs to export (1970: 254-5). Balassa et al documented export drawback systems in Chile, Mexico, Pakistan and the Philippines (1971 see index). And the Bhagwati/Krueger-directed study noted that import concessions under quantitative restriction regimes were frequently linked to export performance in a variety of ways. To the above list of countries the Bhagwati/Krueger study added India, South Korea, and Columbia (Bhagwati, 1978: 24). Economists may have played some role in the origination and implementation of these instruments (eg see Haggard, 1990: 99), but the new approach owed much to exploratory and pragmatic adaptation to the exigencies of economic development in difficult circumstances (see head quote above).

The earlier new development literature did not stress the importance of duty drawback instruments. Nevertheless, by the mid 1980s the importance of 'free trade for exporters' had become a 'lesson' from East Asian success, and one which was strongly oriented
around the free markets versus intervention dichotomy. Balassa argued with more boldness than the more qualified original studies, that Korea and Taiwan had applied a "free trade regime . . . to exports" (Balassa, 1989, "Adjustment": 2 also see Krueger, 1985: 208). This is drawing a long bow. There were plenty of exporters in both Korea and Taiwan who were not given duty free access to inputs (Wade, 1990: 140, Luedde-Neurath, 1986, Chapter Two). Nevertheless this interpretation of one theme of Korean and Taiwanese trade and development policies was useful in the same way and for the same reasons that Hicks' assumption of perfect competition was useful: the liberties it took with the truth may not have been too great, and if so, there were large pay-offs from the generalisation. Balassa's interpretation of Asian development success offers more general, robust and useful implications - and ones which are more easily accommodated into the existing economic corpus than many which emerge from alternative approaches. In this case, Balassa's generalisation permitted him and others like Krueger to argue for the importance of instruments such as duty drawback in allowing "ready access to the international market for whatever purchases [exporters] may require" (Krueger, 1985: 208).

4.6.4 Intra-Industry Trade Theory, New Development Consensus and the Corpus of Normative Economics

A much employed, yet seldom studied instrument of international trade policy is export drawback.
Mark Herander, 1986: 43

Despite the recent proliferation of free trade zones little effort has been made to apply trade theory to this phenomenon.
Kaz Miyagiwa, 1986: 338

Chapter One argued that modern economics tends to be too polarised between 'free trade' in 'intervention' and that it both overvalues the benefits and undervalues the costs of formalism. In this context intra-industry trade 'theory' provides an illustrative vignette. As is the case with its disciplinary cousin, strategic trade theory, the normative significance of the new modelling work is frequently discussed only in terms of its implications for the old debate between free trade and protection (eg Greenaway, 1985). And when thinking about intra-industry trade moved from the suggestive informality of the 1970s to a burgeoning of formal modelling in the 1980s, not only was there a barren harvest of useful new insights for policy, some of the older insights seemed to slip further from view.
In 1974 Corden embraced the conjunction of the 'optimal intervention' and 'new development' literatures in arguing that subsidies were 'first best' intervention and commenting on the costs of the 'home market bias' associated with tariffs (see § 3.4.1 above and 1974: 4, 24). By 1984 Corden was commenting on the difficulties which formalism encounters with scale economies and imperfect competition . . . "The search for simple general principles and for clear results that do not depend on very special cases is still under-way" (1984: 77). Yet in the new development literature, scale economies had been taken to strengthen the case against tariffs which was established in the first place by the principles of optimal intervention.

Greenaway's mid 1980s survey of the normative implications of the new sub-discipline of intra-industry trade theory is similar to its disciplinary cousin - strategic trade theory - in its orientation around the free trade versus 'intervention' dichotomy and its ultimate ambivalence about policy. Commenting that some models of intra-industry trade suggest that tariffs can increase welfare, Greenaway does add that generally in these instances the tariff is actually correcting a domestic distortion. He comments that if so, other policies - particularly subsidies - could usually correct the domestic distortion at lower cost (1985: 87-8, 90). Again, this is the essential insight of the new development consensus. Nevertheless having made this observation Greenaway proceeds to retreat back into ambivalence. He warns against any generalisations, including the conclusion that subsidies are generally superior to tariffs (1985: 96).

Certainly the new intra-industry trade literature showed virtually no interest in ameliorating the intra-industry trade suppression entailed by existing protection despite the widespread existence of such policies. I have not found any analysis or even sustained discussion of the instruments of what I have called 'intra-industry trade policy' in this literature. The plausibility of the 'new development consensus' meliorative case for replacing protection with promotion was thus obscured within the rigours of the new formalism.

For all its persuasiveness and plausibility, the 'new development consensus' had virtually no impact on the disciplinary corpus of the normative economics of trade liberalisation. While debate raged as to whether developing country success had been due to the success of 'free trade', 'free markets' or 'intervention', there was much more limited attention to the policies which the successful countries used to expand trade. As Luedde-Neurath put it in 1986, a preoccupation with the polarities of the protection debate seemed to have come at the cost of practical advice. "[R]elatively little is known . . . about the art of intervention in trade. Most studies condemn or support it, but
have little practical advice to offer on how an LDC [less developed country] might gain
the benefits and avoid the pitfalls of opting for trade controls" (1986: 181).

Many developing countries keen to participate in product cycle and intra-industry trade
pioneered the instruments of intra-industry trade facilitation. Those instruments included
duty drawback schemes which went beyond simple export drawback towards
arrangements such as Elkan had suggested and also export processing zones (EPZs).
Some fairly limited normative economic analysis of both export processing zones and
duty drawback mechanisms exists in the economic literature (Warr, 1989; Grossman,
1982; Herander, 1986). Other instruments, such as Elkan's import/export links have
gone all but totally neglected. And in the corpus of normative economic theory, there
has been little attention given to the way in which these new instruments might refine the
specification of worthwhile trade liberalisation paths. Whilst significant attention has
been paid to the trade restrictionism of the 'new protection' such as voluntary export
restraints (VERs) in the West, there has been less attention given to those trade
expanding instruments whose position on the 'free trade' versus 'intervention' spectrum is
more ambiguous.\footnote{\textsuperscript{42}} In his book on \textit{The Economics of Protection}, a "comprehensive overview of the theory of protection" (1990: xii), Neil Vousden provides elaborate
treatment of the traditional economic analysis of protection and trade liberalisation and
lengthy discussion of the recent innovation of VERs without so much as mentioning
EPZs, duty drawback or import export links.

\section*{4.7 A Concluding Taxonomy of Intra-Industry
Trade Facilitation Policies}

This chapter can usefully be summarised in the following table which offers a taxonomy
of intra-industry trade liberalisation strategies. Firstly, intra-industry trade liberalisation
can occur as a result of traditional trade liberalisation - either unilateral or regional. It can
also be achieved on an \textit{ad hoc}, sectoral basis between countries which may not otherwise
be engaged in preferential regional trade arrangements, as Kojima and Drysdale
suggested. And then there are the instruments of intra-industry trade liberalisation which
operate in the presence of traditional protection. These exempt those engaging in intra-

\footnote{\textsuperscript{42} Thus for instance, by the mid 1980s VERs had come under "intensive study" (Corden, 1985, p. 2). The "ECONLIT" Database to September 1993 lists 72 items on VERs. It lists 43 items discussing 'export processing zones', 'duty free zones' or 'free trade zones' several of which concern free trade areas or customs unions \textit{between} rather than within countries. It lists one article each on duty drawback, duty remission and import/export links (the latter is in fact an article on import/export \textit{requirements} - Herander and Thomas, 1986).}
industry trade from duty. They include traditional instruments such as export drawback and more modern innovations such as EPZs. They also include import/export links as proposed by Elkan. It is worth noting that where the table cites actual examples of intra-industry trade liberalisation mediated by private agents, those episodes tended to be successful. Where extensive administrative mediation by the state was involved, the success of intra-industry trade liberalisation was often limited.

**Table 4.2 Intra-Industry Trade Facilitation Policies**

<table>
<thead>
<tr>
<th>Co-ordination Mechanism</th>
<th>Intra-industry trade liberalisation</th>
<th>Administrative oversight of firms</th>
<th>Market mediation of comparative costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intra-industry trade liberalisation as a consequence of traditional trade liberalisation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>With traditional trade liberalisation</td>
<td>• No examples</td>
<td>• Tariff reduction leading to intra-industry trade expansion</td>
<td></td>
</tr>
<tr>
<td>As part of more comprehensive regional trade liberalisation</td>
<td>• No examples</td>
<td>• Sweden's free trade Agreement with the EEC</td>
<td></td>
</tr>
<tr>
<td>Variations on traditional trade liberalisation to facilitate intra-industry trade</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Traditional trade liberalisation targeted towards non-traditional (intra-industry) trade expansion</td>
<td>• No examples</td>
<td>• Kojima's suggestions for greater 'horizontal trade' between developed Asia-Pacific economies</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Drysdale's proposal for sectoral free trade between Japan and Australia.</td>
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<tr>
<td>Intra-industry trade liberalisation in the presence of traditional trade barriers</td>
<td></td>
<td></td>
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<tr>
<td>Non-traditional trade liberalisation (duty remission)</td>
<td>• Export credits in Australian local content scheme</td>
<td>• Export duty drawback</td>
<td></td>
</tr>
<tr>
<td>Unilateral/Multilateral</td>
<td>• Some import/export links in developing countries</td>
<td>• EPZs in developing countries</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Elkan's footnote</td>
<td></td>
</tr>
<tr>
<td>Bilateral/Regional</td>
<td>• Article 3.7 of NZAFTA</td>
<td>• Canadian 'extended content', Australian export facilitation</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• ASEAN 'part to part' complementation</td>
<td>• Elkan's proposals for customs-drawback-unions.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• The US-Canada Auto-Pact</td>
<td></td>
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</tbody>
</table>

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5 The Economics of Trade Liberalisation: Reform Principles, Priorities and Paths

[The] idea of a sequential order of policies of course also entails the notion of policy priority in the liberalisation process.

Gustav Ranis, commenting on Minister Li's description of the Taiwanese development experience, in Li, 1988: 23

As previous chapters have argued, economists' perspectives on trade liberalisation have been (and continue to be) unnecessarily constrained by a focus on the direct dismantling of trade restrictions and a consequent neglect of other liberalisation options, particularly concessional instruments. This chapter sketches out a much wider arena of 'new trade liberalisation' within which the economics and political economy of the new instruments might be considered. This allows the discussion of trade liberalisation priorities - something which has been largely absent from the literature. This in turn enables a consideration of the merits of import/export links, such as the Australian export credit scheme (see § 4.5.2), as trade liberalising instruments. The chapter accordingly concludes by discussing some of the arguments for and against the automotive export credits scheme in the Australian automotive industry in the early 1970s.

5.1 The Economics of Import Concessions

Another matter ... is the availability to domestic industries of materials and components at or near world prices.

IAC, 1973-74, Annual Report: 19

This and the following section sketch a canvass which incorporates the instruments of 'concessional trade liberalisation', into orthodox economic thinking on trade liberalisation. In a sense the analysis has already begun with the definition of 'concessional trade liberalisation'. One can proceed to define the archetypal concession as an entitlement to import which overrides existing official trade barriers. As will be shown below, it is possible to imagine 'concessional trade liberalisation' of a sufficiently 'pure' form that it reduces to one of the two sanctioned reform rules, top down and across the board reform. And in more 'selective' forms, import concessions offer means of focusing trade liberalisation around particular trade expansion/liberalisation opportunities and priorities.
One can imagine 'pure' import concessions of at least two kinds. A 'value concession' would entitle the holder to import a certain value of imports. Alternatively what will be called a 'duty paid concession' would stand in lieu of a certain quantum of duty paid at customs. Assuming that, once allocated, these concessions are transferable and that firms buying them are perfect competitors, then an expansion of concessions to the point at which they are in oversupply will lower their price. This produces the following results:

**Proposition 1.1:** 'Value concessions' will be used to import those goods which, in the absence of such concessions, would be the most costly to import. Accordingly, where the price of such concessions falls, top down trade reform is the result.

**Proposition 1.2:** 'Duty paid concessions' will be used where they reduce the cost of paying duty. Accordingly, where the price of such concessions falls, the cost of paying any given amount of tariff duty will fall. If all trade restrictions are tariffs, this produces equi-proportional across the board tariff reform.

As has been case with tariff reform generally, actual episodes of reform are 'messier' than any 'ideal type' of reform can generally afford to contemplate. It is possible to characterise the gamut of instruments of 'new trade liberalisation' as examples of import concessions which have been constrained in various ways. Such constraints include:

- limitations on the imports to which concessions apply
- limitations on their transferability and/or
- requiring firms to do something - such as invest or export - in return for concessions.

This complicates the analysis of the effects of such instruments. Be that as it may, a mosaic of instruments have been used in developing countries. To many of these instruments it is possible to attach some trade liberalising 'rationale'. Concessional instruments can provide the policy maker with a menu of options which accelerate the trade liberalisation path in given situations in certain ways. Trade barriers discriminate against a wide range of identifiable entities in an economy. They discriminate against certain industries, export activities within industries, and certain firms and regions. Accordingly particular trade expansion cum development opportunities may be evident within firms, industries or regions. Partial import concessions can target the removal of

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43 Applying the Coase Theorem, it may be assumed that the method of allocation has no effect on resource allocation where holders and buyers of concessions are perfect competitors and concessions are freely transferable. Unless otherwise specified, these assumptions are generally made throughout.
any of these undesired effects as a priority in a trade liberalisation and development strategy, in each case with differing and complex effects on trade creation and trade diversion and so welfare.

5.2 A Taxonomy of Trade Liberalisation Paths

Policymakers have something on their side. Recall that deficit spending as an instrument to create employment preceded the General Theory. Economists should be a little more cautious in assuming that policy wisdom is necessarily on their side. In the area of trade policy I . . . doubt whether we are immensely smarter than the policy-makers.


The table appearing below explores the deep symmetries between traditional tariff dismantling and 'concessional' or 'new trade liberalisation'. In the case of each possible path of reform (Column One) the following propositions clearly hold:

Proposition 2.1 A partial trade liberalisation measure may or may not lead to a net liberalisation of trade, depending on the nature of the action and its context.

Proposition 2.2 Where the complexity of actual economies and existing policies are taken into account, there are likely to be both welfare improving and welfare impairing aspects of most if not all available measures in the case of each type of partial trade liberalisation.44 (These ideas were explored by Viner in the customs union literature by way of the concepts of trade creation and trade diversion.)

Proposition 2.3 As has been done with customs unions and the direct tariff reduction, 'rules of thumb' can be found to indicate what reforms are likely to promote welfare and in what circumstances. Some rules of

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44 Thus with tops down tariff reform, some of the gains from cutting assistance to the industry receiving the highest level of assistance will be enjoyed by the next most highly assisted industry. The reduced size of the rationalised industry will improve welfare (and create trade) whilst the increased size of the next most assisted industry will reduce welfare (and divert trade). Generally, however, the first effect is concentrated, whilst the second effect is diluted, producing the net gains which are usually associated with tops down reform. Given standard neoclassical assumptions, equi-proportional tariff reduction will generally produce unambiguous gross welfare gains without any gross losses (Vousden, 1990: 209). However the confidence with which one may assume that either of the two orthodox reform rules will produce unambiguous welfare gains must wane as the standard neoclassical assumptions are relaxed (Vousden, 1990: 210).
The strength of propositions 2.4 and 2.5 in the argument for at least considering pluralistic approaches to trade liberalisation should be apparent. Proposition 2.4 drives home the point that the differences between the different instruments in trade liberalisation are differences in the path trade liberalisation takes. It also shows how misleading it can be to refer to the orthodox reform rules as 'first best' and heterodox approaches as 'second best' by contrast. Except for the fact that reform moves do not liberalise trade totally and instantly - something common to moves on all reform paths

45 Note that the 'free trade' spoken of here is different for different rows. The path to free trade referred to in rows 1-6 is unilateral free trade, whilst the path to free trade referred to in row 7 is global free trade. Note also that in the case of import export links, further expanding them (as set out in the table) will produce freedom of trade, if one can assume that the trade balance will not change as a result of trade liberalisation. To produce free trade which is consistent with changes in trade balances, one could allow exports to qualify for more or less than their own value in imports. This would enable the country to run a free trade deficit or surplus of any given size.

46 Proof: Assume that a country has trade barriers. Take any of the instruments of unilateral trade liberalisation (Rows One to Six) and move sufficiently far towards free trade that whatever trade barriers remain, trade creation outweighs trade diversion and so there is net trade liberalisation. Now repeat this step for any other instrument of unilateral trade liberalisation. The two instruments chosen now complement each other in liberalising trade.
other than the last move - each instrument is 'second best' and reaches free trade according to its own properties. One distinction which remains is between 'compensatory' reform and other approaches. For compensatory approaches may be able to liberalise trade, but they cannot in any practical sense complete the job of fully liberalising trade on their own.

Pluralism in global trade liberalisation is now well accepted (eg see Dunkel, 1993). For instance, as Australia and New Zealand are showing, unilateral, multilateral and regional trade liberalisation can be combined in trade liberalising ways (also see Johnson, 1968: 167). In the example to be pursued below, tariff reduction and import/export links generally complement each other. Regional trade liberalisation is also being supplemented in Asia with sub-national regional trade liberalisation in the case of the newly fashionable growth triangles. Again, by way of example, regional trade integration can be combined with intra-industry trade liberalisation using Elkan's customs drawback union arrangements. And as several participants to IAC inquiries into the automotive industry argued, an import/export link in the automotive industry might well have raised the 'speed limits' to automotive tariff reform by lowering automotive manufacturing costs (see Chapter Nine below).

Each row in the table represents an 'ideal type' for the purposes of taxonomy, although of course the instruments mentioned have usually been used in 'messier' ways and frequently in conjunction with each other, and with other assistance methods. Likewise as the table illustrates, different liberalisation instruments will accelerate the achievement of different types of 'economies of integration' at different stages of the reform process. For instance, import/export links will typically accelerate the achievement of economies of intra-industry trade and specialisation whereas tariff reduction will accelerate the achievement of inter-industry trade and specialisation. The 'integration economies' accelerated by the instruments of 'new trade liberalisation' frequently comprehend some or all of those in Column Three from Rows Two to Five.

Row six is a whimsical but not entirely flippant inclusion designed to illustrate the plenitude of ways to liberalise trade. Personal trust and affinity between relatives is sometimes an important engine of trade expansion. Accordingly it is possible, at least in principle, to design a trade liberalisation path around such a possibility. For the record, other capricious ways for a country to liberalise trade would be to reduce penalties on, 'de-criminalise' and finally legalise smuggling, or to expand and make transferable the 'duty free' concessions of international travelers.
### Table 5.1 A Taxonomy of Trade Liberalisation

<table>
<thead>
<tr>
<th>Type of Trade Liberalisation</th>
<th>Liberalisation Instrument(s)</th>
<th>Integration Economies</th>
<th>Examples</th>
<th>Path to Free Trade</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Inter-industry trade liberalisation</td>
<td>Quota Expansion, tariffication, tariff reduction</td>
<td>Inter-industry specialisation</td>
<td>Australia, New Zealand, Chile</td>
<td>Tariff and quota removal</td>
</tr>
<tr>
<td>2 Intra-industry trade liberalisation</td>
<td>Import/export links.</td>
<td>Intra-industry specialisation</td>
<td>Canada, Korea, Singapore, Australia</td>
<td>Expand import/export links across industries.</td>
</tr>
<tr>
<td>3 Sub-national trade liberalisation</td>
<td>Export processing zones (EPZs).</td>
<td>Accelerated factor (usually wage) price equalisation,</td>
<td>Wide range of LDCs</td>
<td>Expand EPZ to cover all domestic firms</td>
</tr>
<tr>
<td>4 Firm specific trade liberalisation I</td>
<td>'Brand to brand complementation'</td>
<td>Economies of common governance</td>
<td>ASEAN countries</td>
<td>Expand eligibility for import permits</td>
</tr>
<tr>
<td>5 Firm specific trade liberalisation II</td>
<td>Negotiating import rights with individual firms.</td>
<td>Product cycle trade, Technology transfer and foreign direct investment</td>
<td>Japan, Korea, Taiwan, and a range of other Countries</td>
<td>Expand concessions to all firms</td>
</tr>
<tr>
<td>6 Alphabetical Trade Liberalisation</td>
<td>Import permits for persons with certain surnames</td>
<td>Personal affinity</td>
<td>Countries with strong systems of personal patronage</td>
<td>Expand names eligible for permits</td>
</tr>
<tr>
<td>7 Regional trade liberalisation</td>
<td>Regional free trade areas</td>
<td>Regional trade expansion</td>
<td>Countries of</td>
<td>Expand trade blocs.</td>
</tr>
</tbody>
</table>

Sources:


b See Warr, 1989. In a sense both Singapore's and Hong Kong's status as entrepôt ports meant that they identified their whole economies as 'export processing zones'.

c The Economist Intelligence Unit, 1985: 71 and see Chapter Four above. Note also that this empirical example in fact operates in a regional context. 'Brand to Brand Complementation' is generally available only within the ASEAN block.

d Rodrik, 1993: 18-9

The instruments of the 'new trade liberalisation' comprehended in Rows Two to Five were pioneered by both developing and developed countries. In each case, as one would expect, the particular innovations chosen reflected the particular developmental stage of the countries/industries involved. Developing countries paid particular attention to providing their exporters with imported inputs of capital and intermediate goods and raw materials (Balassa, 1989, "Adjustment"; Krueger, 1985). By contrast, successful
innovation for Canada's more mature automotive industry focused around facilitating intra-industry rationalisation and trade in differentiated final and intermediate automotive products. Similar instruments to the 'extended content' arrangements first used in Canada were being advocated for the Australian automotive industry. However here the trade to be facilitated was not just the intra-industry trade in similar goods sought for the Canadian industry - but also product cycle trade within the automotive industry with Asia with Australia as the technological leader.

5.3 'Subjective' and 'Objective' Resistances to Trade

It is useful at this stage to refer to Drysdale's and Garnaut's proposed distinction between 'objective' and 'subjective' resistances to trade. 'Objective' resistances comprise transport and other (generally) physical obstacles to trade and official barriers to trade imposed by governments. 'Subjective' resistances comprise a range of social, psychological and institutional factors which limit the power of competitive forces to produce economic integration - or movement to uniform pricing of commodities - between different regions. Drysdale and Garnaut comment that the cost of overcoming trade resistances has received scant attention in the *corpus* of trade theory except for the "cameo appearance" of subjective resistances in "the theory of the product cycle". Later they comment that much of the dynamism of Asia-Pacific trade expansion has come from the "progressive reduction of subjective and objective but non-official resistances to trade."

The process has been driven by independent enterprises' search for more profitable patterns of trade, sometimes assisted by provision by governments of public goods that affect the operation of private markets (1992: 7, 10, 12 emphasis added).

Drysdale's and Garnaut's conclusion supports their opposition to discriminatory - *ie* regionally preferential - trading arrangements in Asia. However, they stop short of a suggestion which is more interesting for this thesis. The dramatic reduction of 'subjective' resistances to trade in rapidly developing countries has frequently been underwritten by governments targeting precisely the kind of trade which Drysdale and Garnaut associate with the reduction of 'subjective' resistances to trade - product cycle trade. Developing countries have frequently sought to encourage the establishment of 'export bases' which might find some 'niche' in the international division of labour -
Chapter Five

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frequently within a particular industry.\textsuperscript{47} Often low income countries have found such niches in assembling imported components for re-export frequently with the help of imported capital equipment. And, to a considerable extent, the instruments of concessional trade liberalisation as outlined in the above table have been instrumental in targeting trade reform so as to capture such opportunities (\textit{eg} see Mauritius as discussed in § 5.4 below).

5.4 'Policy Directness' and 'Real Directness'

If we could first know where we are, and whither we are tending, we could better judge what to do, and how to do it.
The Jackson Report quoting Abraham Lincoln, 1975: ix

Assume that at free trade, a particular low wage country would be a major exporter of clothing, and that it currently has significant trade barriers on various inputs into clothing production, including textiles and capital equipment which provide apparel manufacture with negative assistance. Assume further, and not implausibly in a highly competitive international market, that international demand for clothing exports from this country becomes progressively more elastic as free trade is approached. Under an orthodox reform path, the barriers to exports (which are most directly the barriers to the import of apparel inputs) would not be eliminated, but rather phased out. Here the two neoclassical trade reform rules would forego much beneficial trade expansion until they take the country relatively close to free trade.

The 'neoclassical' and 'symmetrical neoclassical' reform rules as set out in Chapter Three might be described as 'policy direct' in the sense that they directly address the policy to be removed, and/or its incentive effects. An alternative approach - 'real directness' - would address as a priority the most invidious effects of the unwanted policy on \textit{economic development and trade expansion}. Where policy is constrained to gradualism, policy makers cannot rationally aim to 'optimise' trade creation in any liberalisation episode - and therefore cannot devise the best gradual trade liberalisation strategy - without an idea of where the pay-offs from trade liberalisation are likely to be. By default or design, at least until liberalisation is complete, there is an important sense in which such an exercise cannot escape discrimination between domestic industries - or

\textsuperscript{47} The expression 'product cycle trade' is used broadly here to include trade which flows from countries finding niches in the production chain of an industry including the importation of capital equipment and intermediate goods for the purposes of exporting finished goods. Importing textiles to export clothing would be a form of 'product cycle trade' according to this definition.
as it has come to be known more colloquially, picking winners and losers. By contrast with 'policy directness', 'real directness' would seek to make a virtue of the necessity of choice in order to 'optimise' trade creation and development in each partial trade liberalisation episode. Real directness could be pursued with either orthodox, 'anomalous', 'compensatory' or 'concessional' trade liberalisation depending on the circumstances.

Of course, where it deviates from the orthodox rules, such a strategy is probably more fraught with the dangers inherent in 'picking winners' - that danger being that the 'picking' is done badly. And as a country moves closer towards free trade, the confidence with which policy makers could 'target' particular industries for 'compensatory' or even concessional assistance to offset the invidious effects of existing trade restrictions would probably fall. But in the hypothetical country discussed above, the assumption that clothing exports will increase with free trade may be a safe enough bet. And there can be strong gains from such an approach. The hypothetical country is styled from the experience of Mauritius, where trade liberalisation and some other measures to reassure investors unleashed a torrent of beneficial trade expansion. Yet the extent of trade liberalisation was only moderate (Levy, 1993: 256). And it conformed neither with the top down nor the across the board rules nor their 'symmetrical' counterparts. Mauritius established an export processing zone (EPZ) and apparel exports boomed (Romer, 1993).

The concept of 'real directness' enables some more flesh to be put on the bones of the taxonomic table of trade liberalisation paths presented above. For the instruments represented in each row address a particular impediment to trade produced by traditional protection with 'real directness'. An EPZ, for instance, deals with the impediments to trade in a particular region within a country with real directness - it makes it a priority of the reform path towards free trade. If policy made the entire transition to free trade using the single trade reform instrument - in the Mauritian example by way of expanding the EPZ - other objectives of trade liberalisation would generally be addressed less directly and later in the reform path. Thus, for instance, were Mauritius to move further towards free trade it could do so by expanding its EPZ but this would discriminate against trade opportunities for firms which remained outside the EPZ. Traditional tariff reform might address their interests sooner. Where this indirectness is undesirable - where it imposes unnecessary and unhelpful constraints on the rate of reform and development - the particular instrument of trade liberalisation can be usefully supplemented with other kinds of trade liberalisation - for instance traditional tariff dismantling.
5.5 Trade Liberalisation and Export Assistance

As will be demonstrated below in the case of Australia's automotive industry, a change in the form of assistance which followed the introduction of an export credit scheme to a protected industry, interacted with the goal of reducing the extent of that industry's assistance. Although export credits would substantially reduce assistance to import replacement in some circumstances, they would increase assistance to exports and thus in some sense undermine the policy goal of reducing assistance to the industry. This interaction necessitated an attempt to think about the two objectives (as far as possible) together with a view to some 'mutual adjustment' between them. The following sections attempt to do this. They begin with an exploration of the economics of import/export links in various circumstances and in the context of trade liberalisation. Consistently with the methodological themes in this dissertation, no attempt is made to demonstrate that a particular arrangement was 'optimal'. However the discussion does demonstrate the substantial attractions associated with the industry's export credit proposals and so underlines the claim that they deserved serious consideration from economists. It will be evident from Chapters Seven to Nine that - as was the case with intra-industry trade policy more generally at the academic level - this never occurred. 'Mutual adjustment' was never achieved, either between the two objectives of trade reform - intra-industry and inter-industry trade liberalisation - or between the two parties engaged in the search for better policy - the economists of the IAC and the business interests of the industry. Indeed it was not really attempted.

5.5.1 Illustrating the Economics of Specialisation and Intra-industry Trade

Unless otherwise specified, the following sections consider an economy which is neoclassically 'well behaved'. Markets are sufficiently close to being perfectly competitive that they are treated as perfectly competitive in the long run although occasionally imperfectly competitive phenomena (particularly scale economies) enter the analysis informally. Likewise, the focus is on economic efficiency considered as the output or consumption of a nation acting as a single producer/consumer. Distributional issues are generally not considered. Note however, that intra-industry resource movements often have significantly milder impact in terms of both adjustment costs and distributional impact than inter-industry resource movements (Grubel and Lloyd, 1975: 127-9; also see Krugman, 1978: 15 Chen, 1995 and IAC, "Reductions", 1982: 94).

This sub-section develops a simple heuristic illustration of the economies of intra-industry specialisation and trade. The diagram in Figure 5.1 is a simple variant of the
usual partial equilibrium Marshallian supply and demand diagram for an importable into a small country. It has the traditional 'scissors' of domestic supply and demand schedules and a horizontal schedule representing infinitely elastic supply and demand around the world price. The focus is on long run partial equilibrium and on 'the industry' rather than a firm. The analytical foundations of the diagram come from the HOS world in which trade is driven by comparative factor costs. Therefore, strictly speaking, the diagram illustrates HOS intra-industry trade - say the simultaneous export of steel furniture and import of plastic furniture - rather than intra-industry trade reflecting product specific scale economies. Nevertheless, the welfare conclusions to which the diagram gives rise for HOS assumptions are suggestive of similar conclusions for non-HOS intra-industry trade. The following changes to the traditional diagram allow the illustration of intra-industry trade.

1) Instead of dealing with discrete products, an aggregative perspective is invoked which is akin to the mapping of macro-economic aggregate supply and demand schedules. The analysis focuses on aggregate long run supply and demand in a domestic 'industry' producing a complex range of products which are variously 'comparatively advantaged and disadvantaged' against overseas producers, given their domestic factor costs. By analogy with their macro-economic counterparts, the axes of the industry diagram measure 'aggregate prices' and 'aggregate physical output' across the industry as measured by appropriately weighted indices.

2) Because of its diversity, the industry may both import and export. This requires two supply schedules - the supply (export) schedule \( S_e \) and the supply (domestic) schedule \( S_d \). As the industry's production increases, this drives factor prices up and so both \( S_d \) and \( S_e \) slope upwards. Exporters take the 'world import price' for their exports, but pay transport and tariff costs. This ensures that supply to the domestic market for any product within the industry commences at a lower cost than supply to export markets. Superimposing the supply (export) schedule onto the diagram and translating it sufficiently to the right to make its origin touch the \( S_d \) curve produces the basic diagram illustrated below. As output rises beyond the point of export viability, the supply curves bifurcate and there is 'double counting' in the diagram. In Figure 5.1, total output at free trade equals production for the domestic market (B) plus production for

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48 The industry I have in mind is Australia's automotive industry. However it is not necessary to define the industry with great rigour to render the subsequent exposition coherent. There must simply be two sectors in the domestic economy - 'the industry' and 'other activities'.

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the export market (C-A). The quantity of goods imported equals D - B.
As drawn here, the industry is in trade deficit as (D - B) > (C - A).

3) The diagram provides a way of representing the costs of inward orientation. Because of the domestic demand for variety, beyond some point the domestic industry cannot expand its domestic sales without incurring rising 'diversification costs' associated with diversifying production into products which it produces less competitively. After they become significant, 'diversification costs' rise at an increasingly rapid rate as output for the domestic market rises: the \( S_d \) curve becomes progressively steeper. The domestic industry is assumed to have a significantly lower market share in export markets than in the domestic market. Accordingly there are no incentives to diversify production for export any more than production is already diversified for the domestic market. Thus, although the \( S_e \) schedule commences at a higher price/cost level than the \( S_d \) schedule, it does not experience progressively increasing 'diversification costs' as is the case with the \( S_d \) schedule. By the same token, it is assumed that 'the world' is sufficiently large that it does not experience diversification costs and that accordingly, while the cost of producing new variants rises domestically, the cost of importing them can continue to be represented by the horizontal world price line whatever level of product diversity is reached.
Note three simplifications which eliminate interdependencies between the schedules.

1) 'Diversification costs' have been made a function of output for domestic supply. It would be more realistic to say that diversity increases with the domestic industry's domestic market share.

2) Because exports use the same factors as supply to the domestic market, the two schedules are strictly speaking interdependent. This interdependency has been ignored.

3) Price changes in the domestic industry are assumed to be uniform across all its products.

However, in the principal illustrations and demonstrations to which the diagram is devoted, loosening these assumptions would complicate exposition without materially changing the outcome of the analysis. So doing is accordingly left to another time.

### 5.6 The Economics of Import/Export Links

Assume that an 'industry' - some sub-set of the economy - is assisted by a single protective trade barrier - a uniform tariff or quantitative restriction on imports - yielding the same nominal rate of assistance within the industry to all production for the domestic market. An import/export link within the industry will eliminate the home market bias of
existing protection. Trade barriers give local producers privileged access to a domestic market in which prices have been artificially inflated. Export credits give exporters precisely the same privilege and so equalise the nominal rate of assistance to export and import replacement (cf Krueger, 1978: 293). Assuming concessions are costlessly transferable, which is done below unless otherwise specified, profit seeking firms will trade them to ensure that they go to their most highly valued uses - with firms specialising in importing, exporting or any mix of the two depending on their efficiency. An import/export link will generally not impair the transparency of trade barriers. In one respect it will enhance transparency. The price at which import concessions change hands provides a measure of the nominal assistance effects of existing trade restrictions and thus a measure of any 'water in the tariff'.

5.6.1 Import/export Links as 'Intra-industry Trade Policy'.

Traditional import for re-export (export duty drawback) and export for re-import (offshore assembly) concessions are designed to alleviate the invidious effects of trade barriers on the production of goods part of which are traded during the production process. As discussed earlier, they involve substantial compliance costs associated with tracking the items in question to ensure that, for instance, duty free imports (exports) are physically incorporated in re-exports (re-imports) (IAC, "Concessions", 1987: 12 and see § 4.6.1 above). There are also difficulties in defining what constitutes 'embodiment' of inputs into outputs. Imported sewing machines are (presumably) an input into the production of Mauritian clothing exports, but they are not physically incorporated into that clothing. Traditional import for re-export schemes often fail to influence incentives throughout the production chain offering the producers of inputs to export little or no assistance since the producer of the final (exported) good can always acquire rights to import inputs duty free (Balassa, 1989: "Subsidies", 43).

Most importantly, import for re-export schemes are irredeemably partial in their capacity to ameliorate the costs which traditional protection imposes on intra-industry trade. Thus the Assistance Evaluation Branch of the IAC concluded in 1977 that duty drawback schemes for exporters did not "at all adequately compensate exporters for the tariff-inflated prices of their material inputs (Assistance Evaluation Branch, 1977: 12)". Duty drawback mechanisms are unsuited to facilitating the vast bulk of intra-industry specialisation which does not directly involve import for re-export or export for re-import (Kol and Rayment, 1989). At a time of growing diversity in demand for both final and intermediate goods, a producer might wish to specialise in the production of a particular kind of (final or intermediate) good necessitating the importation of other
products which are close substitutes in production in the short and medium term (Grubel and Lloyd, 1975: 145-6). For instance a firm might wish to achieve economies of scale in manufacturing a particular kind of product - such as a particular type of steel or automotive assembly. With short or medium term constraints on capacity this will necessitate the importation of other kinds of products from the same industry. Here imports are in some sense necessary to sustain export activity. But traditional intra-industry trade policies do not alleviate the problem.

Providing an import/export link operates over a domain which is sufficiently broad to link imported inputs with exported outputs; it can provide more efficient and rational intra-industry trade policy than traditional (duty drawback) instruments. In addition to its administrative efficiency (see § 4.6.1 above), it 'backwardly integrates' export orientation throughout the production chain. Exporters will direct the assistance they receive back down their supply chain to economise on the use of valuable import concessions. An import/export link exempts that portion of trade which is intra-industry trade - the import activity in the industry which is matched by export activity - from the costs which barrier protection would otherwise impose on it. It accordingly facilitates intra-industry trade and specialisation in both intermediate and finished products, even where imports are not physically embodied in exports.

5.6.2 Import/export Links and Protection

The rest of this section analyses the resource allocation implications of import/export links in the presence of traditional protection. To clarify analysis, the 'industry' is assumed to be the only assisted activity in the economy and free trade is assumed to be best with terms of trade changes as a result of tariff changes ruled out.

5.6.2.1 Quantitative Restrictions

Assume that an import/export link is introduced into an industry protected by quotas. In Figure 5.2, domestic production for the domestic market and domestic consumption take place at B' on the $S_d$ curve and at D' on the $D_d$ curve respectively. These levels of production and consumption correspond to the domestic price level which equals the world import price plus unit quota rent ($p_w + qr1$). The domestic industry also produces at C on its $S_e$ curve corresponding to the world import price $p_w$. 

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The industry adjusts to the import/export link in two stages.

5.6.2.1.1  

**Stage One: Increasing Imports, Falling Prices**

If the industry already exports (as is the case in the illustration above) existing exports will now earn import concessions increasing imports. This improves welfare in the same way a simple expansion of quotas would. Imports expand and prices fall to clear the domestic market. Price falls lower the rate of assistance and reduce domestic production.

5.6.2.1.2  

**Stage Two: Intra-industry Trade Adjustment**

Once the above process has run its course the situation changes. If domestic prices have not yet fallen to their free trade level, quota rents are still positive and so, exports receive assistance from the import concessions they generate and so they expand. Export growth is matched by import growth under the import/export link. There is 'symmetrical tariff reform' within the industry. The highest cost production for the domestic market is liquidated, whilst lower cost production for export markets expands. Disparities of assistance within the industry being addressed from 'above' and 'below' (cf § 3.5). The industry moves down its $S_d$ schedule and up its $S_e$ schedule. Note that as this 'intra-industry trade adjustment' proceeds, domestic prices must fall to clear increased imports in the domestic market. This reduces quota rents and the rate of assistance to
both import replacement and export accordingly falls. Intra-industry trade will expand until it is no longer profitable to expand intra-industry trade. This occurs - equilibrium emerges - when symmetrical tariff reform within the industry can go no further. The (rising) level of disability of export activity meets the (falling) level of disability of import replacement activity at the new (equilibrium) quota rent - qr(e). Production for the domestic market falls from B' to B", demand expands from D' to D" whilst exports expand from C to C" - as illustrated in Figure 5.3 below:

Figure 5.3

Generally speaking, the steeper both the \(D_d\) and the \(S_d\) curves, the more assistance must fall to allow import growth. And the flatter the \(S_e\) curve, the more exports will grow with the new assistance they receive. Because export growth equals import growth, the following relationship holds.

\[(B' - B") + (D" - D') = (C" - C)\]  

Several things follow. Firstly the social cost of additional exports is strictly smaller than the cost savings they bring about.

**Proof:** The deadweight cost of the additional exports is given by the extent to which their production cost exceeds the revenue they produce or the horizontally shaded triangular shape under the \(S_e\) curve below \(P_w + qr(e)\) and above \(P_w\).
The deadweight cost saved equals the vertically shaded trapezoid shapes beneath $P_w + qr(1)$ and the $S_d$ and $D_d$ curves and above $P_w$. By inspection, the trapezoid shapes are both strictly larger than the rectangle given by their respective bases - $(B' - B'')$ and $(D'' - D')$ - and the interval $qr(e)$. From (1), the area of those rectangles equals $qr(e)[(B' - B'') + (D'' - D')] = qr(e)(C'' - C)$. But by inspection, the horizontally shaded 'triangle' is contained by and so is smaller than the rectangle $qr(e)(C'' - C)$.

Secondly, it will be seen that where export is already viable at $P_w$, as was the case with Australia's automotive industry, the welfare gains will be large. If the $S_e$ curve is linear or concave, the $C - C''$ welfare triangle is less than or equal to half the size of the two rectangles $qr(e)(B' - B'')$ and $qr(e)(D'' - D')$, which itself is significantly smaller than the total vertically shaded areas. The result is only likely to be different with very substantial degrees of convexity of $S_e$ above $P_w$. Thirdly, despite the fall in assistance rates the industry's output rises. By inspection, as intra-industry trade expands domestic demand rises. Thus, although domestic production for the domestic market necessarily falls, it does not fall by as much as export production rises. Where the constraint on reform is the rate at which the industry declines, this means that intra-industry trade adjustment can be accompanied by further traditional trade liberalisation - in this case quota expansion.

5.6.2.2 Tariffs

Assume an import/export link is introduced into a simple uniform ad valorem tariff regime operating across an industry.

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49 It should be noted further that the welfare conclusions derived here do not depend on the relative positions of these curves but rather on the weaker assumption that exports along with supply to the domestic market are capable of responding to assistance. Given this, by the principles of optimal intervention, the most efficient way of increasing industry output with assistance is with promotion rather than protection which only provides assistance to production for the domestic market. By inspection, the above proof applies where the supply (export) curve is steeper and so rises above the supply (domestic) curve and/or where the supply export curve begins at some point above $P_w$ but below $P_w + qr1$. These geometric proofs coincide with the intuition that, where quantitative restrictions constrain an economy, export facilitation provides a means of relaxing those constraints and so improving welfare. Where there are no other tariff restrictions, the relaxation of quotas is strictly welfare improving (Vousden, 1990: 216-7). Although some of the gains from a relaxation of quantitative restrictions goes to funding exports which would not otherwise be viable, this cost is strictly smaller than the gain from increased imports - because the funds made from increased imports must fund the increase in exports.
5.6.2.2.1 Stage One: Displacement of Tariff Revenue

Existing exporters will sell their duty free concessions to those who would otherwise have to pay tariffs. This displaces tariff revenue and, for as long as any remains, imports do not rise. This produces a simple subsidy to existing exporters.

5.6.2.2.2 Stage Two: Export Expansion Further Displaces Tariff Revenue

If existing exports are insufficient to displace all initial tariff revenue, exports increase in response to assistance. They continue to displace tariff revenue and, except where exports embody imported inputs, no significant increase in imports takes place. Exporting will expand to a point where the level of disability of exporting equals the cross-subsidy available from import concessions. If this point is reached before all tariff revenue is displaced, imports will not expand and exports receive assistance at the tariff rate. So far the import/export link has acted as a simple export subsidy. Under the assumptions set out above, this simply increases the assisted industry's size and so reduces welfare.

5.6.2.2.3 Stage Three: Intra-industry Trade Adjustment

If exports expand to displace all tariff revenue, but can expand further at the level of assistance provided at that point, 'intra-industry trade adjustment' then takes place in the same way examined for quotas. Exports and imports rise by equal amounts and prices fall until equilibrium is reached (see § 5.6.2.1.2 above).

5.7 Tariff Compensation for Manufacturers?

This section outlines some of the attractions of export assistance to the automotive industry - particularly by way of an import/export link- in the context of more traditional trade reform.

5.7.1 Intra-Industry Disparities of Assistance

Australia is a small remote country with a factor endowment atypical of the main trading countries, it seems natural therefore that Australia should have a relatively large volume of inter-industry trade. But there is room for more intra-industry trade than we have now.

Ronald Duncan, Assistant Commissioner, IAC, 1978: 282

The IAC's traditional agenda explicitly encompassed reducing disparities of assistance, not only between but within industries. Providing one can reduce intra-industry
disparities of assistance without exacerbating inter-industry disparities - a point which is examined below - there are several reasons for giving intra-industry disparities a higher policy priority than inter-industry disparities. Firstly, as Peter Lloyd argued, the dispersion of effective rates of assistance was frequently greater within industries than between them (1972: 252-3; 1975: 152). Secondly, activities within industries are probably more substitutable in both production and consumption - they compete more directly in both their input and output markets - than activities in different industries (cf Lloyd, 1972: 252-3) and so disparities of assistance lead to greater allocative inefficiencies. A third and related point is that because activities within the same industry generally compete in the same input market there will be a greater level of co-location and sector specific human and physical capital within than between industries (Krugman, 1991). This strongly suggests that structural adjustment within an industry will generally have lower adjustment costs than structural adjustment between industries (see § 5.5.1). In his critique of tariff compensation, Peter Lloyd suggested the strategy of unifying rates of assistance within industries as a worthy possibility, although he preferred top down reform in both manufacturing and agricultural sectors (1975: 152). Unlike Alan Lloyd (1975: 15), he did not focus on the merits of pursuing both strategies together.

Given the inward orientation of most protection for manufacturing, unifying intra-industry rates of assistance in advance of complete tariff reform requires compensatory export subsidies for manufacturing. Without any corresponding adjustment to tariffs, export assistance will be of ambiguous value. *Ceteris paribus*, it will increase the industry's export output and therefore its total output. Tariffs may have swollen the size of manufacturing industries above their free trade optimum. But at the same time, they may nevertheless have *reduced* their export output *below* free trade levels. If this is the case, export expansion will improve intra-industry resource allocation whilst the industry's expansion will worsen it. Peter Lloyd believed that protection had reduced the export performance of Australia's manufacturers. He argued that much of the assistance to agriculture had been designed to assist agricultural exports, whereas in manufacturing it had been designed to raise the cost of imports to users - many of whom were other manufacturers (P. Lloyd, 1972: 252-3).

One might add that various governmental *systems* were export oriented for agricultural goods and inward oriented for manufacturers. Thus Australia's trade negotiating strategy focused much more on improving foreign market access for Australia's primary products than its manufacturers. Likewise Australia's regulation of domestic markets frequently imposed costs on both international and even interstate trade (Industry
Commission, 1990: 163-5). In so far as this was a protectionist measure, its aim was (presumably) to impose costs on importers of manufactures. But by deviating from international norms, unique Australian specifications would have imposed additional costs on Australian manufacturers supplying export markets.

Although export assistance will have an ambiguous effect on resource allocation, it will probably enhance productivity in several ways. If there are product-specific scale economies, export assistance will enhance productivity by securing longer production runs. Also, exports may bring a hitherto predominantly inwardly oriented industry into closer contact with the international market, with a range of potential benefits. These include widening the field of international rivalry, extending the search for profitable market opportunities, and coming into closer contact with 'best practices' in foreign markets (eg see Garran, 1994).

5.7.2 Intra-Automotive-Industry Disparities of Assistance

The automotive industry exemplified these considerations. For import replacement alone, on Stubbs’ assumptions, effective assistance ranged between several hundred per cent for assembly under the small volume plans, to a little over forty per cent for medium sized vehicles (1972: 94ff). However Stubbs calculates assistance available. The assistance actually used is a more complex matter. Given their dominant market share in the relevant sector of the market, the least assisted medium vehicle manufacturers may have competed away some of their available assistance with lower output prices. And whatever assistance was implicit in medium vehicle prices, it was only available to Australian manufacturers after they had discharged their onerous obligations under the local content plans. Those obligations could have led to component manufacturers 'capturing' some or all of the assistance available to medium vehicle assembly. Thus assistance to medium vehicle assembly for the domestic market could have been quite low or conceivably negative. And it seems clear that automotive exports endured significant negative assistance (see below).

The domestic market share of Australia's automotive industry was presumably greater than its 'natural' free trade level. But at least until the late 1970s, given the transport costs to the Australian market, it seems quite possible that, after some 'infant industry' protection in the late 1940s, car manufacturing would have prospered at free trade in the late fifties and sixties (see § 2.5.2.5 above). Given this, the industry may well have achieved greater export output and greater export orientation at free trade than it did with protection. In 1977 the IAC's Assistance Evaluation Branch estimated that automotive protection in 1974-75 imposed negative assistance at an effective rate of minus 15 per
cent on automotive parts exports and minus 60 per cent on exported vehicles - the latter figure being the second most negative of all the ASIC four digit disaggregated industry groups. At the more aggregated two digit level, 'transport equipment' received minus 31 per cent assistance, the most negative of all two digit export groups. The calculation included the effect of the two major assistance schemes then in existence - the 'compensatory' Export Market Development Grants Scheme and the 'concessional' duty drawback scheme (Assistance Evaluation Branch, 1977: 13, Table One, 3-4).

5.7.3 A 'Relative Cost' or a 'Product Variety' Shock for the Australian Automotive Industry?

The growing domestic demand for diversity increased the costs of disparities of assistance within the industry. For the more diversified Australian demand became, the greater was the diversification cost incurred by the Australian industry in achieving any given market share. In terms of the diagram developed above, it is possible to distinguish between two kinds of trade shock. Domestic output can fall because supply costs in a domestic industry have risen relative to other suppliers to the world market. This would be illustrated by downwardly shifting world supply and/or upwardly shifting domestic supply schedules. But imports can rise because domestic consumers demand greater product variety. The increased penetration of Japanese vehicles into the American and Australian markets in the 1970s had elements of both kinds of trade shock. Japanese vehicles were increasingly price (and so, one presumes, cost) competitive (The Economist, 9th April, 1994: 80; IAC, PMVs, 1981: 45). However, as Chapter Two has shown, to a considerable extent, increasing import penetration in the mid 1970s represented a 'product variety' shock. Throughout the 1960s, consumer demands gradually changed towards smaller vehicles and more specialised derivatives of passenger and commercial vehicles. And the swing towards smaller cars was given sudden new impetus by the petrol price rises associated with the first oil shock of 1973 (cf §§ 2.3, 8.1).

Assuming for the sake of illustration that the product variety shocks did not effect aggregate physical demand in the industry - only the composition of that demand - the change in consumer taste raises the cost faced by the domestic industry in achieving former levels of sales to the domestic market. This can be captured as a leftward shift of the upper portion of the S_d curve. Figure 5.4 below captures such a shock - see the changes labeled with a "1". It also illustrates the expense of an inwardly oriented response to a 'product variety' shock. Assuming that policy is constrained to return domestic production to its 'pre-shock' levels, trade barriers are introduced producing the
changes labeled with a "2". If industry assistance were increased in a way which did not discriminate on the basis of the destination of output, it could return the industry to its previous level of output at much lower cost. This is because the industry is able to increase its output to pre-shock levels at much lower cost by expanding export as well as production for the domestic market. This is true for any non-zero export elasticity of supply by virtue of the principles of optimal intervention. But the illustration shows how increasing diversification costs raise the stakes.

Figure 5.4

In fact the IAC's 1977 research on the negative assistance accorded automotive exports suggests an even more perverse state of affairs than this. For not only was the industry on a quixotic march up its increasingly unrewarding S_d curve, but the protective instruments it used to do so - tariffs, and quantitative restrictions on both vehicles and components - raised domestic costs within the industry and so actively suppressed the industry's expansion along its much more promising S_e curve. Greater export orientation would also have improved productivity within the Australian industry by facilitating higher volume production runs. Dynamic gains through the learning associated with new forms of international integration - like product cycle trade with Asia - may also have been in the offing. One would also expect greater export orientation to
have contributed to more balanced Australian trade negotiation and domestic regulation strategies, as the costs of foreign and domestic market impediments to Australian export activity became more pronounced - particularly relative to their benefits to import replacement.

5.7.4 The Directness of Intra-Automotive-Industry Trade Liberalisation

The export incentives have been vital to many companies (ourselves included), not so much because we needed help to develop our export strength, but because we needed a significant subsidy to offset:

(a) the high cost of the local content being exported
(b) the high cost of shipping cars from Australia to almost anywhere in the world - from Australia, the Tasman and Pacific oceans, for example probably represent the highest cost per mile major transport routes in the world.

Peter North, Leyland Australia, IAC, PMVs, 1974, Transcript: 1755-6.

In proposing an import/export link, the automotive industry was, as one would expect, promoting its own interests. But it was also proposing policy innovation which would have liberalised the rapidly growing product cycle and intra-industry automotive trade as a priority in trade liberalisation. The very high rates of assistance implicit in the local content plan and the protectionist industrial and political culture which the automotive industry embodied provided the policy economists of the IAC with an adversary of whose potency they were only too aware. But the relative technological maturity of the industry, its saturation of the domestic market and its strong export growth also offered them a challenge to produce a variant of trade liberalisation which was well suited to the developmental opportunities inherent in the situation.

When it came to the automotive industry, the Australian economy would have benefited from simultaneously tackling two of the impediments to trade entailed by existing protection - impediments to greater inter-industry and intra-industry trade. Yet there were clear constraints on the rate at which the industry could contract: that is, on the rate at which inter-industry trade liberalisation could proceed. And liberalising trade by tariff reductions alone tied the rate of intra-industry trade liberalisation to the rate at which inter-industry trade liberalisation was possible. Subsequent events would demonstrate that while there was also political resistance to rapid intra-industry trade liberalisation, it was insufficient to prevent intra-industry trade liberalisation being vigorously pursued, even by a Government which had often lacked courage in tackling tariff reform. The
continuing disparities of assistance and restrictions on trade within the industry entailed by orthodox reform paths meant that policy needed to address both the level of assistance, and its form. This could have been achieved by converting the existing protection into promotion - output subsidies - and reducing those subsidies over time. However this was never seriously considered. The alternative was to combine a tariff-only reform path with the export credit scheme for which sections of the industry clamoured, and would continue to clamour.

5.8 The Politics of Export Assistance to Manufacturers

I think there can be little doubt that purely from a public relations point of view specific positive measures such as export subsidies are helpful in bringing about reductions in protection against imports.

Max Corden, 1980: 27.

The above sections suggest that the arguments for some kind of tariff compensation for Australian manufacturers may have been as strong or stronger than the arguments for tariff compensation for farmers. Because of its lower adjustment costs (see §§ 5.5.1, 5.7.1 above), intra-industry trade liberalisation is likely to attract less political opposition than inter-industry trade liberalisation. Assuming for the sake of argument that 'compensatory' export assistance poses some risks to the politics of trade liberalisation - it is hard to see that the risks posed by export assistance to manufacturers are greater than those posed by export assistance to agricultural producers (as discussed in § 3.4.3 above).

Section 3.4.3 nevertheless outlined ways in which export assistance might contribute to the establishment and/or maintenance of a political 'virtuous cycle' in which export success accelerated the movement of resources into export activity - taking the economy closer to free trade - thus accelerating trade liberalisation at the same time as improving the public standing of reform and the prospects for further and faster reform. The same may be said of export assistance to manufacturers. However there are other ways in which export assistance to manufacturers may have contributed to the politics of reform. Had the export orientation of Australia's manufacturers increased more quickly, the focus of Australia's manufacturing businesses, policy makers and trade negotiators might more quickly have been turned away from their preoccupation with protection for the domestic market towards exploring ways of expanding export market penetration. Domestic debate on Australia's industry policy might have lost some of its 'identity bias'
(cf § 2.5.2.3 above) as manufacturers realised they had as much or more to lose from foreign governments' trade barriers as they had to gain from Australian trade barriers.

Australia's use of non-tariff barriers, which operated by raising costs of supplying the Australian market, might more quickly have been identified for the negative sum game that it was. And faster manufactured export growth might also have made it harder for higher cost manufacturing firms to obtain community support for more assistance. As Michael E. Porter puts it, "[c]ompanies often attribute the success of foreign rivals to 'unfair' advantages. With domestic rivals there are no excuses" (AFR, 17th July, 1990: 12). As numerous authors have suggested, in elaborating the 'new development consensus', export success can be crucial to galvanising domestic political support for liberalisation and generating a 'virtuous cycle' of trade liberalisation, success and so further liberalisation (Falvey and Kim, 1992: 914; Krueger, 1985: 14; Dervis and Petri, 1987: 251-2; Levy, 1993: 247).

5.8.1 The Political Economy of 'Concessional' Trade Liberalisation

The logical extension of complementation is free trade.

The Australian Woolgrowers' and Graziers' Council, 1979: 2

Where policy makers seek to maximise the scope for a political 'virtuous cycle' of liberalisation, 'concessional trade liberalisation' has some particular attractions over 'compensatory trade liberalisation'. For assisting exporters with privileged concessional access to the benefits of liberalisation achieves several (usually) worthwhile political objectives. Firstly, where reform is politically difficult, the interests of exporters can be balanced against the interests of the beneficiaries of import restrictions. In what might be assumed to be the mercantilist eyes of the public, those defending domestic markets might find it hard to press their interests against those winning new export markets. Secondly, as was the case with Australia's automotive industry, it is often difficult to develop decisive political support for orthodox reform. Nevertheless, where the protected industry is protected by quantitative restrictions - as Australia's industry was after 1975 - an import/export link will deliver substantial intra-industry and inter-industry trade liberalisation on its own (eg see §§ 5.6.2.1.1, 5.6.2.1.2 and 5.6.2.2.1 and 5.6.2.2.3 above).

Thirdly, if a particular reform move is attractive politically, it may generate political momentum for more of the same. Even if it is trade liberalising at the outset, beyond a certain point, more 'compensatory' export assistance will begin to undermine trade
liberalisation. For compensatory reform does not satisfy proposition 2.5 above: it cannot, on its own, achieve free trade. 'Concessional' trade liberalisation can take the economy to free trade. Although - like most trade liberalisation moves - 'concessional' reform can provoke lobbying for welfare impairing policy, it can also help set up a political 'virtuous cycle' supporting progressively freer trade. The concessions provided in export processing zones in the Philippines, Malaysia and Korea, were extended to exporters outside those zones. And as these countries become more developed, their interest in EPZs waned and more far reaching reforms took centre stage (Warr, 1989: 85). Fourthly, domestic import concessions conditional on export may establish salutary incentives in protectionist foreign markets. For foreign firms and policy makers know that, to the extent that they import from a country with an import/export link, those imports will earn concessional access to that country's market.

As subsequent chapters demonstrate, these points were appreciated and pointed out by the advocates of export facilitation. The Fraser Government seized on export facilitation as a means of both intra-industry and inter-industry rationalisation with a vigour which it failed to demonstrate for many other structural reform issues. And as an IAC minute noted, export facilitation's capacity to reduce local content was politically "easier to defend with the ability to point to the explicit requirement that exports will increase" (Minute, 16th April 1980: 14). The Woolgrowers' and Graziers' Council saw export facilitation as a particular kind of free trade which could be extended (see head quote: also see Stubbs, 1972: 79). And Minister Anthony commented on the prospect that export credits might influence other countries in the region to accept more Australian exports because the proposed export credit scheme would give them better access to the Australian market (1971, Attachment: 10).

Events since the period under study have since corroborated the argument that concessional trade liberalisation can help promote a political 'dynamic' of liberalisation. Within a decade of its adoption in the early 1980s, the most vociferous opponents of export facilitation were largely converted to its cause, and both those with and without access to it have clamoured for its extension just as firms have sought entry to Asian EPZs. Access to import/export links has no doubt been sought for the implicit assistance it provides. But with an import/export link attached to the quantitative restrictions of quotas and the local content plan, one automotive firm's export assistance was another's tariff cut and the logic which this embodies was ultimately embraced by the industry. In the 1990 review of automotive industry policy, importers sought improved access to export facilitation to improve their access to the domestic market and to place them on an equitable footing with domestic manufacturers (Industry Commission, 1990: 106).
Likewise, the previously trenchant opponent of export facilitation, the Federation of Automotive Products Manufacturers (FAPM), claimed that liberalising and extending export facilitation would improve its predictability and so "could result in more restructuring and specialisation as [it is] used to develop export markets for more highly competitive products replacing those less competitive with imports" (cited in Gruen, 1990: 30, emphasis added).

Likewise when an import/export link was introduced to the Australian textiles and apparel sector and export growth accelerated dramatically, lobbyists for these industries came round to the view that their own problems could only be addressed by export growth, not more protection in the domestic market (The Age, 24th November 1993: 15). Import/export links did not perform miracles with the political economy of assistance in these sectors. Firms continued to lobby for trade regimes according to their own perceptions of their own self-interest. But those perceptions changed somewhat, and became much less inwardly oriented, more focused on international trading opportunities and more tolerant of importing products which Australia was least competitive at manufacturing.

5.9 'Mutual Adjustment' between Intra-Industry and Inter-Industry Reform Objectives

If the so called first-best solution will take 20 years to reach [free trade] whereas the second-best solution will take 15 years, then first-best is really second-best.

Alan Lloyd, 1978: 16

This chapter concludes by returning briefly to the economic argument. It will be recalled that although both 'compensatory' and 'concessional' export assistance have their benefits, they can also have possible costs associated with increasing the industry's size and/or its level of exports above what has been assumed to be their free trade optima. To make progress in what Braybrooke and Lindblom call "margin dependent choice" (1963: 83) - ie trading off the costs with the benefits of the multiple alternatives available to the decision maker - it becomes necessary to consider both inter-industry and intra-industry issues together.

One compelling way in which such tradeoffs might have been considered is as follows. It seems reasonable to assume that the constraint on trade reform is the rate at which the industry's output declines, and that the intra-industry reallocation of resources associated with moving from inwardly oriented protection to 'promotion' or trade neutral assistance produces relatively low adjustment costs. In such circumstances it will be both possible
and desirable to introduce export assistance to remove the 'home market bias' of tariffs at
the same time as introducing larger reductions in traditional protection than could
otherwise take place. This replaces protection with promotion thus improving the
efficiency with which the assistance regime achieves any given level of output. Yet it
does so without increasing the level of output above the level which has been determined
by political constraints (cf Garnaut, 1991: 30). In such circumstances the two forms of
trade liberalisation illustrate propositions 2.4 and 2.5. They complement each other in
moving the economy towards freer trade. Moreover, as will be seen from subsequent
chapters, they also exemplify proposition 2.6; export credits may facilitate faster tariff
reform by lowering the automotive industry's costs, thus permitting it to withstand faster
and/or greater tariff reduction for any level of output. Whilst it is easy to quibble with
these, or any other assumptions, I know of no alternatives which better meet the multiple
objectives which assumptions must meet - that of simultaneously providing simplicity,
tractability and veracity.
The following four chapters focus on the IAC's handling of intra-industry trade and trade liberalisation in its inquiries into the automotive industry. Unlike the thematic and analytical style of previous chapters, the analysis in the following chapters is framed within a broadly chronological narrative. This is necessary to place the policy advice under discussion within its historical and political context. This style also permits material to be brought within the discussion which, though it does not concern intra-industry trade as a principal issue, vividly illustrates the pitfalls of economic discourse introduced in Chapter One. This chapter briefly sketches the inception of the IAC as a bastion of economic expertise and outlines the way in which the 'IAC line' grew out of an almost exclusive focus on allocative efficiency, a characteristic of orthodox (HOS) trade theory at the time. This chapter then outlines the confused circumstances which produced the 1973-74 inquiry into the automotive industry. As an introduction to the three chapters which follow, the chapter also outlines the scope which was apparent in the historical circumstances of the time, for 'mutual adjustment' between the perspectives of different participants in the policy debate. The central theme of Chapters Seven to Nine is the lack of engagement between the IAC and those with whom it disagreed.
6.1 The Emergence of the IAC

In [its] last seven years the [Tariff] Board had ceased being simply an *ad hoc* operator and had undertaken all the functions given it under [its] Act. [I]t had increased public participation in the Government's decision-making . . . and developed, refined and widely publicized a more comprehensive and systematic approach to tariff assistance. . . . Its [five] divisions gave uniform advice which paid due regard to the interests of the community.

Alf Rattigan, 1986: 194

By the late 1960s Australia's protection regime was the aggregation of hundreds of *ad hoc* decisions. Rattigan's great strategic triumph against the prevailing political economy of Australian protectionism, was to found his revolution on the traditions of the past. The Tariff Board's ostensible public role was to ensure that tariffs were set so as somehow to 'balance' the sectoral interests of manufacturers with the public interest. However Governments' sympathies were typically with the manufacturers and, as Glezer puts it neatly, until Rattigan, the Board "oscillated between rationalizing government preferences and moulding them" (Glezer, 1982: 34). Rattigan came to emphasise the 'transparency' of the Tariff Board process of public inquiry, not just as a device for eliciting information and opinion from all comers. 'Transparency' was crucial to constraining the interference of McEwen and his department. If McEwen sought to direct or advise the Board, Rattigan would insist he do so in a form which could subsequently be published (Rattigan, 1986: 41ff). Transparency emerged as a crucial procedural safeguard of both the independence of Tariff Board advice and the protection of the public over well organised sectoral interests.

The other side of 'transparency' was the appeal to the Board's objectivity and technical competence, which Rattigan associated with professional economic expertise. From its inception in 1921, the Tariff Board had been intended to assist in the transition from *ad hoc* - one parliamentarian called it "happy-go-lucky" - to 'scientific' tariff setting (see Capling and Galligan, 1992: 81). Such aspirations had never really been achieved. Neither the Government, nor the Tariff Board could spell out the criteria which governed its recommendations and important empirical issues were often impossible to determine with any precision (Glezer, 1982: 29ff). Rattigan's crusade involved strengthening the Board's professional expertise. By the first of January 1974 when it became the IAC, the Tariff Board possessed formidable and, within the Australian bureaucracy, largely unmatched economic expertise (Warhurst, 1982: 5).

Whatever their respective motivations, Rattigan's reformism melded remarkably well with Whitlam's. After a generation with the ALP in opposition, Whitlam proposed the
establishment of several public commissions to provide strategic policy advice which was independent of the established public service. The commissions would be fundamental to informing the public on and involving it in "the great national affairs and the great national decisions" (Whitlam, 1972: 5).

Within a few months of Whitlam's election, Rattigan proposed, and Whitlam agreed to establish, Sir John Crawford as a one man inquiry to advise on establishing the new Commission. One of Rattigan's closest colleagues within the Tariff Board - Bill Carmichael - provided Crawford with extensive administrative support (Rattigan, 1986: 154-5). The Crawford Report comprised only 159 paragraphs and it embraced the Rattigan 'vision' with only very slight modifications. Crawford spoke of one criterion for selection of members of the commission being "general competence" and of the need for "[w]ell qualified people able to contribute to the elucidation of the public policy issues involved in assistance to industries". Crawford emphasised the importance of expertise to the Commission and emphasised that by this he did not mean industrial expertise. However, it was "of the utmost importance that the Commission be provided with economic analysis of the highest standard" (1973: 18, 27). Subsequently, many of the Commissioners and almost all of the professional staff recruited to the IAC were economists (Warhurst, 1982: 5).

6.2 The 'IAC Line'

At the heart of the Tariff Board/IAC's approach was the same preoccupation with allocative efficiency (see § 3.2.1 above) which typified the professional economic literature on trade at the time (Corden, 1984). The IAC Act, which Rattigan was instrumental in drafting (Rattigan, 1986: 161), spoke of "improving the efficiency with which the community's productive resources are used" (IAC Act, S22(1){b} and cf {a}). In its inaugural Annual Report the Commission emphasised that "'efficiency' includes much more than the technical efficiency with which particular production is undertaken" (IAC, Annual Report, 1973-4, 1974: 17). And while the IAC nowhere stated that it would ignore technical efficiency, it made it clear that it would focus "primarily" on what it called "economic or relative" - ie allocative - efficiency. Technical

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50 In further defending the autonomy of the Commission and its role as guardian of protection policy, Rattigan argued that Crawford should also recommend against 'policy references'. Crawford obliged, although he fell short of Rattigan's request that he recommend that they be proscribed (Rattigan, 1986: 158). Crawford recommended that governments be able to send policy references but that they should refrain from doing so unless "there are some very special reasons for doing so", in which case "these reasons should be fully explained publicly before the reference is sent" (Crawford, 1973: 31).
efficiency was considered to be a matter which was up to individual entrepreneurs (IAC, Annual Report, 1973-4, 1974: 17).

This focus on allocative efficiency saw full employment and perfect competition implicitly assumed: the former assumption being reasonable in 1973, the latter being Hicks' assumption that the benefits of a more realistic (ie monopolistic) model of the economy would be outweighed by its costs (cf § 1.2.1.1 above). Assistance to one activity attracted resources into it and accordingly drew them from elsewhere. Given such a perspective, as the Commission pointed out, "the higher the . . . assistance required by an Australian industry to enable it to compete . . . the lower the relative efficiency with which [it] uses the community's resources (IAC, Annual Report, 73-4: 17). The IAC's perspective on political economy was also clearly articulated. It approvingly quoted the Brigden committee's fear that protection could enervate entrepreneurial spirit as firms directed their energies towards gaining assistance rather than improving their efficiency (Annual Report, 1973-4: 13). The new approach emphasised the simple and appealing principles to which Adam Smith had given voice and in so doing enabled an escape from the "maze" of issues which had dogged the Tariff Board throughout its existence (Rattigan, 1986: 20).

The IAC's political strategy for dealing with protectionism was also summarily spelled out. Firstly, to minimise the cost of and opposition to adjustment, reform should occur gradually (Charles and Farrell, 1975: 97). Nevertheless, in the light of the experiences of the Tariff Board, the new Commission conceded that in the past there had been "very great resistance to change in high cost industries, which have a vested interest in maintaining the status quo". In response the Commission sought to contain the expansion of high cost industries to at least reduce their relative importance as low cost industries grew (Annual Report, 1973-4: 21).

6.3 The (Tortured) Emergence of the 1973/4 Inquiry

By February 1973, after the December 1971 changes to the plan, Nissan and Toyota sought entry to the local content plans (AIM, 6th February: 6, cf Rattigan, 1986: 174). This raised some difficult issues for government and an interdepartmental committee - representing the Departments of Prime Minister and Cabinet (PM&C), Treasury, Customs and Excise (the administrators of the local content plans) and the new Department of Secondary Industry (formerly the Department of Trade) - was duly convened in early 1973 to consider automotive industry policy and the entry of Toyota and Nissan into local manufacture.
CHAPTER SIX  THE IAC'S EMERGENCE AND SENDING THE AUTOMOTIVE REFERENCE

The Department of Secondary Industry wished to retain the local content plans but PM&C and Treasury wanted them replaced with a tariff-only regime at lower tariff levels (Warhurst, 1982: 185). The Department was strongly supported by its Minister Dr Jim Cairns who saw in the plans opportunities to move towards a vision of 'National Planning' which he had sketched out three years before (see Interview with Cairns, SMH, 15th December 1972: 11). For Cairns 'National Planning' was not any particular policy but rather an elaborate consultative policy advising apparatus which would 'deepen' democratic policy making (1971: 13, 49). Cabinet skirmishing proceeded from June to August, with Cairns' Cabinet submission urging colleagues to maintain the local content plans and use them "to influence the multinational companies, in implementing our policies in respect of product rationalization, resource usage, local equity, pollution control etc. through close government supervision of the Plans" (Glezer, 1982: 162 also see § 6.4 below).

On 28th August 1973 Cairns and Whitlam jointly announced that Toyota and Nissan would be invited to manufacture locally should they wish but that protective arrangements would be reviewed after a full Tariff Board inquiry. (The Tariff Board became the IAC on the 1st January 1974.) The Tariff Board's terms of reference released the next day were not wholly consistent with the earlier press release and illustrated the vicissitudes of the Cabinet process. In addition to requiring advice on whether the industry should receive assistance and if so in which form, the reference required the Tariff Board to "have regard for" various government "desire[s]" most of which were dear to Cairns' heart. The Government desired "to maintain a viable automotive industry" and to improve its "technical economic efficiency". It wanted high local content and "product rationalization". It wanted improved labour relations and production techniques and "substantial Australian participation, including equity, in the industry". And it wanted an industry which "maintains a high level of safety in construction and use, with effective anti-pollution devices" which was "well located for social employment and environment purposes" (IAC, PMVs, 1974, Appendix One: 2).
6.4 **Australia as an Export Base: Intra-Industry Restructuring and the Scope for 'Mutual Adjustment'**

Australia is now a regional centre for the automotive industry, and the government's policy recognises that manufacturers may wish to co-ordinate their production with other manufacturing facilities in the Asian Pacific region. Manufacturers' import and export plans would therefore be related to Australian production.

**Whitlam's and Cairns' Press Release announcing the 1973-74 Inquiry, IAC, PMVs, 1974, Transcript: 2291**

The press statement reflected a new economic nationalism (cf *The Age, The West Australian*, 30 August 1973). It said that Toyota and Nissan had already agreed to "considerable" local equity in their Australian activities and that advice was being sought about using the Government Aircraft Factory to manufacture for the industry. The statement also implied that Australia's status as a nascent automotive export base had significance for assistance policy (see above quote).

The previous chapter outlined various advantages of an export credit scheme from both political and economic perspectives and its potential role in mediating 'mutual adjustment' between policy objectives and perspectives. These arguments can be deepened with reference to the particular context of the IAC inquiry. The export credit scheme had the potential to provide a policy framework for realising aspirations which had to that time appeared only occasionally, and then usually in a vaguely expressed form. And it provided equally promising scope for mediating 'mutual adjustment' between the objectives of various interested parties to the inquiry - including the Commission.

Like Elkan in 1965, by 1973 many people had sought to forge some 'middle ground' between protection and free trade. Cairns was one, although he was the most vague:

To work most effectively with poorer nations Australia must not join the attempt to simplify trade policy into line with the old market mechanisms, but instead must plan Australian development to co-ordinate as much of it as possible with theirs. This can be no accidental result of market forces ... [I]t can come only from carefully selected objectives appropriate to increasing trade. ... We need effective Australian nationalism, just as the poorer countries do, and it is in our interests to make our nationalism work consistently with theirs. We cannot achieve their interests, or ours, by playing the rules of free trade, which are the rules of the already powerful. But equally we cannot long continue with out old haphazard hand-out policy of protection (1971: 26).
Cairns never spelt out what he meant. But, *inter alia*, these words suggest something like the export credits scheme. Cairns might not have accepted that the export credits should be 'deregulated' into the liberal import/export link analysed in Chapter Five above. But his sentiments suggest support for amending the administration of the existing export credit scheme to permit much greater restructuring and intra-industry trade with developing countries. The Tariff Board's terms of reference sought advice on developing this agenda, requiring the Board to "give consideration to all measures which might be effective in implementing the goals set out elsewhere in [the reference] noting that the government considers that neither tariffs alone, nor policies akin to the present motor vehicle plans would be effective in implementing all these goals" (IAC, PMVs, 1974, Appendix One: 2).

Others were of a similar mind to Cairns. David SyCip, an Australian businessman involved in the Filipino automotive industry, had made similar points about integrating respective economic 'nationalisms'. He proposed 'regional complementation' as a means of cutting through the mutually conflicting nationalisms of developed and developing countries. "The answer would seem to lie in dis-aggregated industries, for both developing and developed counties, so that the work of producing finished manufactured goods may be shared. Instead of nationally integrated industries there should be inter-nationally integrated industries" (SyCip, 1970: 9-10, emphasis in original). Hartnett's comments on the need for intra-industry restructuring from the mid 1960s have already been mentioned (see § 2.5.2.2 above). The Managing Director of Leyland Australia, Peter North sought to avoid free trade but, nevertheless to replace protectionism with a "practical course" which "could steer that fine line between the madness of economic nationalism, and the daring of aggressive, but sound, industrial entrepreneurialism". The task of integrating the Australian industry with the global automotive industry had been profoundly retarded by the sixties' emphasis on progressively higher cost import replacement.

Had we faced this task ten years ago, we could have been on the way today to a market served by a combination, of unique Australian products selling in the domestic market beside built up imports coming through lower tariff barriers, and in export markets with the strength of Australian design, instead of the weakness of higher cost, mirror image versions of cars created in Europe and America (Martec Seminar, May 1973, Transcript: N5).

Manufactures' export growth had obvious and broadly based political attractions. In addition to what one might presume was its popular (mercantilistic) appeal, Whitlam had always spoken of the importance of manufactured exports (see § 2.5.2.1 above) and Cairns' advisors were saying similar things. Brian Brogan, "one of the only economists
in whom Cairns had any faith" (Rattigan, 1986: 211-2), commented to an industry seminar that the Government's response to the IAC report would consider "ways of making the export of automotive products . . . more attractive". Brogan added in sympathy with the emerging IAC line that "the previous government was perhaps too concerned about the interests of the manufacturers. We will take a slightly broader view". Interestingly, despite Cairns' hostility to multinational companies, Brogan commented that the Labor Government appreciated that there was "no realistic alternative" to foreign domination in the industry and that as a consequence "the government will . . . be rather attracted to the plans that the vehicle manufacturers might have for integrating their Australian plants with their plants abroad. I think there are advantages for all of us if the Australian economy is opened up to international competition, but I think we also believe that the Australian automotive industry has something very important to contribute to Australia" (Martec Seminar, May, 1974, Transcript: F5).

These perspectives might have offered the scope for forging common ground between protectionists and free traders, and between sectional interests and the IAC representing the public interest. Certainly there were some active partisans of the tariff debate who were interested in testing how far they might be able to find common ground with their adversaries. In 1971 Bert Kelly wrote in his diary that, to his surprise, a meeting with Australia's arch protectionists - including Sir Charles McGrath of Repco, senior Liberal Party figure and one of the architects of the local content plans - did not comply with the usual formula.

I expected that we would spend the first half hour trading platitudes and the last two or three trading insults. But, to my surprise, everybody tackled their work in a most responsible way and then we came to agreement without, I'm certain, giving away any of the principles by which we stand. Evidently they are beginning to realise, these high protectionists, they can't afford to be stupid in their arguments and expose themselves to ridicule (Kelly, 19th March, 1971).

It would be naive to believe that much common ground between McGrath and the trade liberalisers was even in the offing at this stage. Yet Kelly was not without his successes in at least in reducing the areas of disagreement between himself and his protectionist adversaries. In late 1973 he was able to get:

the manager of GMH [to] agree . . . with my general thesis that if we had not fragmented the car industry as we had and let it develop naturally we would probably have one, or at the most two, manufacturers of cars and wouldn't have to put any requirement on them to have a certain percentage of Australian content. We would have more people making cars, cheaper
cars and have less high tariff protection against imported cars (Kelly, 24th October 1973).

The philosopher Allan Gibbard comments that "the norms of accommodation" between those who have abandoned the search for the best outcome are "norms of the second best" (1989: 183). Of course in this context this is an apposite, though unintended pun. For it turns out that what imbibes export credits with their capacity to 'offer something' to the industry - their capacity to both facilitate and assist exports - is what gives them their 'second best' appearance to the trade liberalisers. Yet export credits provided a promising arena within which the industry and trade liberalisers might have searched for some mutual adjustment and accommodation. Participants extolling the virtues of export growth may or may not have been embracing mercantilist logic. But as almost all the comments quoted in this sub-section show, they also accepted the benefits of greater import competition. It is this latter effect which provided the potential payoff for the trade liberalisers in exploring the attractions of export credits.

It will be recalled from Chapter Three's discussion of the tariff compensation debate, that what came close to an 'in-principle' objection to 'second best' policies arose largely from the Commission's misgivings about their potential to exacerbate the politics of protectionism. But here the 'second bestness' of the export credit scheme offered the potential to do the opposite. As Chapter Five has argued, in a range of circumstances, a sufficiently liberal export credit scheme on its own would have improved intra-industry resource allocation and productivity as well as reduced the effective assistance available to the industry. And if policy constraints were imposed by the Government's requirement that the Tariff Board make recommendations consistent with a "desire" to ensure the industry's prosperity, the export expansion and prosperity of the most competitive sections of the industry offered potential for accelerating the rationalisation of the least competitive parts of the industry. Baranson of the World Bank had already spelt out the appropriate considerations commonsensically enough:

The analysis in this study develops what economists would call a 'second best' solution. The study starts with the question, given a determination to develop an automotive industry, how may sector efficiency be maximized at successive levels of resource commitment? Stated another way, manufacturing and marketing strategies are sought which should permit the industry to operate in the range of maximum comparative advantage (1969: 5).

Of course these considerations apply mutatis mutandis to the determination of any long term assistance program, and so to any gradual trade liberalisation regime which contemplates protection for substantial time. In fact, as the following three chapters
demonstrate, during the course of both major inquiries into the industry, the Commission never seriously engaged with these issue. In writing its 1974 report, the Commission failed to engage largely because of its very considerable neglect of automotive exports (see Chapter Seven below). When challenged after the publication of the 1974 report, the Commission held fast to the conclusions in its report, despite being provided with an alternative perspective which raised the 'second best' issues and despite emerging evidence that its expectations about the state of the market could be seriously awry. It avoided engagement with those proffering an alternative view by imposing upon them a burden of proof in the argument which was inappropriately heavy in the circumstances and which the Commission itself could not have met in defence of its own views (see Chapter Eight below). And despite the issue being raised quite specifically in the terms of reference for the 1979-81 inquiry and by participants, the Commission again failed to engage with those who suggested alternative views (see Chapter Nine below), again by imposing upon them a burden of proof which it was impossible for them to meet. In each case the Commission's technical achievements were part of the reason for its failure to engage.

### 6.5 The 1974 Report as a Showcase of Economic Expertise

[The] authority which the Board accumulated and exercised ... depended on formulating knowledge. What gave the Board added standing among the tariff public was the legitimacy it could appeal to on the basis of its intellectual superiority. The symbols surrounding its independence - its impartiality and its effect on the process of decision-making through its emphasis on public scrutiny - were bolstered by its claim to superior understanding of the wider economic effects of tariff-making, an understanding the Board had in the past claimed with much less assurance. Knowledge - or what was widely accepted to be knowledge - added stature, and persuasiveness, to the Board's preferences.

Leon Glezer, 1982: 110

The automotive inquiry was an opportunity for Rattigan to deploy the expertise which he had so assiduously built since the late 1960s. When it was fully underway in December 1973, permanent staff at the Tariff Board had increased from 105 in 1967 to 388 (Warhurst, 1978: 2). The newly formed Industry Economics Division (IED) contributed two major pieces of quantitative research - one on vehicle demand, the other on economies of scale in the industry. Warhurst comments:

The models were developed ... in consultation with outside experts.

Academic seminars were convened to discuss the models. IED was
confident in the expertise it had built up. . . . This was however the first occasion in which [its] methodology had been fully utilized. The [Tariff Board] decided that this research would be exemplary and devoted its best professional resources to achieving such a result (1982: 189).

The studies provided useful, but very partial insights into the problems which the Tariff Board/IAC had been set. In one sense they contributed to the 'rigour' of the IAC's ultimate report. The material presented in the studies had been lovingly worked over. But in contrast to the technical skill which the Commission brought to its task, its 'integrative' skill in applying those techniques in pertinent ways and in integrating the perspectives which were coming before it into its work proved inadequate. There was a lack of attention not just to the opportunities for mutual adjustment explored in the previous section but even to the phenomenon of automotive exports itself. Judging from their output, the technical focus of the Commission's economists detracted from their own appreciation of the 'second bestness' of the policy making situation in which they were placed and indeed the 'second bestness' of their own recommendations. And even in their own terms, the studies of future vehicle demand and scale economies and the use to which they were put provide textbook illustrations of the pitfalls of technical expertise which is applied with insufficient thoughtfulness.
This chapter analyses the Commission's 1973-74 report on the industry. After briefly outlining the major themes of the report (§§ 7.1, 7.2 below), the chapter outlines the many ways in which the Commission's view of the industry appears 'shoehorned' into the analytic categories of the HOS framework (§ 7.3 below). In fact, as recorded above, the Commission devoted considerable effort to quantifying scale economies in the industry, and scale economies are strictly inconsistent with an HOS world. However, except in so far as they reinforced its anti-protectionist message, the Commission remained largely insensitive to the policy implications of scale economies. The analysis of scale economies brought forth no reflection on what Elkan, Drysdale and Peter Lloyd, as well as many of the industrialists appearing before the Commission, thought followed directly from their existence - the degree to which exports might provide a small manufacturing country with access to more economic production volumes.

Likewise, and again despite prompting from the industrialists appearing before it, the Commission remained largely insensitive to the economic implications of product differentiation in the industry. As well, but partly because of this, the Commission was probably unduly pessimistic about the competitiveness of the industry and its prospects in the domestic and export markets, particularly in areas where it enjoyed the advantages of product differentiation (§ 7.4 below). One of the most striking things about the report is its lack of interest in automotive exports and their prospects; the HOS framework on which the Commission largely relied had no room at all for exports from an industry which was a net importer (§ 7.5 below). Not surprisingly in such circumstances the Commission showed little interest in the scope for intra-industry trade policy (§ 7.6 below).

The excellent work of scholars such as Linder, Elkan and Vernon would have helped the Commission better appreciate the issues before it. But by the mid 1970s, Vernon was far from centre stage and Linder and Elkan had been marginalised in the academic corpus. This is lamentable enough in itself. But it is too easy to blame this fact for the Commission's failures of vision. The issues which had been theorised by Linder, Elkan
and Vernon did come before the Commission. Participants to the inquiry raised them clearly and commonsensically enough and important insights about product differentiation made cameo appearances in working papers. But the Commission remained largely resistant to them all.

7.1 The Commission's Major Themes

The Commission's report arrived in July 1974, somewhat to the chagrin of officers in PM&C who had implored the Commission to report before deteriorating economic circumstances swung the political pendulum against reform (Warhurst, 1982: 189-90). It was an unprecedented 218 page tour de force of analysis and comment not counting several substantial appendices. As Davidson and Stewardson approvingly put it, the report confirmed "the broad analysis which economic first principles would suggest" (1979: 183). The report offered a telling indictment of the waste inherent in the local content plans. Since the vehicle plans had been introduced, the industry had enjoyed approximately $1,500 million or more than half its wage bill as the 'subsidy equivalent' of the tariff and of tariff revenue foregone as a result of by-law concessions. And far from nurturing infant industries, protection, particularly the local content plans, had "tended to encourage small scale inefficient production at the expense of large scale more efficient production" (IAC, PMVs, 1974: 132, 135). Largely because of its lack of access to scale economies, the industry faced higher costs than the automotive industries of most major developed countries (IAC, PMVs, 1974: 1).

The IAC recommended the new broom of a tariff-only regime. It proposed to discontinue the local content plans immediately replacing them with a 35 per cent tariff on vehicles and components with the tariff phasing down to a "long term" rate of 25 per cent over the next seven years (IAC, PMVs, 1974: 6). The Commission argued that its recommendations would see significant rationalisation of the sub-sectors of the industry manufacturing components and light vehicles. But it anticipated no loss of market share in the most substantial and competitive part of the industry: medium - Holden Kingswood - sized cars, their derivatives, and those large light vehicles which shared significant components with them - six cylinder Toranas and Cortinas. Its demand forecasts suggested that demand would continue to swing towards smaller vehicles but at
a sufficiently slow rate to ensure continued albeit slow demand growth for medium sized vehicles (IAC, PMVs, 1974: 165, 73).

### 7.2 'A Number of Specific Issues'

[The larger companies in Australia seem] to regard labour as a commodity to be bought as any other commodity, and fail ... to recognise the importance of having workers identify with the company. In this regard the management attitude of companies in Japan and Germany provides a contrast. In these countries there is a belief that the enterprise should be concerned with the interest of the employees and employees concerned with the interests of the enterprise.

IAC Working Paper, "Assistance": 27

Rattigan sought, unsuccessfully, to prevent the reference from including issues which were outside the Tariff Board's usual purview of industry assistance (Rattigan, 1986: 176-8). They were largely marginalised in the Commission's report (Warhurst, 1982: 189). It handled them all in a section which was structurally, if not formally, a postscript to the report 'proper'. The Commission may have done its best on these matters, and some of its suggestions were helpful and sensible applications of economic 'first principles', though they were not explored in any detail.

However much of the chapter was little more than reportage. The Commission's contributions were summary and showed little interest in the economics of the industry outside its traditional assistance framework. Thus the Commission observed that Borg-Warner's single-union factory at Albury had fewer disputes than its factory in Fairfield but offered no analysis on whether or not this phenomenon was generally observable, and if so, what its policy implications might be. Its discussion of labour relations, concluded by observing the Government's "desire to maintain a viable automotive industry" and calling for it to "take positive and decisive steps" to encourage "Australian research and experimentation in the field of labour relations in the passenger vehicle industry" (IAC, PMVs, 1974: 184, 201). The Commission reported on Volvo's experiments in the area of labour management (IAC, PMVs, 1974: 200). But despite

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51 This is a simplification of the Commission's comments, which suggested a surge of growth in 1974 followed by small declines in the market from 1975 to 1977 followed by renewed slow growth after 1978.

52 Thus the Commission suggested for instance that "where anti-pollution devices can be offered as optional extras on motor vehicles, it seems unnecessary for people operating vehicles primarily in country areas to be forced by registration requirements to install them" (IAC, PMVs, 1974: 195).
observations in working papers noting higher labour productivity in Japan and possible links between this and a more collaborative relationship between labour and management, the Japanese industry was not mentioned in the section on "Labour Relations". Working papers had raised profit sharing as a possible prospect, but this did not find its way into the report (Working Paper, "Assistance": 4, 27ff).

Whilst the Commission could not reasonably have dealt comprehensively with all of the 'non-assistance' matters raised in the terms of reference, its published discussion offered little of use to the Government or the industry. And some of the issues arranged in this section of the Commission's report, particularly export credit arrangements, were clearly assistance matters. Considering them in this section of the report prejudged the possibility of assessing them according to the assistance criteria which the Tariff Board/IAC had developed over the preceding six years.

### 7.3 An HOS view of the Industry

Presiding Member: Generally, it seems to be argued by economists that the minimum economic scale for production of body stampings is a much higher figure than the minimum economic scale for the production of engines, so you are tending to argue against an accepted doctrine in this area?

Witness -- I have found very few economists who know anything about the automotive industry ... [E]conomists ... tend to generalise, and think there is one solution to all problems in any industry.

Peter North, Managing Director of Leyland Australia, IAC, PMVs, 1974, Transcript: 1802

Warhurst comments that the Commission was ill-equipped to deal with what he calls 'non-economic' issues raised in the references (1982: 189). But there were major weaknesses in its handling of the normative micro-economics of assistance to the industry - the Commission's bread and butter. Those weaknesses appear to have been directly related to the preponderance of economic expertise within the inquiry team and the absence of familiarity with the industry. The IAC's 'experts' included no experts on the automotive industry itself (personal communication with a staff member of the inquiry). Automotive industry consultants Martec came to play a significant role in the debate in late 1974. They offered their services to the Tariff Board in September 1973 but it rejected the offer, Martec claimed later "without giving it serious consideration" (Martec, 1976: 3.14.3). As Chapter Eight argues, the skills and perspectives of Martec and the Commission were almost perfectly complementary. But the value of this complementarity was never realised.
CHAPTER SEVEN

The Commission's understanding of the industry is recognisably structured by the HOS framework, so dominant in the 1950s and 60s and from which the technical apparatus of the Commission's assistance evaluation methodology sprang. The metaphors used to describe the industry are almost invariably static ones, with a fundamental preoccupation being the 'degree of disability' of the industry and its different sub-sectors vis-a-vis different countries. The implication of treating comparative costs as the sole or overwhelmingly determining competitive factor in the market, is that the market is essentially perfectly competitive - that product differentiation does not influence the prices at which suppliers can sell.

In addition, as this chapter outlines, this preoccupation with cost disability as a measure of market competitiveness actually hampered the IAC in throwing off its protectionist heritage. From its very anti-protectionist vantage point, the Commission implicitly assumed something which had been a foundation stone of Australian protectionism - that in the absence of some special factor - whether it be natural or government induced protection or some other advantage - Australian manufacturing was unlikely to be competitive in domestic or export markets. Such a perspective kept both the IAC's and protectionists' focus largely on the question of how much protection was necessary for the industry's survival in the local market - even if the answer they gave differed. This was an inauspicious perspective from which to appreciate issues other than the industry's survival - particularly the prospects for it to prosper in world markets (see § 7.4ff below).

7.3.1 Assembly and Manufacture

The CKD pack is one of the last remaining vestiges of economic colonialism. It costs more to build and ship a CKD pack, than it does to build and ship a complete car. Before you take into account the cost of assembling it locally.

Mr Peter North, Managing Director of Leyland Australia, Martec, Industry Seminar, May 1973, Transcript: N6

The Commission oriented much of its thinking around what it called a "fundamental relationship": cost disabilities . . . "decrease with increasing scale of operation, but increase with the level of local content attained" (IAC, PMVs, 1974: 145). This downplays an important phenomenon which had been evident for some time. In 1964 Lawrence Hartnett had told the Tariff Board that local assembly of imported components was almost invariably uneconomic (Tariff Board, 1965, Transcript: 47A). By 1974, car assembly under protection was well represented in the effective protection literature as an example of 'negative value added' (Corden, 1971: 51). This point appears in the nooks
and crannies of the Commission's 1974 report. Thus in an appendix the Commission cited a contemporary World Bank study of the industry in developing countries, which commented that "vehicles assembled overseas from CKD units are more costly (3 to 10 per cent more) than completely built up units from the exporting country" (IAC, PMVs, 1974, Appendix 8: 27). The reason was that "special handling and packaging costs more than offset slight savings in assembly costs" (Baranson, 1969: 39).

Australia's experience was similar. GMH, Ford and Chrysler had each withdrawn from decentralised (multi-state) vehicle assembly in the 1960s and 1970s, sometimes despite the withdrawal of state preferences. The IAC's evidence suggested that CKD packs did not even enjoy much of a sea freight advantage over built up imports (Working Paper B 11: 4, cf IAC, PMVs, 1974: 149). The Commission concluded correctly that the location of assembly and component production were clearly related (IAC, PMVs, 1974: 49, 150). Assembly and component production were 'locational complements' with each activity lowering costs for the other where they share the same location. Yet the Commission's handling of the issue was unfortunately partial. For such a relationship implies at least three things. As the Commission pointed out, it gave a "degree of local advantage" to firms supplying components to Australian vehicle assemblers (IAC, PMVs, 1974: 150). However, the Commission did not fully appreciate that locational complementarity imposed a significant disadvantage on assembly activity in Australia where this involved the assembly of imported components. Importing vehicles in pieces was a particularly inefficient way of importing vehicles into Australia. As local content approached 100 per cent, diversification costs would rise steeply and outweigh any advantages of local component manufacture and assembly. However the most competitively manufactured Australian vehicles were nevertheless likely to have reasonably high local content.

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53 Thus GMH closed down Western Australian assembly facilities at Mosman Park in 1972 (IAC, PMVs, 1974, Transcript: 88), whilst Ford had done the same ten years before (The West Australian, 6th June 1972: 4). Chrysler had given notice that it would close down a Port Melbourne assembly plant in April 1972 (The Australian, 5th April, 1972: 1). GMH was expecting to lose its state preferences from the Western Australian Government when it closed its Western Australian plant, but this had not happened to Ford ten years before (The West Australian, 6th June 1972: 4). The dispersal of GMH's plants had been one of the terms of its original agreement with the Australian Government for the production of an 'all Australian' vehicle and its major competitors may well have felt some pressure to bear a similar cross. By the end of the 1950s, GMH was taking steps towards greater centralisation of production (Bennett, 1994: 17-8).
In fact - although the Commission did not highlight this phenomenon - its adherence to 'economic first principles' in recommending a tariff-only regime meant that its recommendations in 1974 would have put paid to uneconomic CKD assembly operations. It would be less lucky in 1981, when it failed more fully to grasp the issue (see § 9.7.2 below). Even in 1974, however, the Commission suggested that under its proposed tariff-only regime, manufacturers of small light vehicles "should be able to operate profitably at low levels of local content" (IAC, PMVs, 1974: 9, and see 159). Likewise it commented that under its recommendations "most assembly operations [would be] undertaken at low levels of local content" (IAC, PMVs, 1974: 160), without apparently appreciating what it had said elsewhere, that without special government assistance to assembly it was significantly more expensive to assemble a vehicle locally than to import it CBU.

7.4 The IAC's Pessimism about the Industry's Competitiveness

The relevance of the Commission's implicit HOS framework (and within this context its pessimism about the industry's cost competitiveness) was captured in its assertion that "Australian products which require very high protection against imports" could not "be at the same time a force in export markets" (IAC, "Martec", 1974, Appendix 2: 3). The reasoning and analysis upon which the Commission based its conclusions of uncompetitiveness is thus worthy of scrutiny. This section argues that what analysis the IAC did leaves significant room for believing that it may have overestimated the cost disadvantages facing medium sized car manufacture in Australia by about 15 per cent. It also suggests that there were possible opportunities on the export side which went all but wholly unexplored by the Commission.

It is not necessary to argue that the Australian industry or any section of it was world competitive without assistance in order to cast doubt on the IAC's recommendations for the industry. Those recommendations were predicated on the government's desire to maintain the industry as mandated in the reference and accordingly involved substantial assistance for a prolonged period. The motivation behind exploring the potential export competitiveness of the industry is thus to explore the prospect that, by extending assistance to exports, the Commission might have recommended policy which met the constraints set out in its terms of reference at lower economic cost.

In the mid seventies the IAC offered several views of the industry's competitiveness. One emerged from the HOS inspired inter-industry factor and trade intensity studies in its Annual Report. Others emerged in its 1974 report on the automotive industry. These
studies are briefly explored in turn. The section then considers the competitiveness of the industry in the presence of product differentiation - a subject which was largely neglected by the Commission.

7.4.1 **Analysis of Factor, Import and Export Intensities**

In its inaugural Annual Report, the IAC did not explicitly identify the automotive industry as uncompetitive. The industry did however self-identify along with the textiles clothing and footwear industries as a 'high cost' industry which, given the local content plans, it undoubtedly was. And 'high cost' industries were clearly associated with uncompetitiveness in the Commission's first Annual Report (see § 6.2 above, and Annual Report, 1973-4: 17).

7.4.1.1 **Factor Intensities and Export Competitiveness**

In addition to its association of high assistance rates with high costs, the IAC's first Annual Report explored the characteristics of Australia's most competitive manufacturing industries, and concluded that the manufacturing industries with the greatest export intensity were typically capital intensive, high wage, high labour productivity industries (IAC, PMVs, 1974: 16). According to the informal HOS framework to which this reasoning appealed, the clothing industry was clearly unsuited to the comparative advantage of a high wage country such as Australia. When compared with other manufacturing it was less than one quarter as export oriented and capital intensive, had less than half the labour productivity and paid wages of about two thirds the manufacturing average. The automotive industry offered a much less neat fit. It had higher wages and labour productivity than manufacturing generally. Its capital intensity was 10 per cent lower than general manufacturing, although most value-added in the industry was added by vehicle assembly which had higher capital intensity than manufacturing generally (IAC, Annual Report, 1973-74, Appendix 4.1 and see Statistical Appendix Tables A6.1, A6.2).

7.4.1.2 **Export and Import Intensities**

The Commission's first Annual Report also made some play of export and import intensities of the automotive industry. Given that the summary table in the Annual Report reported the industry as having a lower export intensity and higher import intensity than the manufacturing average, some cautionary comments are offered. 'Manufacturing' for the Commission's purposes here included lightly processed foods, fibres and minerals such as 'meat and abattoir by-products', (ASIC 2111) 'scoured and carbonised wool' (ASIC 2312) and 'Basic Metal Products' (ASIC 291) including
pelletised, metallised iron ore (ASIC 2911). These 'manufacturing' industries faced favourable factor cost prices and so had very high export and low import intensities. If one allows for this by excluding 'primary based' manufacturing industries, according to the Industry Commission's current methodology, one finds the automotive industry outperforming elaborately transformed manufacturers in export intensity in the early and mid 1970s. Given the simultaneous growth in imports, the automotive industry's import and intra-industry trade intensity were also greater than other elaborately transformed manufacturers (see Statistical Appendix, Tables A7.3, to A7.5). Automotive imports would have been reduced by the industry's heavy protection, although the next subsection suggests that import penetration was also greatly affected by changes in domestic demand. The industry's export and intra-industry trade performance was the more notable for the trade restrictiveness of the local content plans and the negative assistance protection heaped upon automotive exports (see § 5.7.2).

7.4.2 Disparities of Competitiveness within the Industry as Measured by Market Share

After 1968, imported vehicles and those assembled from predominantly imported components occupied a steadily growing share of the small and large light vehicle market, rising to about 70 per cent in 1973. Of those vehicles manufactured in Australia, very few were exported. On the other hand, Australian medium vehicles captured over 95 per cent medium car domestic market share right through the sixties and seventies (IAC, PMVs, 1974, Appendix Seven: 18, Table A7.15 and see Chapter Two above). In this part of the market, the Australian industry's export intensity was over 15 and 12 per
cent in volume and value terms respectively. This was well over its import intensity. In medium vehicles Australia was a net exporter.54

7.4.3 Costs, Prices, Product Differentiation and Competitiveness

I am sorry to say this but there is no minimum scale, it depends upon the conditions and the competitiveness. In Japan our lowest volume production engine is only 3,000 per month and our biggest volume production is 40,000 per month. Many can be possible.

Mr Tamura, Toyota, IAC, PMVs, 1974, Transcript: 406

The Commission was undoubtedly correct in finding very high degrees of cost disability in local manufacture of light vehicles when compared with imports. Beyond this, its attempt to measure the competitiveness of the industry was fraught with difficulty and frustration. It probably overestimated the degree of cost disability of local manufacture of medium sized cars. Whether or not it did, its implicit framework abstracted from the marketing possibilities presented by product differentiation.

7.4.3.1 The Vicissitudes of Measurement

The report's comment that "several firms" refused the Commission access to information on overseas costs (IAC, PMVs, 1974: 98) was something of an understatement. The

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<th>1971</th>
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<td>By Volume</td>
<td>By Value</td>
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<tr>
<td>Exports/Prodn</td>
<td>17.3%</td>
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<td>By Volume</td>
<td>20.8%</td>
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Source: Working Documents "Production" and "Export Sales". Data source: Evidence. NB. Ford, Leyland and Chrysler supplied incomplete information - ie values without volumes or vice versa. These figures were estimated by using plausible comparisons with data from other firms, which was complete. Figures for 1973 appear to show a substantial increase in export intensity, but were supplied in very incomplete form and have accordingly been omitted.

54 The 95 per cent market share to domestic manufacturers is calculated in terms of volumes (units of vehicles), but the figures do not change much when measured in terms of value. The main assembled and/or imported vehicles occupying this sector were Toyota Crowns and Datsun 260Cs, each of which retailed in Australia for approximately 10 to 20 per cent more than standard model Holden and Falcons (Modern Motor, April 1974). If this were the case uniformly within the sector, it would lift the import share as measured by value marginally - from approximately five to approximately six per cent. This contrasts with an export intensity by value of more than double this.
Commission had the cost profiles of only two overseas vehicles. One was a small vehicle from a Japanese company and the other was a European medium sized vehicle (Working Paper A2: 5). In addition the Commission's detailed local cost information was also problematic. As the author of much of the cost analysis in working papers "A2" and "B7" lamented "[c]omparisons of production costs between individual local producers and between local and overseas manufacturers" had been "severely hampered by a lack of uniformity by different companies in the basis of allocation of costs to the standard categories in the Commission's costing schedule" (Working Paper A2: 5). The component pack from which one vehicle was assembled cost much less than comparable vehicles. "The costing appears deficient in several overhead items, and is in total much lower than the cost to make and sell all other vehicles" (Working Paper A2: 6). Some cost information for locally manufactured vehicles suggested that manufacturing costs rose with increased scale - something which was paradoxical to say the least, given the Commission's focus on scale as a major explanation of Australian cost disabilities. Indeed, it was also belied by reported profit performances (Working Paper A2: 7).

These difficulties drove the Commission towards primary reliance on price rather than cost comparisons. Whilst it gathered some figures on the retail prices of vehicles in overseas countries (Working Paper B7), the Commission placed far more weight on comparisons with the import prices it obtained from various operators in the Australian market (Working Paper "Assistance": 2; IAC, PMVs, 1974: 81). This raised an obvious problem. For several reasons, in many countries, export prices were often below domestic prices. Firstly exporters generally enjoyed some degree of protection in their domestic markets by way of transport costs and/or trade barriers, whilst in foreign markets the opposite was the case. In the presence of some monopoly power, by the principles of 'spatial competition', the exporting firm can be expected to price discriminate in favour of customers who are more costly to service (Greenhut, 1970: 318-25). Secondly Australian tariffs based on stated export prices gave exporters to Australia an incentive to understate their export (and so import) prices. Particularly where the importing firm in Australia was a subsidiary of the exporting firm offshore, any resulting paper losses from underpriced exports could be recouped as higher margins by the importing subsidiary.

After previous 'dumping' scandals (Stubbs, 1972: 92-3), Australian Customs had established minimum export f.o.b. prices designed to prevent dumping by Japanese and Italian vehicles. The Commission took these minimum prices without satisfying itself as to Customs' methodology (Working Paper, "Assistance": 2). And its report spoke of the "the understatement of value" with respect to imported upper medium vehicles from
Europe (IAC, PMVs, 1974: 83) - some of which originated in Italy (Working Paper A2: 3). Whilst the Commission calculated corrected disabilities for the industry using adjustments to allow for "apparent dumping margins" for the imports from some European countries (Working Paper A2: 3), and published them in its report, (IAC, PMVs, 1974: 83), it used the unadjusted figures in its table of price disabilities (IAC, PMVs, 1974: 82). In the upshot, the IAC figures on cost disabilities were problematic on their face. There were wide disparities in price competitiveness, even where comparisons were broken down into vehicle classes and competitor countries. The Commission offered two quantifications of the industry's competitiveness - the "price disadvantages for locally produced vehicles" and the "cost disadvantages" of local manufacture. "Price disadvantages" were generated from staff calculations from import prices rounded to the nearest five per cent (cf Working Paper A2, Table Two).

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<thead>
<tr>
<th>Table 7.1 &quot;Price Disadvantages&quot; of Local Vehicles in the Australian Market</th>
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<tr>
<td>Category</td>
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</tbody>
</table>

Source: IAC, PMVs, 1974: 82, Ultimate source: Evidence.
(a) advantage
(b) not available

The IAC's figures on "cost disadvantages" were generated by adding back freight plus an adjustment to correct for the possibility that Australian vehicle selling prices had been artificially depressed to minimise liabilities for sales tax. The Commission calculated 'nominal' selling prices for Australian vehicles which would yield a 10 per cent return on assets for the Australian manufacturers. This added 18 per cent to the price of small and large light cars and 12 per cent to medium cars. Thus the Commission was vigilant to allow for the possibility that Australian manufacturers had a financial incentive to report unrealistically low prices, but less vigilant about the prospect that exporters to Australia faced similar incentives. The Commission's estimates of "cost disability" were much greater than their estimates of "price disability".

55 No figures were presented corresponding to American vehicles presumably because the Commission was unable to obtain American export prices to Australia for any appropriate vehicles.
Table 7.2 "Cost Disability" of Australian Vehicles against Imports

<table>
<thead>
<tr>
<th>Category</th>
<th>Japan</th>
<th>Europe</th>
<th>USA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small light</td>
<td>70-100+</td>
<td>&quot;about 25&quot;</td>
<td></td>
</tr>
<tr>
<td>Large light</td>
<td>80-85</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Medium</td>
<td>&quot;approx 45&quot;</td>
<td>40-50</td>
<td></td>
</tr>
<tr>
<td>Upper Medium</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Light Commercial</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: IAC, PMVs, 1974: 98.56

The fragmentary nature of this information is notable. The conclusion of a summary working paper apparently completed by a senior staff member after the original working papers, was that "we must concede that our estimates of the total cost disadvantage may be too high. The quality of the data was suspect and the methodology employed to arrive at estimates of cost disadvantages is far from ideal". "Nevertheless", the document continued, "all the information we have points to disadvantages of the same high order" (Working Paper, "Assistance": 4). This was not quite true.

7.4.3.2 The Cost Competitiveness of Medium Car Manufacture in Australia

All the Commission's evidence pointed to high cost disabilities in the manufacture of small vehicles against those of the Japanese industry. As it reported, the Commission's data suggested cost disadvantages, but much lower ones in the production of medium sized cars. Even this information was not unambiguous. The only detailed cost breakdown the Commission had of medium car manufacture indicated that a European unit was produced at between five and fourteen per cent higher cost than the three Australian medium vehicles, although the European vehicle had relatively more luxurious appointments (see Working Paper B7, Table Three).57 Likewise GMH's evidence indicated that (ex-tax), Australian Holden prices were significantly less than the roughly comparable vehicles GM manufactured in Germany (IAC, PMVs, 1974, Transcript: 58C), and about the same as prices in Britain for (roughly) comparable cars. These figures were broadly corroborated in the Commission's comparative domestic price

56 The figures for Japan correspond with Table 2: 3 of "Assistance to the Passenger Motor Vehicle Industry" and on inspection it will be seen that these figures are generated from the figures from Working Paper A2, Table 2.

57 Comparably 'optioning' the Australian cars would have added a little over 10 per cent to the cost of the Australian vehicles although this does not allow for the European vehicles' smaller dimensions and engine capacity (see Working Paper B7, Table 3).
studies (Working Paper B7: 2 of Table Two; Working Paper A2: 3 of Table One and Table Five). The Commission's table on price disabilities in the Australian market noted that in some cases the Australian industry apparently enjoyed a price advantage over European medium vehicles (see above). However, perhaps for reasons of confidentiality, it failed to quantify the level of advantage. More importantly, the Commission gave the impression that this price advantage was only available in the Australian market - counting transport costs for European cars to Australia - whereas its evidence suggested that, in some comparisons, Australian vehicles had a price advantage over comparable European ones in their respective domestic markets (Working Paper B7, Table One: 2).

The first sentence of the report finessed these complications by reporting that the Commission had found that costs of production were "significantly higher" than costs in "Japan, North America and most European countries" (IAC, PMVs, 1974: 1, emphasis added). Yet the tone of the report, and the central 'message' it carried, was one of generalised if not uniform uncompetitiveness. The heterogeneity accommodated by the IAC's initial words rapidly fell from view in both the Commission's thinking (see below) and its subsequent contributions to the debate. In public correspondence with the bureaucracy after the report's release, Rattigan wrote that "the Commission found that the local industry, in its present form, was at a high level of cost disadvantage against overseas producers, ranging from about 45 per cent on medium cars to over 100 per cent on small light cars (Rattigan to Steele: 1). No allowances were made for the possibility that there might be substantial sections of the Australian industry which were much less uncompetitive and which may have enjoyed some competitive advantages over other producers.58 Against both Japanese and American medium cars, Australian vehicles were probably at a cost disadvantage although the extent of this disadvantage was probably overestimated by the Commission. The Commission's estimates of Japanese vehicles' cost competitiveness was based on the import price of CBUs which suggested disabilities of between 20 and 30 per cent against the Japanese, which were then extended to 45-57 per cent by adding back freight and the adjustment for understatement of domestic ex-factory prices (Working Paper, "Assistance": 3). Although it allowed for the possibility that Australian vehicle prices were artificially depressed, it did not investigate the possibility

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58 The central message of the report is recounted by Rattigan twenty two years later in his memoirs with the reservations removed. As Rattigan has it "the costs of production were considerably higher in Australia than in Japan, North America and the European countries" (1986: 213).
that Japanese export prices were likewise depressed. Certainly the Commission's study of comparable retail prices of Japanese and Australian medium vehicles - ex-tax in their respective domestic markets and including tariffs and tax in one Asian market - indicated a disability of between 27 and 33 per cent (Working Paper B7, Table One: 3; Working Paper A10: 61).

It seems that the USA figures were calculated from the Commission's information on American domestic vehicle prices. Yet the figuring of the working papers had these vehicles at a respective domestic price advantage of approximately 30 per cent against comparable Australian domestic prices (Working Paper B7, Table One: 3). I am unsure how the Commission arrived at its 40-50 per cent price disability from these figures, and can only surmise that it did so by adding its allowance for artificial (sales tax induced) deflation of Australian prices. Yet it is hard to justify such a practice because in this instance the price comparison was between ex-tax retail prices. For as the Commission explained the issue, the *modus operandi* of any understatement of prices to avoid tax involved the manufacturers understating their wholesale prices. This was done with a view to recouping any consequent loss of wholesale revenue in higher handling margins effectively restoring the retail price to the price it would have had if the wholesale price not been understated - less the presumably very small margin of wholesale tax avoidance (IAC, PMVs, 1974: 57).

7.4.3.3 Comparative Costs and Product Differentiation

Let GMH and Ford fight for [number one] position with the Japanese. We will be happy where we are, or to slightly improve our share [of 1.5 per cent of the domestic market].


The Commission expended considerable effort attempting to discover the cost structure of the industry compared with industries offshore. But it showed much less interest in other issues which are typically unproblematic in a perfectly competitive environment but which loom much larger in the presence of product differentiation and imperfect competition. There were occasional comments in working papers such as the following: [M]arkups on some imported vehicles, particularly those described as 'luxury cars' cannot be explained in terms of freight etc. costs and duty. . . . It may be misleading to draw general conclusions from the practice of these cars, as they supply a small and distinguished sector of the market in which demand schedules . . . are relatively price inelastic (Working Paper, "Assistance": 11).
The Commission's report noted considerable evidence that product differentiation - as provided for instance by the 'optioning up' of cars - was capable of extracting premiums in the market which bore little or no relation to the costs of supply (Working Paper B7: 4; also see IAC, PMVs, 1974: 81). Yet whilst the Commission's examination of competitiveness provided useful information, it was both insensitive to the possibilities which product differentiation held out for the Australian industry and crucially influenced by its focus on the domestic market. There was little soul searching about which cars to compare with which in the Commission's cost and price studies. And the Commission expended virtually no effort investigating the extent to which product differentiation could influence elasticity of demand and the implications which this might have for its cost/price comparisons and for the competitive potential of the Australian automotive industry in domestic and export markets.

One working paper commented that "[c]ars of similar specifications can be readily grouped into particular price brackets" (Working Paper B7: 1). In fact different vehicles appeared in different groupings depending upon which market was under inspection. For instance a range of two litre family sedans comprised a discernible vehicle 'class' in England's retail market selling for about £2,000. These vehicles consistently undercut six cylinder family sedan prices in England, which began at about £2,300. European exporters to Australia recovered at least some of their tariff and transport costs and accordingly, in Australia, European two litre family sedans sold at a price *premium* to the local six cylinder family sedans.
Table 7.3 Prices for Similar cars in Australia and England mid 1974

<table>
<thead>
<tr>
<th>Engine Power</th>
<th>Displacement</th>
<th>Wheelbase</th>
<th>Australian Price</th>
<th>English Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>4 Cylinders</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Volvo 144 DL</td>
<td>$4,975</td>
<td>£2,195</td>
<td>90 BHP</td>
<td>1,986 cc</td>
</tr>
<tr>
<td>Volvo 144 GL</td>
<td>na</td>
<td>£2,850</td>
<td>135 BHP</td>
<td>1,986 cc</td>
</tr>
<tr>
<td>Peugeot 504</td>
<td>$4,598</td>
<td>£1,976</td>
<td>98 BHP</td>
<td>1,971 cc</td>
</tr>
<tr>
<td>Peugeot 504</td>
<td>$5,198</td>
<td>£2,195</td>
<td>110 BHP</td>
<td>1,971 cc</td>
</tr>
<tr>
<td>6+ cylinders</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Holden Kingswood*</td>
<td>$3,094</td>
<td>na</td>
<td>129 BHP</td>
<td>3,313 cc</td>
</tr>
<tr>
<td>Holden Premier</td>
<td>$3,660</td>
<td>na</td>
<td>135 BHP</td>
<td>3,313 cc</td>
</tr>
<tr>
<td>Holden Statesman</td>
<td>$4,095</td>
<td>na</td>
<td>135 BHP</td>
<td>3,313 cc</td>
</tr>
<tr>
<td>Ford Falcon</td>
<td>$2,825</td>
<td>na</td>
<td>130 BHP</td>
<td>3,280 cc</td>
</tr>
<tr>
<td>Ford Fairmont</td>
<td>$3,950</td>
<td>£3,125**</td>
<td>230 BHP</td>
<td>4,945 cc</td>
</tr>
<tr>
<td>Ford Fairlane</td>
<td>$3,970</td>
<td>£3,793</td>
<td>250 BHP</td>
<td>5,752 cc</td>
</tr>
<tr>
<td>Vauxhall Ventura</td>
<td>na</td>
<td>£2,331</td>
<td>122 BHP</td>
<td>3,294 cc</td>
</tr>
<tr>
<td>Ford Granada XL</td>
<td>na</td>
<td>£2,393</td>
<td>138 BHP</td>
<td>2,994 cc</td>
</tr>
<tr>
<td>Ford Granada GXL Ghia</td>
<td>na</td>
<td>£3,157</td>
<td>138 BHP</td>
<td>2,994 cc</td>
</tr>
</tbody>
</table>

* Holden medium cars are all 'optioned' to the 202 cubic inch six cylinder engine
** Fairmonts and Fairlanes sold in England were more 'optioned up' than those sold in Australia. In England the vehicles were supplied with V8 engines whereas the Australian price quoted is for six cylinder vehicles.


The Commission's analysis of competitiveness did not consider these issues. When a working paper commented that "comparisons have been made only for those vehicles which are close to competitors in the market" (Working Paper, "Assistance": 2), "the market" meant the Australian market. Classifications were taken from ADAPS - a private organisation which collected and published market information relating to the industry. Yet in some areas where it was considered that ADAPS classification did not "accurately place vehicles in market categories", classifications were changed. Thus, for instance the Renault 12 was moved from 'small light' to 'large light' and the Peugeot 504 was moved from 'medium' to 'upper medium' to reflect their price in Australia, notwithstanding the fact that the ADAPS classifications were, in these cases at least, a better reflection of the technical specifications of the vehicles in question (Working Paper...
Thus whilst the IAC generally compared vehicles which were technically similar, it also frequently 'promoted' imported vehicles from lower priced classes to higher ones because of their higher price in Australia.

Because Australia's major competition in smaller vehicle classes was from similarly sized and priced Japanese cars, and because there was little effective import competition in medium cars, these problems were not large in these sectors. But the problems were acute in the case of upper medium vehicles. The Commission's cost/price comparisons of Australia's 'upper medium' vehicles compared the competitiveness of current Australian production of 'upper medium' vehicles with the list prices of similar vehicles as CBU exports from their home country. However the Australian production chosen in these comparisons was European 'upper medium' vehicles assembled in Australia from CKD packs. This yielded disabilities of between 40 and 85 per cent, or between 12 and 70 per cent assuming that export prices had been understated (Working Paper A2: 3; also see IAC, PMVs, 1974: 83). It seems that the Commission was observing the inefficiencies of low volume offshore assembly as much as any particularly Australian inadequacies in the production of 'upper medium' vehicles (see Working Paper A2: 3-4 of Table One).

The Commission could have compared the domestic ex-tax price or cost of one of GMH's, Ford's or Chrysler's luxury optioned medium sized sedans, or their long wheel base offerings in the 'upper medium' sub-sector of the Australian market, with the European 'upper medium' offerings. Certainly some European vehicles were more technically sophisticated, yet some were not (see § 7.5.2.1 below). And the Australian vehicles were both larger and more powerful than the European ones. Such a comparison would have produced estimates of competitiveness within a wide band given the diversity of product offerings both in Australia and overseas. But at the more 'optimistic' end of that band from Australia's perspective, the disability it measured in the 'upper medium' segment of the market would have been a price disadvantage of approximately 10 per cent (with local and overseas vehicles measured at their ex-factory prices in their home market) or, with freight to Australia included, a duty free advantage.

As the name suggests, the Renault 12 was competing in the 1200 cc class whilst the Peugeot 504 was competing in the two litre class (The actual engine displacements were 1,289 and 1,971 ccs respectively [Autocar Magazine, 20th July 1974: 72]).

Whilst the Commission sought to ensure that Australian vehicles had the same options as imported vehicles it did not do the same in the other direction. No allowance was made for the much greater size and power of the Australian products over European 'upper medium' offerings.
in the Australian market. This ex-tax domestic retail price advantage to Europe would have largely evaporated had the Australian vehicles been compared with six cylinder European vehicles (which would still have been smaller than the Australian vehicles) rather than their more frugal two litre European competitors.

7.5 Automotive Exports

7.5.1 The Neglect of Exports

There was strikingly little on the issue of Australian automotive exports in the report. The 18 page report "Summary" did not mention exports (pp. 1-18). Of the Commission's 218 page report, just over three pages were devoted to sustained discussion of automotive exports and their prospects. This discussion comprised the Commission's treatment of "Overseas Markets" a sub-section in Section Five of the report dealing with "The Market". In examining 'future export prospects' the Commission offered reportage. Although relatively non-committal, its tone was both passive and rather pessimistic. Australian manufacturers had been expanding their market share in New Zealand. The Commission did not seek to investigate the extent to which exports were currently dependent upon trade preferences in the New Zealand market. And it did not attribute the expansion of Australian market share to any increases in the level of Australian trade preferences in New Zealand. Nevertheless it concluded that future export prospects to New Zealand would "depend on the continuation of the preferential tariff on vehicles and the nature of restrictions on imports in New Zealand". Likewise in South Africa, expected increases in exports were thought to be probably "only marginal" because GMH and Ford had recently been displaced as market leaders by the Japanese and because of South African protectionism (IAC, PMVs, 1974: 96).

South Africa and New Zealand together represented 75 per cent of Australia's export trade (IAC, PMVs, 1974, Table, A 7.17, Appendix Seven: 21). Yet the market for exports to developing Asian countries had been growing strongly. Between 1971-72 and 1973-4, exports to "Developing Asia" grew from just under one eighth to over one fifth of all automotive exports (Industries Assistance Commission, 1981: A 84). Commission staff prepared a page or so of notes on export markets such as the Philippines, Thailand, Malaysia, Indonesia, Singapore and Korea (Working Paper A10: 57-62). The report summarised this work by commenting that prospects for further export market expansion in these low income markets was "limited" (IAC, PMVs, 1974: 97).
By 1974, automotive exports to Japan had quadrupled their share of Australian automotive exports in four years although, given that this was from a minuscule base, they still comprised only about one per cent of total automotive exports in 1974 (Industries Assistance Commission, 1981: A 84). But the fact that Australia was exporting - admittedly in relatively small numbers - to high income countries including the major automotive producing and consuming countries was neither reported nor considered. Neither were the ideas of Drysdale, Kojima, Elkan or David Sycip (see Chapter Four and § 6.4 above). Throughout the IAC's discussion, no comment was made on the extent to which the Australian industry or Government might be able to enhance the industry's performance in export markets. And whilst the Commission's brief discussion noted the frustration of Australian automotive exports resulting from foreign trade barriers, the Commission did not suggest that this be considered in Australia's trade negotiating strategy.

7.5.2 Product Differentiation and Exports

| Commissioner -- When you say there is no place in the world to buy a Holden kind of car except Australia, what is so different about a car like that . . . ? |
| Peter North [Managing Director of Leyland Australia] -- My point was not a kind of car like a Holden. You cannot buy a Holden. There are many cars of varying kinds available, but when one carries its own brand name, this is going to establish its rightful position in terms of market forces, not in terms of economics. Take for example the marketing role of a Rover and a Jaguar. It is different in England from the marketing role of those two cars in this country. In this country they are substantially luxuries, but in their own country they are moderate luxuries. |

IAC, PMVs, 1974, Transcript: 1757

Where discussion in the 1974 Report deviated from simple reportage, the analysis offered was of an 'in-principle' kind without supporting quantitative illustration or analysis. The Commission suggested that the industry's success could be attributed to:

- cost advantages in countries which consumed right hand drive vehicles,
- its relative competitiveness in supplying six and eight cylinder vehicles,
- the preferences it enjoyed in New Zealand and
- Australian export incentives (IAC, PMVs, 1974: 95) which amounted to $6.1 million dollars for the industry for 1972-73 (IAC, PMVs, 1974: 147).

These factors are significant by virtue of their exclusive reference to the concept of the supply cost (duty paid into the export market). The Commission had informally invoked
something of Linder's model in its inaugural Annual Report by observing that Australian manufacturers might expect to develop exports where their products were based on "skill, innovation, or design" (IAC, Annual Report, 1973-4: 18). But there was little of this in the report on the automotive industry. There was virtually nothing about innovation or the prospective future 'evolution' of the industry and nothing on the price elasticity of demand in the presence of product differentiation.

And while the IAC's first two points cited above refer to scale economies and indivisibilities in production, they do so implicitly and from a 'negative' perspective: that is, they focused on possibilities for the industry to make the best of a bad (ie uncompetitive) situation. The prospect of the industry currently, or in the future, enjoying competitive advantages other than by way of some form of protection - for example by way of transport costs, its domestic manufacture of right hand drive vehicles, or government mandated assistance - was absent. The other side of this coin was that export markets were generally considered as a 'vent for surplus', not a field of opportunity which might permit Australia not only to ameliorate its weaknesses - by increasing its otherwise suboptimal scale of production - but to optimise dynamically its strengths. For all the effort and sophistication of their study of scale economies, the IAC's economists remained silent on the role which exports might play in achieving economies of scale at the plant or industry level (IAC, PMVs, 1974, Chapter Six). Instead the discussion was couched in terms of the scale of production of various components which "the Australian market could support" (eg IAC, PMVs, 1974: 106, 108, 113, emphasis added).

Reflecting Australia's relative strength and Japan's relative weakness in 'medium' and large sized vehicle manufacture, GMH had just begun exporting Statesman vehicles to GM's sister company in Japan, Isuzu (Working Paper A10: 46). Likewise, Ford was exporting to the other major developed right hand drive automotive market - England. It was exporting Australian manufactured Fairmonts, Fairlanes and Falcon GTs as well as large American manufactured luxury vehicles - the Landau and the LTD (Autocar, 20th July 1974: 2) - which were assembled and then re-exported with right hand drive in Australia (Source: Bill Hartigan, 1991). Yet the IAC offered no comment on the Japanese or English markets, or on the kinds of difficulties which Australian automotive exporters faced there. A reader of the IAC report and all its attachments would never have learnt that GMH had built a left hand drive car in the late sixties which contributed about 10 per cent of its export earnings, and that other manufacturers had considered doing the same (see Chapter Two above).
The Leyland representative had associated the product differentiation of the Mini-Moke - its indigenous design evolution - with its export success (IAC, PMVs, 1974, Transcript: 1831). The Commission briefly addressed this issue from an inwardly oriented perspective, observing that the proliferation of overseas designed models in the domestic market led to fragmentation in component production (IAC, PMVs, 1974: 137). And while the matter was not elaborated on in any working papers on exports or export incentives, a working paper on vehicle pricing noted that "the only vehicles exported were of indigenous design, eg Holden and Torana, Falcon and Valiant" (Working Paper B7: 3). But the implications of these kinds of considerations for export markets were nowhere explored in the report or its attachments. Probably the most 'product differentiated' Australian vehicle was the Mini Moke. There were no close substitutes at least in the Australian market. In the early 1970s the Mini-Moke consistently exported over 40 per cent of its output by volume and in one year the figure was over 50 per cent (personal communication with JRA executives, 1983). But this was nowhere in the report. Even in the working papers the production and export figures for each car line, or by vehicle class were nowhere compiled in a single series.

Nor would the reader have learnt of GMH's extensive technical assistance to the automotive industry of Korea and other Asian countries (IAC, PMVs, 1974, Transcript: 100) or of Ford Australia's attempts to imitate Leyland's Mini Moke by coordinating the development of the low cost "Fiera" for Asian markets (see § 2.5.2.5.1 above). This was despite its lengthy treatment in hearings, discussion in working papers and Stubbs' contemporary description of the Fiera project as "potentially one of the most significant developments of the 1970s for the Australian industry" (Working Paper A10: 47, Stubbs, 1972: 295). In fact, the Commission's four point 'thumbnail' sketch of the economics of exporting set out above would have led one to consider most of the developments referred to in this sub-section as unlikely. Stubbs had commented that "it can be seen that the prospects for export depend very heavily on the decision of the vehicle companies to select certain countries as centres for their export efforts" (1972: 295). Yet despite some cursory mention of the fact in some working documents (eg see Working Paper A10: 47), the reader would have been hard pressed to learn from a reading of the entire report and attachments, what many in the industry, the Government and members of the ALP caucus evidently considered to be of considerable significance, that Australia was becoming an automotive 'export hub' for Asia (see § 6.4 and Warhurst, 1979: 21).
7.5.2.1 Domestic Mass Marketing: Export Niche Marketing

[A] very substantial portion of [the Volvo's] total volume is exported. The vast majority is never exported as a bread and butter motor car, it is exported as a luxury motor car. It is a bread and butter car in its home country and a luxury car in these other countries.

Peter North, IAC, PMVs, 1974, Transcript: 1751

From an initial belief that the car [a Volvo 164] would prove to be vastly superior to most other vehicles I was gradually affected by a feeling of disillusionment.

Reviewer, Motor Manual, August, 1972: 44

Recall Linder's model of intra-industry trade, in which firms mass market at home and 'niche' market elsewhere (§ 2.5.2.4). It is possible to enrich this perspective by noting that the economics of niche and mass marketing can be quite different. Because of transport costs, producers almost invariably enjoy greater market share in domestic than in export markets. Transport costs also enable the exporting firm to price discriminate in favour of the export market without fear of arbitrage. Mass marketing at home and niche marketing in export markets was evident amongst European automotive firms in the 1970s as it is today.

The six cylinder Jaguar XJ6 sold in England for slightly less than twice the price of mass marketed six cylinder vehicles such as the Vauxhall Ventura and the Ford Granada XL. In Australia it sold for well over three times the price of a standard Holden Kingswood or Falcon and a little under three times the price of their luxury variants, the Premier and the Fairmont. The comparison was starker still for the V12 Jaguar selling in England for just over twice the price of the Vauxhall Ventura and in Australia for nearly five times the value of the standard Australian sixes.61

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61 The 'luxury' market seemed to exhibit this relative price inelasticity more than other segments. The Commission's estimates indicated that, between 1951 and 1973, quality adjusted prices in Australia had risen by 41 per cent and 19 per cent for small and medium cars respectively but by 240 per cent in the case of luxury cars (IAC, 1974: 79-81).
Table 7.4 Medium Sized Vehicles in Australia and the United Kingdom

<table>
<thead>
<tr>
<th>Car</th>
<th>Australian Price</th>
<th>English Price</th>
<th>Engine Power</th>
<th>Displacement</th>
<th>Wheelbase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Holden Kingswood *</td>
<td>$3,094</td>
<td>na</td>
<td>129 BHP</td>
<td>3,313 cc</td>
<td>9' 3&quot;</td>
</tr>
<tr>
<td>Holden Premier</td>
<td>$3,660</td>
<td>na</td>
<td>135 BHP</td>
<td>3,313 cc</td>
<td>9' 3&quot;</td>
</tr>
<tr>
<td>Holden Statesman</td>
<td>$4,095</td>
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<td>135 BHP</td>
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</tr>
<tr>
<td>Ford Falcon</td>
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<td>na</td>
<td>130 BHP</td>
<td>3,280 cc</td>
<td>9' 3&quot;</td>
</tr>
<tr>
<td>Ford Fairmont</td>
<td>$3,950</td>
<td>£3,125 **</td>
<td>230 BHP</td>
<td>4,945 cc</td>
<td>9' 3&quot;</td>
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<tr>
<td>Ford Fairlane</td>
<td>$3,970</td>
<td>£3,793</td>
<td>250 BHP</td>
<td>5,752 cc</td>
<td>9' 8&quot;</td>
</tr>
<tr>
<td>Vauxhall Ventura</td>
<td>na</td>
<td>£2,331</td>
<td>122 BHP</td>
<td>3,294 cc</td>
<td>8' 9&quot;</td>
</tr>
<tr>
<td>Ford Granada XL</td>
<td>na</td>
<td>£2,393</td>
<td>138 BHP</td>
<td>2,994 cc</td>
<td>9' 1&quot;</td>
</tr>
<tr>
<td>Volvo 164</td>
<td>$7,175</td>
<td>£3,450</td>
<td>175 BHP</td>
<td>2,980 cc</td>
<td>8' 9&quot;</td>
</tr>
<tr>
<td>Jaguar XJ6</td>
<td>$9,700</td>
<td>£4,405</td>
<td>170 BHP</td>
<td>4,235 cc</td>
<td>9' 1&quot;</td>
</tr>
<tr>
<td>Jaguar XJ12</td>
<td>$15,000</td>
<td>£5,367</td>
<td>250 BHP</td>
<td>5,343 cc</td>
<td>9' 4.6&quot;</td>
</tr>
</tbody>
</table>

* Holden medium cars are all 'optioned' to the 202 cubic inch six cylinder engine

** Fairmonts and Fairlanes sold in England were more 'optioned up' than those sold in Australia. In England the vehicles were supplied with V8 engines whereas the Australian price quoted is for six cylinder vehicles.


The price premiums achieved by many European vehicles, particularly from Germany and Italy, were frequently associated with the hallmarks of technical sophistication such as overhead camshafts and fully independent suspension (Autocar, July 20, 1974: 68ff). But other successful European vehicles were not particularly sophisticated. Volvos for instance had conventional in-line overhead valve engines and live coil suspended rear axles, as did the Holden Kingswood (Autocar, July 20, 1974: 74-5; Modern Motor, September 1971: 102). And Volvo's most luxurious offering, the six cylinder 164, shared most of the much cheaper four cylinder 144's panel work and mechanical equipment. It was differentiated from the 144 with a stretched wheelbase, a larger but similarly unsophisticated engine and some reworking of the front outer panels in much the same tradition as the stretched wheelbase Australian 'Fairlane' and 'Statesman' variants on the Falcon and Holden. One Australian reviewer commented that its suspension seemed "almost archaic" compared with some European rivals, and that twin carburetors had spared the engine a "tendency towards a plodding, agricultural performance" (Motor Manual, August, 1972: 44-5). Yet despite significant price premiums against technically comparable indeed frequently superior but mass marketed,
six cylinder vehicles, Volvos cheerfully occupied a global market niche which, though it was small for the globe, was not so small for Volvo.

What were the prospects for Australian automotive manufacturers imitating the Europeans by mass marketing at home and niche marketing for export? Certainly the relative prices of the respective vehicles in the Australian market reassured Australian consumers that European vehicles were of higher quality than their competitors either Japanese or Australian. In fact independent assessments of the respective 'build quality' of the various vehicles collected in 1984 (the earliest date available to me) indicates that Australian vehicles did suffer from worse build quality than European vehicles - but that the quality leader was Japanese vehicles - not European ones. Likewise safety marketing and high prices may not have indicated safer cars. Current data published by the Monash Accident Research Centre indicates that the Holden Statesman fares only very slightly worse in fatalities per 100 accidents than the most expensive Volvo '700 series'. And the Falcon EB sedan performs comparably with luxury marques including those with a particular focus on safety such as Volvo, Saab and Mercedes (Vic Roads, 1992: 7, 8, 11).

Whilst the Australian vehicles did not have technical sophistication to offer they did have their size, their power, their sturdiness and, against equally unsophisticated vehicles such as the Volvo 164, their price - even into the European market. The Ford Fairmont was sold in England for about 10 per cent less than the Volvo 164 - the larger but similarly appointed Fairlane for about 10 per cent more (see Table 7.4 above). Both were larger and more powerful than the Volvo 164. But the point cannot be made sensibly without admitting the possibility that such a strategy would very probably have

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63 Vehicle Quality (Faults per Vehicle)

<table>
<thead>
<tr>
<th>Average reported faults per vehicle</th>
<th>1984</th>
<th>1985</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australian vehicles</td>
<td>2.8</td>
<td>2.7</td>
</tr>
<tr>
<td>Japanese imports to Australia (max)</td>
<td>1.7</td>
<td>1.7</td>
</tr>
<tr>
<td>Japanese imports to Australia (min)</td>
<td>1.2</td>
<td>1.1</td>
</tr>
<tr>
<td>European Imports to Australia</td>
<td>2.0</td>
<td>2.2</td>
</tr>
</tbody>
</table>

Source. Automotive Research and Marketing Services, Australian New Car Buyer Survey, supplied by Paul Sexton of the AIA.
changed the developmental 'trajectory' of the vehicles themselves. Had Australian manufacturers sought to capture a small share of the European or world market for large cars and limousines for instance, Australian vehicle exporters would have had an interest in investing in equipping them with the necessary technical features to prosper in such markets. One might speculate that the maintenance if not the inception of the 'luxury' characteristics of many European vehicles - the build quality of the Mercedes, the 'safety' features and marketing of the Volvo, for instance - had as much to do with those firms' export marketing to the affluent of the world as it did with the quality and safety consciousness of their own home markets.

The above normal profits earned on 'optioned up' vehicles (see above) raised the prospect of marketing more highly 'optioned' vehicles into less profitable export markets whilst still covering marginal cost. Yet, whilst the possibility of marginal cost pricing in export markets was discussed in a working paper on "Export Incentives" (Working Paper B13: 4), there was little discussion of this option or of the way in which it might affect Australian firms' export strategies. The potential for mixing mass marketing at home with 'niche' marketing offshore and policy arrangements which might facilitate it were nowhere explored in the Commission's report or working papers. Although the Commission's report commented on the particular similarity of the Swedish automotive industry to Australia (IAC, PMVs, 1974: 25), it was rarely mentioned again. There was no information let alone analysis of the differences between prices of Australian products and other non-Australian imports into export markets, even though the Commission observed that the f.o.b. prices of European 'upper medium' vehicles to Australia "were generally below the stated current domestic values" (p. 83).

7.6 The IAC and Intra-Industry Trade Facilitation

The IAC's preparedness to recommend long term assistance for the industry raised the issue of the extent to which trade might be facilitated notwithstanding this assistance. Tariffs would directly impede inter-industry trade where they directly imposed costs on exporters from other industries such as agriculture and they would directly impede intra-industry trade by taxing automotive imports and directly raising the cost of automotive exports with imported content. The IAC showed surprisingly little interest even in inter-industry trade facilitation. Rural interests argued for lower tariffs on four wheel drive vehicles because they were an input to exports (IAC, PMVs, 1974, Transcript: 2308, 2216). The Commission responded summarily that it could "see no justification for the separate treatment of such vehicles" (IAC, PMVs, 1974: 177).
The facilitation of intra-industry trade received similarly short shrift. Between 1968-69 and 1972-73 intra-industry trade went from 27 per cent of Australian automotive trade to 60 per cent before falling to 48 per cent in 1973-74. This took the intra-industry trade intensity of automotive trade from 82 per cent to 136 per cent of the average intra-industry trade intensity for elaborately transformed manufactures over the period (see Statistical Appendix, Table A7.4). As noted in Chapter Five above, by the early 1970s two pieces of 'intra-industry trade facilitation policy' were in place: Article 3.7 of NZAFTA and the automotive export credit scheme. Because of its potentially greater importance, the focus of this section is primarily upon the latter of these two schemes. The Commission gave very little attention to either scheme, but almost all the attention it did give went to the NZAFTA arrangements.

7.6.1 The Functioning of the Export Credit Scheme

We see no merit in making a further substantial investment in engine plant and associated foundry facilities for a 4-cylinder engine. In fact, we believe that 4-cylinder engines would be an appropriate balancing factor for the trade created with the export from Australia... to industrially developing countries in the Asian region. Our current planning demonstrates that the 4-cylinder engine is a logical item to be used in the development of component complementation, and Government endorsement of such an import policy would be a means of achieving true rationalisation and complementation between Australia and neighboring developing countries.

GMH to the Commission. IAC, PMVs, 1974, Transcript: 101

By December 1973 the export credit scheme was two years old. But the major companies were mystified by its operation. GMH had been told that an export credit, once earned on an approved export program, would earn an import entitlement which was relatively free of restrictions (IAC, PMVs, 1974, Transcript: 125). Yet despite numerous applications, neither GMH nor Chrysler had been granted access to the scheme. The Department had told Chrysler that access to the scheme was only available where it was entering "a new market with a new model". In 1972 Chrysler began exporting sedans to South Africa, but because it had previously exported some station wagon panels to South Africa it was denied export credits (IAC, PMVs, 1974, Transcript: 1355). By April 1974 one car line with fairly minor exports had earned export credits (Working Paper B13: 2). But even so, the usefulness of these credits was

64 Indeed in mid 1975 GMH officials were still unaware of the status of their applications under the scheme, the Department of Trade and Industry not having responded to their correspondence (IAC, 1975, Transcript: 122, 1355).
profoundly compromised by constraints such as the 'non-reversion rule' (IAC, PMVs, 1974, Transcript: 1566 and see § 2.4 above). Credits were of little, if indeed any use where they could not be used to displace less competitive domestic manufactures with imports. As with its applications for export credit earnings, GMH submitted several proposals for 'reversion' to the department starting in April 1972. Over a year and a half later it had received no decision (IAC, PMVs, 1974: 142). As GMH confessed to the Commission:

We have managed to develop the new exports but we have been unable to develop any reciprocal trade to date. Of course you understand that the concession is only approved by the government provided the reciprocal trade does not harm or affect the Australian industry. In most cases we get the impression that the sort of goods we should like to import would in fact be considered by the component industry as harmful and therefore our application might not be approved. . . . There is also this 'no-reversion' rule (IAC, PMVs, 1974, Transcript: 69).

7.6.2 The Politics of the Export Credit Scheme

Within the limits proposed for export content incentives the government should let individual companies devise the best economic arrangements with a minimum of economic restrictions.
Ford to the IAC, IAC, PMVs, 1974, Transcript: 1586

The squeamishness about adjustment which had typified the local content and export credit schemes profoundly influenced the politics of export credits. Although export credits could loosen the constraints of the local content scheme, the constraints on using export credits to 'revert' to imported components meant that the advantages of the export credit scheme would be enjoyed predominantly by newcomers. As Chrysler explained, the existing scheme would provide:

disproportionate benefits to new manufacturers entering the Australian market. These new companies commencing with no exports from Australia would have access to any market and would therefore be able to acquire permanent, in built advantages over the existing manufacturers, who have already created export markets in many areas (IAC, PMVs, 1974, Transcript: 1354 cf Ford: 1566, GMH: 1986).

Industry consultants Martec explained that the Japanese companies could minimise their Australian investment by sourcing relatively few components in Australia for domestic assembly and for export so as to earn the right to import their other components (MIP, February, 1972: 6). Chrysler conceded its fear that the Japanese firms would import "a new line of presses to produce a limited number of inner body panels . . . by imported steel, and then export the packs or the panels to a high usage area like Japan" (IAC,
There is some evidence that the Japanese firms were thinking along these lines (e.g., see Toyota, IAC, PMVs, 1974, Transcript: 362). Likewise the Japanese academic Takeshi Mori commented on the major Japanese firms' apparent ambitions for complementation in Asia and added that Australia was one of the most important countries both as a market and as a manufacturing base. This was particularly the case for companies such as Toyota and Nissan, which had previously invested in facilities in Korea and Taiwan which they had been forced to close. At the time, Korea and Taiwan and Australia were the only Asian countries outside Japan where skilled labour was available in abundance. Mori suggested Japanese firms were addressing "the possibility of using Australia as a useful foothold in their global logistics plan" (1974: 31-2).

Whilst (not surprisingly), strongly supporting all other export incentives, Chrysler requested the termination of export credits (IAC, PMVs, 1974, Transcript: 1354, 1359). Ford, which had sponsored the original scheme to accommodate their growing Asia-Pacific aspirations and even requested the Commission to recommend liberalising the administration of the scheme (see quote at head of section), nevertheless requested that export credits be limited to five per cent of local content (IAC, PMVs, 1974, Transcript: 1583). And although GMH requested a more liberal export credit scheme than the other established manufacturers, it also proposed to protect its interests against newcomers with a 'hurdle' of 90 per cent local content to qualify for the scheme (IAC, PMVs, 1974, Transcript: 1987).

7.6.3 The IAC and the Economics of Intra-Industry Trade Facilitation

[Export credits] can easily be made to sound virtuous and Adam-Smithian. How far the motor industry arrangements are trade-creating and how far trade diverting, or how far they will improve Australia's allocation of resources, is less easy to assess.

Davidson and Stewardson, 1974: 164

The above quotation provides an exemplary professional response to intra-industry trade facilitation policy. Given its origins in the politics of protectionism the response is pre-
eminently skeptical. Both Harry Johnson and Gerald Helleiner had a similarly jaundiced view of Canada's 'extended content' arrangements, with Johnson highlighting their potential as an export subsidy (1963: 226) and Helleiner commenting wryly on the way in which business interests had ensured free trade for themselves whilst keeping it out of the dangerous hands of consumers (1981: 84). However, the authors of the above passage suggest that the ultimate judgment must be founded on an assessment of expected empirical costs and benefits. They proceed to outline a simple framework for so doing. Nothing like this was even hinted at in the Commission's report.

The Commission's comments on the policy merits of export credits were largely inscrutable. The report offered no substantive evaluation of Australia's existing export credit scheme. There were occasional comments on 'complementation'. Yet they often suggested that the Commission was focusing on it as something occurring largely offshore and within firms rather than at the level of government policy. The report's one paragraph discussion of "existing complementation schemes in South East Asia/Pacific" appeared to comment on the extent to which Australia might benefit from the policies of companies or national governments offshore, without any comment about the export credit scheme (IAC, PMVs, 1974: 213). Throughout both the Commission's internal Working Papers and its published report, there was virtually no discussion of the extent to which such plans might either have implications for - or be affected by - trade policy instruments in Australia. Indeed, the export credit arrangements received their only mention - one paragraph of reportage - in a five page Working Paper on "Export Incentives" (Working Paper B13).

The Commission offered glimpses of some of the potential benefits and costs of complementation. Outlining the operation of Article 3.7 of NZAFTA it commented approvingly that "co-operation between manufacturers" was "an obvious way of extending the size of the market available to them" (IAC, PMVs, 1974: 178 also see Working Paper B16: 9). It likewise observed that regional complementation more generally represented "a way in which greater economies of scale and specialisation could be achieved" (IAC, PMVs, 1974: 214). Flagging the potential for government complementation schemes to divert rather than create trade, it commented on the importance of basing such schemes on the principles of efficient sourcing (IAC, PMVs, 1974: 214). However the Commission made no attempt to evaluate the respective potential costs and benefits of complementation within Australia or offshore within any coherent framework. This meant that, like Lloyd and Grubel's comments on the policy implications of intra-industry trade (§ 4.6.2 above), the Commission offered no
concrete advice on how to facilitate cost reducing intra-industry trade in the presence of trade barriers or of the likely welfare effects of so doing.

The Commission concluded that its tariff-only proposals would "tend to encourage participation by local manufacturers in regional complementation schemes and government intervention should not be necessary" (IAC, PMVs, 1974: 214). The reference to regional complementation appears to refer to other countries' complementation schemes. However the Commission did not explain why its proposed tariff-only regime would facilitate Australian participation in regional complementation arrangements offshore significantly more than the existing local content scheme - particularly with the export credit facility. And, although in important ways import/export links are liberalising (cf Chapter Five above), the Commission's implicit suggestion that they were additional interventions was a portent of its deliberation on import/export links when it was required to assess the export facilitation scheme in 1979 (see Chapter Nine below).
Formal operations relying on one framework of interpretation cannot demonstrate a proposition to persons who rely on another framework. Its advocates may not even succeed in getting a hearing from these, since they must first teach them a new language, and no one can learn a new language unless he first trusts that it means something.

Michael Polanyi, cited in Loasby, 1976: 193

This chapter focuses on the debate which occurred after the release of the 1974 report. In this the IAC had a variety of critics including manufacturers and unions. But the IAC focused its defence of its report on two critics, the South Australian Government and a report commissioned by the Federal bureaucracy from the automotive consultant Martec Pty Ltd. Despite their pronounced weaknesses, both these critiques made important contributions. Both warned plausibly, and as it turned out correctly, that the Commission's predictions about the future disregarded emerging signs that its assumptions were wrong. Martec brought something more to the discussion - a knowledge of and 'feel' for the automotive industry and its development. The material discussed in this chapter provides textbook illustrations of the vices of over-reliance on technical expertise (as explored in § 1.3 above). As stated previously, Martec's and the Commission's skills and perspectives were highly complementary. Either could have trawled through the other's contribution for ways to improve their own, and for the common ground which emerged when considering both perspectives, as far as possible, together (cf § 1.3.2.1). This chapter illustrates how comprehensively the opportunity for such dialogue and mutual benefit was passed up and the inadequate policy outcomes to which this led.

8.1 The Aftermath of the IAC Report

[A]s the energy crisis deepens and the local economy falters, the second quarter is likely to see a tapering off [of demand] leading to a sizable fall-off in the final half in 1974. The drop will be particularly evident in the medium-car sector which is dominated by Holden, Falcon and Valiant.

Trevor Dawson Grove, AFR, 27th December, 1973: 5

The 1974 automotive report was the Commission's greatest challenge to that date and (as is the way with such things) its chances of success were always uncertain. In the event, however, the IAC's timing was remarkably unlucky. As its research gathered
momentum, economic storm clouds gathered (see above quote). The causes of the macro-economic downturn, which began at about the time of the report's release (Rattigan, 1986: 207-8), had disproportionately ill effects for manufacturing. On top of falling aggregate demand, Australia's manufacturers faced wage and energy cost increases. The expansion of Australian mineral and energy exports meant that it was some time before the rise in Australian producer costs found its way into currency devaluation (see § 8.2.1). Things were particularly difficult for automotive manufacturers. Increasing petrol prices accelerated the previously gradual swing in consumer demand towards smaller vehicles (cf § 2.3 above).

During the Tariff Board hearings, both GMH and Ford were at full capacity (IAC, PMVs, 1974, Transcript: 1548). However, from late 1973 some were predicting a recession with particular difficulties for the automotive industry (see quote at head of section). By late 1973, both Leyland and Chrysler were making losses, whilst in 1972, the hitherto most profitable firm, GMH, had recorded earnings which were nearly 20 per cent lower than its 1971 results and 50 per cent lower than those of 1970 (IAC, PMVs, 1974, Transcript: 61). In a portent of things to come, less than a month before the release of the IAC's report, Leyland retrenched 1,000 workers. Ten days later Lucas, an electrical component supplier to the motor vehicle industry, dismissed 80 employees. Both Lucas and Leyland foreshadowed further dismissals (Rattigan, 1986: 208-9). Two weeks before the automotive report was released, a regular three monthly survey which had previously reported product shortages and optimism showed that business sentiment had turned sharply negative (Rattigan, 1986: 207-8).

And the relative productivity of Australian vehicle production fell against other countries not just because Australia's productivity fell with the fragmentation of Australian production but also because the productivity of other automotive producers - particularly Japan - rose strongly. As the seventies wore on, the magnitude of the Japanese achievement gradually revealed itself. Earlier 'Fordist' or 'Taylorist' production systems had focused on command and control strategies, and so frequently constructed adversarial relationships within the industry between employers and employees and between suppliers and assemblers. By contrast in the new Japanese production system, vehicle manufacturers devolved more control to employees and to suppliers and encouraged them to collaborate in continuously improving product and process design and so the productivity with which they worked together (Womack et al, 1990, Chapters Two and Three; The Economist, May, 14th 1994: 75 and see § 9.3.1 below for figures on Japanese productivity and price performance over the 1970s). The net export intensity of Australia's automotive industry ([Exports - Imports]/Turnover) fell fourteen
percentage points between 1972-73 and 1974-75 whilst the net export intensity of elaborately transformed manufacturers fell nine percentage points (Statistical Appendix, Table A8.1).

8.2 The Bureaucracy Looks for Options: The IAC enters the Fray

The bureaucratic and political melee which greeted the ambitious IAC recommendations and the difficulty of the circumstances into which they were cast (Warhurst, 1982: 193-200), provided an opportunity for the IAC to take the debate to its critics in defence of its own work. The major bureaucratic participants were the Department of Prime Minister and Cabinet (PM&C) and the Standing Interdepartmental Committee on Assistance to Industry (SIDCAI) which comprised PM&C in the chair, and the Departments of the Treasury, Manufacturing Industry, Urban and Regional Development, Overseas Trade and Customs and Excise (Warhurst, 1982: 195). Through its PM&C representatives, SIDCAI wrote several times to the IAC seeking further information in an effort to assess the report and possible alternatives. In many ways the IAC was now achetypically living out the role which Rattigan had sought for it, as the expert 'arms length' adviser to government with its own claims and opponents' counterclaims being exposed to public scrutiny. Yet the ensuing set pieces of question and answer, claim and counter claim illustrate the costs of dialogue as contest. The IAC conceded virtually nothing to its opponents and in the process foreclosed what prospects there were for productive dialogue and mutual adjustment and through it, mutual gain.

8.2.1 Diagnosis Dire: Outlook Optimistic?

At the end of 1971 the ... largest selling import ... was the Mazda 1600 Capella. Its price ... was ... around about $150 cheaper than a Kingswood Holden. Today a Kingswood ... Holden costs ... around $550-600 [more than the Mazda] - a dramatic change in competitive relationship between models and between sources of production.

Rob O'Connell, Martec Seminar, May 1974: 03-4

There was an essential tension between the IAC's findings about the industry's uncompetitiveness and its recommendations. The IAC's findings of uncompetitiveness helped it establish the urgency of reform by highlighting the costs of protection. On the other hand the more uncompetitive the IAC found an industry, the more disastrous would be the expected result of tariff reform. Some important shortcomings in the report appear to spring from this tension. The Commission found that the cost disability

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against Japan of medium and large light vehicles was 45 and 80-85 per cent respectively. Nevertheless it concluded that under its recommended 25 per cent tariff-only regime, Australian made medium vehicles would maintain their existing 95 per cent share of the domestic market, and that if market demand swung more strongly towards light vehicles than the Commission had predicted, the major local manufacturers could be expected to occupy "a significant place in that market" (IAC, PMVs, 1974: 160). The following two subsections explore these tensions between the IAC's findings and its predictions.

Before proceeding it is worth noting that the previous chapter's critique of the IAC's cost/price analyses was based on the IAC's own data which was collected in late 1973 and early 1974. The cost competitiveness of the industry was deteriorating fast at the time (IAC, PMVs, 1974, Transcript: 1784), and had changed still more by the time the IAC's report was debated in late 1974. GMH raised its prices by 22 per cent during Calendar year 1974 (excluding an additional price rise of about eight per cent for a new model), a figure which was typical of the major Australian manufacturers (AFR, 21st May 1975: 7). And while the Government devalued in September 1974, the Australian dollar had risen by more than this against the yen since August 1973 (Reserve Bank Bulletin, Table F9). Ironically, what were probably overly pessimistic analyses of the earlier data may have been about right by late 1974!

8.2.1.1 The Viability of Medium Car Manufacture

If medium car manufacture was 45 per cent more costly in Australia than in Japan or the United States (IAC, PMVs, 1974: 98), a 25 per cent tariff would combine with approximately 15 per cent transport costs to leave the Australian industry at a five per cent cost disadvantage against imports. The Commission replied to SIDCAI questioning along these lines that advantages of local presence and freedom from the constraints of the local content scheme would see producers "at some advantage over North America" (Rattigan to Steele, Attachment One: 15), something which is not apparent from the argument or from any exploration of the issue in the report. The Commission envisaged that the medium car manufacturers would face lower costs because, in the absence of the local content scheme they would reduce their local content from over 95 per cent local content (IAC, PMVs, 1974, Appendix Seven: 22, Table A7.18) to about 85 to 90 per cent (IAC, PMVs, 1974: 162). It should be noted by way of an aside, that an important summary working paper concluded shortly before the report's completion that they would not reduce their level of local content (Working Paper "Assistance": 19). Even accepting the Commission's ultimately published view, a change in sourcing of about 10 per cent local content seems highly unlikely to provide the needed five per cent reduction
in costs to meet the cost of imports. For products designed in Australia, as virtually all of the Holden and most of the Falcon then were (personal communication with GMH and Ford), this is a tall order indeed and nowhere justified in the Commission's report or supporting documents. Perhaps the Commission envisaged that the remaining local content would also be cheaper, but it did not elaborate or quantify this line of reasoning.

Given the locational complementarity between component manufacture and assembly the Commission's appeal to the advantages of local production seems reasonable where the question relates to the production of components for assembly in Australia and/or where the major source of competition comes from vehicles assembled from CKD packs. But the 45 per cent figure compared Australian manufactured vehicles with CBU imports. Clearly CBU importing involves some disadvantages in terms of inventory holdings and response times to customer preferences. But it is not clear what these disadvantages are worth and whether, for instance they offset or outweighed any marketing advantages which might have been associated with the mystique and higher quality of imports at the time. In such circumstances, if the Commission's estimate of current cost disability was accurate, its prediction that in the medium to long term Australian medium vehicles would retain their 95 per cent domestic market share against lower cost CBU imports surely stretches credulity (IAC, PMVs, 1974: 159).

8.2.1.2 The Viability of Light Car Manufacture

There was a similar tension between the Commission's pessimism about the competitiveness of Australian light car manufacture and the Commission's description of its prospects under the report's recommendations. The light car market comprised small and large light segments as well as a new six cylinder segment which typically involved 'shoe-horning' a medium car six cylinder engine into a smaller vehicle ordinarily powered by a four cylinder engine. GMH led the pack in 1969 with a Torana powered by a Holden Kingswood six cylinder engine. Both Leyland and Ford had followed suit with six cylinder Marina and Cortina ranges and by 1973 these vehicles occupied eight per cent of the light vehicle market (IAC, PMVs, "Papers", 1974, Volume 3, § 2.4.6.3). The IAC measured the cost disability of the light car segment (excluding the six cylinder sub-segment) at 80-85 per cent for large light and more for small light cars (cf § 7.4.3.1

For a change in sourcing of (say) 10 per cent of total content to improve cost structures by 5 per cent, it would be necessary for imported components plus transport costs and 25 per cent duty to be 50 per cent cheaper than locally supplied components. (In fact this does not account for the imported content which was already in the vehicles which was currently being imported duty free and which, under the Commission's recommendations, would have attracted a duty of 25 per cent).
above). This would clearly swamp a 40 per cent cost impost from tariffs and transport costs without huge local productivity improvements. The light car market was also more fragmented than the medium car market. Apart from the brief time when the Leyland P 76 made four, the big three American firms occupied over 95 per cent of the medium car market with locally manufactured vehicles. By contrast, in the light car market, competition took place on much more equal terms between the big three Americans, Leyland and various Japanese assemblers and importers (Working Document, "Production" and see IAC, PMVs, 1974, Appendix Seven: 22-3).

The report concluded that the six cylinder large light market would continue to grow strongly "with the major part of this market being held by local manufacturers" (IAC, PMVs, 1974: 159). This prediction was problematic because the local manufacturers' six cylinder light vehicles depended on the availability of light vehicles into which the manufacturers' six cylinder engines could be fitted and, as the previous paragraph argues, it is hard to see how the local manufacture of light vehicles could have survived the Commission's recommendations. The report commented that the substantial growth in the market for light vehicles other than the six cylinder light vehicles would be met "mainly by imports" (IAC, PMVs, 1974: 159). It then went on to comment (and reiterated against its critics later), that:

The assistance recommended by the Commission should encourage the existing high content manufacturers to concentrate their production in the large light and medium car categories and maintain market coverage by sourcing CBU or CKD light vehicles from the low cost plants of associate companies. . . . However, if over the long term the market swing to light cars should become more pronounced than presently forecast, the Commission would expect the major local manufacturers to occupy a significant place in that market with locally produced vehicles (IAC, PMVs, 1974: 160).

Yet the Commission had not solved the problems of fragmentation in the large light market. Indeed its internal documents indicate that even if it had, Australian large light car production would still have been at a significant, if smaller, disadvantage. Shortly before the report's finalisation, a minute (apparently from a senior staff member) warned that the Commission's intention of recommending against special arrangements to facilitate the manufacture of Australian light cars might be badly received. The minute surmised that six cylinder large light vehicles might occupy about 15 per cent of a projected light car market of about 350,000 by 1980. The predicted absence of

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Australian manufacturers from the rest of the light vehicle market led the minute's author to consider "the possibility of Australian manufacturers mounting a combined venture to produce one light car which each would market". He had in mind the possibility of a jointly produced light vehicle occupying 50 per cent of the 300,000 light vehicle market not already occupied by six cylinder light cars. The minute proposed that the Commission "at least canvass the idea explicitly" in its report (Undated Minute, "Effects": 2).

The author conceded that the issue had not been fully researched, but set out the following rough calculations:

**Table 8.1 Cost Disability of Australian Large Light Vehicles**

<table>
<thead>
<tr>
<th>Item</th>
<th>Calculated Disability</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Total Current Cost Disability</td>
<td>80%</td>
</tr>
<tr>
<td>2 (a) Attributed to Scale</td>
<td>35%</td>
</tr>
<tr>
<td>(b) Scale disability at 150,000 per annum</td>
<td>5-10%</td>
</tr>
<tr>
<td>Total Reduced Cost Disadvantage</td>
<td>50-55%</td>
</tr>
<tr>
<td>Tariff (25%) + freight costs</td>
<td>40-45%</td>
</tr>
<tr>
<td>Balance [of disability]</td>
<td>10%</td>
</tr>
</tbody>
</table>

Source: Undated Minute, "Effects": 2.

The minute concluded that "with our reservations about the basic data we would be hard pressed to conclude with confidence that this venture would be uneconomic" (Undated Minute, "Effects": 1-2). The analysis underpinning the above calculation was carried through to the final report, which had large light vehicles at a cost disability of 80-85 per cent (IAC, PMVs, 1974: 98), and lack of scale economies accounting for "about half of the assessed cost disadvantage against Japanese producers" (IAC, PMVs, 1974: 125). But the Commission's assessment that Australian manufacture would emerge if the market swung towards such vehicles (quoted above) somehow defied this analysis.
8.2.2 Debates on Long Term Demand

There is scarcely any question in economics which might not be advanced by bringing to bear on it (i) a knowledge of what statistics have to say combined with (ii) a knowledge of what statistics can't be made to tell, but which has to be reckoned for in a realistic solution. (i) without (ii) seems to me to be so dangerous that on the whole it is more likely to do harm than good.

Alfred Marshall, cited in Pigou, 1925: 424

The Commission believed that its recommendations would bring about relatively modest - though not necessarily smooth or predictable - structural change (IAC, PMVs, 1974: 168). To a large extent its view was founded on projections of long term future medium car demand which, although they were broadly consistent with the industry's expectations during the inquiry, turned out to be very over-optimistic. To use the terminology introduced in Chapter One, the Commission neglected to exercise the 'integrative skill' necessary to assess the likelihood that, for all the 'technical skill' embodied in its long term demand projections, they might nevertheless be seriously wrong.

Peter Dixon has commented on the failure of economic projections during this time:

> Because the historical record up to the time of the shock had no examples of large oil-price movements, the predominantly statistical models underestimated the impact of this event in influencing the future course of the world economy (1993: 5).

Given this one can not be too hard on those whose projections turned out to be wrong. The real methodological vice exhibited by the IAC's economists was not that they were wrong, but that they were so sure they were right! It is hardly a fine point of philosophy or economic methodology to observe that the more one is forced to extrapolate from events which have actually taken place to those which have not, the more one must assume and so the more likely one is to be wrong. Economists of the IAC should have appreciated at the time, and made it clear in their report and subsequent public comments that their best estimates might not have been very robust at a time of huge and unprecedented structural change - not to say upheaval. Econometrics - and all science for that matter - can easily be worse than useless if it does not come with some understanding of the robustness of its claims.

Where it has initially been poorly exercised, 'integrative skill' is frequently developed after the event in discussion with others who probe the weaknesses of a piece of technical work bringing different perspectives and concerns to bear. However, the Commission's adversarial stance in public debate ensured that despite the warnings of
others, it never came to assess carefully the confidence which might be put in its projections. In addition to vigorous industry and union lobbying, the South Australian Committee report and the Martec report roused the IAC to direct - and to onlookers somewhat irregular (Warhurst, 1982: 204) - public intervention in the debate. The debate on demand projections can usefully be separated into three constituent projections - those for

- the total Australian demand for vehicles,
- the demand for medium vehicles within that total demand and
- export demand for Australian vehicles.

This subsection deals with the first two of these points and the IAC's response to them, while the subsequent section deals with the latter point in the context of a more extensive consideration of Martec's contribution and the IAC's response.

The South Australian Committee argued that the IAC had overestimated both the total demand for cars and the proportion of that demand which would be for medium sized vehicles. Martec defended the IAC's projections of total demand, only to suggest that the composition of demand would swing even more strongly against medium sized cars than the South Australians had suggested. Where the IAC projected that small vehicles would satisfy 56 per cent of the total market for cars in 1980, the South Australians projected that the figure would be 62 per cent (IAC, "Evaluation", 1974, Attachment: 10) and Martec suggested, somewhat sensationally, that the figure would be "closer to 80 per cent" (MIP, October, 1974: 7). Whilst the IAC conceded some uncertainty about the future, it disparaged the contributions of those it took to be its major antagonists as essentially useless on account of their technical inferiority (IAC, "Evaluation", 1974: 2). But as will be seen, whatever their technical prowess, the IAC's critics raised legitimate questions about the plausibility of the IAC's forecasts.

While the IAC's projections lay roughly within the middle of the range of projections offered by the industry in evidence some months before - a point which the IAC rarely failed to use in its defence (Rattigan to Steele, Attachment One: 4; IAC "Evaluation", 1974, Attachment: 10) - the South Australian projections on the future market share of medium sized vehicles were not as pessimistic as the most pessimistic of the vehicle manufacturers (IAC "Evaluation", 1974, Attachment: 10). This suggested that the South Australians' projections were plausible and by no means outlandish. This was reinforced by the rapid emergence of news on cost competitiveness (see § 8.2.1 above) and demand changes (this section below) which gave greater grounds for pessimism than the news available to the Commission as it drafted its report. But the central thrust of the South Australians' submission was hardly that theirs was the best model for
predicting future vehicle demand. It was rather that the Commission was or might be wrong. Around this point there was no real engagement. At no time did the Commission focus on assessing the likelihood that its projections were wrong and the risks which this might entail. It focused instead on its reasons for believing that it was more likely to be right than the South Australians - on the "evidence available" which would cause it to "revise its projections" (Rattigan to Steele, Attachment One: 6). This boiled down to various demonstrations that the IAC's critics' methods were "inferior in predictive performance to the Commission's model" when compared with the history of Australian vehicle demand (from which the Commission's model had been derived) (IAC "Evaluation", 1974, Attachment: 7).

Throughout the debate there was little acknowledgment by the IAC of the inherent difficulty of predicting demand six years into the future at a time of substantial micro-and macro-economic upheaval. Martec expected the circumstances of the energy crisis to produce discontinuities in past patterns of demand. It accordingly focused on gleaning clues to the future from trends emerging at the time, including those emerging after the IAC had reported, in contrast to the longer term historical focus of the IAC's econometrics. Martec's report to PM&C noted that in the few months since the IAC report had been released, small car market share had risen from the 47 per cent reported in the IAC report (IAC, PMVs, 1974: Appendix Seven: 18), to 53 per cent, just three percentage points short of the market share the Commission had projected for 1980. It suggested further that the Sydney automotive market represented as good a guide to the future as was available, because Sydney's heavy traffic congestion and high level of car ownership resembled the future and had anticipated future trends in the past. In Sydney small car market share was already above 56 per cent (IAC, "Martec", 1974: 14-15).

The IAC did not assess the likelihood that Martec was right that there was an historical discontinuity in market demand. Nor did it address the question of how one might assess likely future trends if there were such a discontinuity emerging. The Commission argued that Martec's evidence was "insufficient to support" its conclusions of discontinuities (IAC, "Martec", 1974: 15). The IAC protested that "in a period affected by industrial disputes and supply shortages, there could be little confidence that movements over such a short period would have any value as indications of long term trends" (IAC, "Martec", 1974, Attachment One: 15). One need not disagree with this. Observed irregularities may represent fundamental discontinuities or mere disturbances, and the earlier the assessment the more necessarily speculative it will be. But the Commission's fastidiousness towards its opponents was nowhere turned upon itself. If one should have "little confidence" in Martec's methodology, the Commission never
explained how much confidence one should have in its own methodology. In the circumstances, Martec's suggestion of a discontinuity was far from outlandish and worthy of careful consideration. With Martec as with the South Australians, the Commission dealt with its critics by effectively imposing the onus of proof upon them rather than meeting their criticism directly or indeed discharging that onus of proof itself as the Crawford report had suggested (Crawford, 1973: 27):

The Commission cannot accept the argument that, for longer term projections, a discontinuous change in the Australian motor vehicle market can be interpreted from the last few months registration data (IAC, "Martec", 1974: 22).

The data did foreshadow a discontinuity.

### 8.3 Martec, Exports and an Intra-Industry Trade Led Recovery of the Industry?

Flew to Sydney to attend a most interesting seminar arranged by Martec Limited. First class it was. An officer of the Department of Secondary Industry, Denis Ives, gave a first class talk, also Robin O'Connell of Martec was good. There were some very interesting people there. I admire the frankness with which their problems were analysed and admitted. It makes you realise how much . . . sense you can get out of secondary industry if only they would cease treating you as a simpleton.

Bert Kelly, Personal Diary, 29th November 1973

The organisation which became Martec was formed in 1966 by Michael Aiken, a Bachelor of Commerce from Melbourne University. At that stage Aiken was a consulting economist to BIS Shrapnel, which provided consultancy services to the automotive industry. Aiken was joined in 1969 by Rob O'Connell and by the early 1970s, Martec was the major consultancy firm in the automotive industry, providing services to all sectors of the industry. The two partners ran seminars every six months on the progress of the industry, offered analyses of various aspects of the operating environment of their clients in the industry, published bulletins between conferences and had an interest in the industry newsletter *Automotive Industry Matters* (Martec, 1971).

From the outset Martec's style was suited to its commercial *milieu*. Its analysis of the industry was frequently peppered with self advertisement and salesmanship; its prose reflected a tension between the demands of arresting expression and English grammar (see below). Nevertheless Martec's partners were young, entrepreneurial and extremely familiar with the industry. Their contribution was highly complementary to the IAC's. The Commission's technical strengths certainly compensated for Martec's relative
technical weakness. But where the Commission's approach frequently reflected an awkward reliance on the economic textbook, Martec's approach to its material reflected the protean opportunism of a market operator.

As discussed in Chapter One, the Commission sought to measure minimum efficient scale (MES) using a textbook definition without apparently realising the wholly arbitrary nature of the definition it was using (IAC, PMVs, 1974: 100). For the relevant policy question required some appreciation of market circumstances - the scope for product differentiation to raise demand and/or lower its price elasticity. The Commission proceeded to assess the level of competitive disability of the industry without reference to the opportunities provided by product differentiation (cf § 7.4.3 above). And it sought to glean emerging responses to major and unprecedented economic shocks with econometric modelling which relied on data from the distant past.

On all these issues Martec offered valuable insights, as for instance when it suggested that the Sydney market offered a useful window on emerging market trends (§ 8.2.2 above). And on some issues, the pictures sketched by Martec's examples were worth a thousand of the Commission's words. Martec searched for enlightening analogies - comparisons of 'rather like' and 'rather like'. And the examples it chose were tailored to illustrating the Australian policy problem at hand. The scholarly studies and examples cited by the IAC on the significance of scale economies related to large developed markets where MES as defined in the economics textbooks could be reached and where economists had focused their econometric analyses. By contrast Martec focused on the 'niche' players in the world industry such as Volvo and BMW in Europe and Isuzu in Japan (AIM, October, 1974: 13). No econometric studies had been done on them. Yet they provided a potential role model for the Australian industry - particularly in export markets. And in contrast to the IAC's static perspective, Martec asked "where [should] the automotive industry in Australia be persuaded to evolve in the last two decades of the twentieth century?" (AIM, 24th July, 1974: 9)

### 8.3.1 Martec and Intra-Automotive-Industry Trade and Specialisation

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<td>Michael Aiken, on export credits, AIM, 30th May, 1972: 2</td>
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Michael Aiken was sympathetic to the 'economistic' critique of the local content plans and frequently quoted economist Gary Purcell's scathing attack on the local content plans (eg see AFR, 19th September, 1968: 29). Writing well before the cost of Australian
protection and the competitive achievements of the Japanese had become fully apparent, Pursell had pointed to the importance of scale economies and deplored the neglect of their significance amongst policy makers and "even in the various reports of the Tariff Board" (1968: 2). He argued that there was little wrong with the economic fundamentals of Australian automotive manufacture except that Australian policy makers had gone "out of their way" to weaken and fragment the industry with high protection:

The local producer should be able and should be encouraged to export on a large scale. The single Swedish producer Volvo exports over 60 per cent of its production. If ... a net export surplus could be achieved - as it is by the main European manufacturing countries and Japan - the level of activity and the scope of car and component manufacturing would be greater than under any conceivable alternative plan (1968: 2).

Although critical of the local content plans and sympathetic towards gradual tariff reform (Martec, 1972: 3.14; MIP, September/October 1972: 6, April, 1973: 5), Martec was rather like a political party in opposition: more explicit as a critic of existing policy than in proposing concrete alternatives.68 Nevertheless by early 1972 Martec was setting out its own vision in which automotive industry policy would facilitate the integration of the Australian industry and the automotive industries offshore. "If we must have Plans" Martec opined, why not promote an Australian industry which "locally manufactures a few, a very few, models completely, but also produces some other vehicle components both for export and for domestic use within a relatively competitive vehicle assembly environment. ... Australia has a strong domestic market preference traditionally for medium sized cars" (Martec, 1972: 1.8). This perspective led Martec to identify the export credit scheme announced in December 1971 as "the major new step in the plans" (MIP, February, 1972: 6). Before its services were contracted by PM&C, Martec raised these issues in its published response to the IAC report, commenting that "vertical disintegration of manufacture, is conspicuously absent from the IAC blue print for the future" (AIM, 24th July, 1974: 9).

8.3.1.1 Martec's 'Appreciation' of the IAC report

Martec produced two documents for PM&C: one evaluating the IAC's demand projections, the other proposing future policy. Martec argued that under the IAC's recommendations exports would collapse. It pointed out that since the IAC had

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68 After quoting selected extracts from a variety of sources (including some of their own material) all of which were generally sympathetic to tariff reduction, the Martec bulletin Motor Industry Prospects distanced itself from tariff reform. "We might not like these things being said, but it is Martec's responsibility to draw our subscriber's attention to these undercurrents" (MIP, February, 1973: 6-7).
completed its report, New Zealand had increased sales tax differentially on medium sized vehicles as a fuel economy measure \((MIP, \text{October 1974: 6})\). It commented further on what it saw as the long term strategic significance of exclusive reliance on inwardly oriented protection such as the Commission had recommended. Multinational car producers would "progressively exclude Australia as a source in their . . . approach to world wide design and complementation" \((MIP, \text{October 1974: 7 cf p. 11})\). Martec concurred with the IAC's basic diagnosis of the industry's woes. Production was fragmented and producers had inadequate access to economies of scale. But it parted company with the IAC when it came to solutions \((MIP, \text{October, 1974: 12})\). Martec argued that the Commission's recommendations were inconsistent with its terms of reference which called for a viable, high local content industry utilising a high degree of indigenous technological capability which nevertheless recognised consumer choice. Martec came to the view that under the Commission's recommendations, vehicle manufacturing would be dramatically wound back as the domestic market swung towards smaller cars and exports contracted.

\subsection*{8.3.1.2 Martec's Alternative: an Intra-Industry Trade Led Recovery}

Martec criticised the Commission's proposals as unintentionally "negative or destructive" \((MIP, \text{October, 1974: 12})\). It proposed 'intra-industry trade facilitation policy' instead. As Grubel and Lloyd would do the following year (see § 4.6.2 above), Martec argued that intra-industry trade could and should be facilitated, and suggested concessional treatment under existing protective arrangements without explaining clearly how such a scheme might operate. Martec called for an approach which would allow for automotive exports of components and/or vehicles "to exceed significantly, (and eventually exceed several-fold), the level of domestic sales . . . The quid prod quo in this complementary international trading and automotive sourcing pattern should be CBU importation into Australia. Anything less farsighted than this will accentuate and guarantee continuation of today's problems in the industry" \((MIP, \text{October, 1974: 13})\). Much of Martec's thinking revolved around its appreciation of the continuing growth of intra-industry trade including product cycle trade in Asia with Australia as a potential 'technology leader' \((MIP, \text{October, 1974: 14})\). It called for assistance arrangements which encouraged global automotive companies to "see Australian production facilities, Australian

\footnotesize{\textsuperscript{69} Unless otherwise indicated all emphases in the text are Martec's and conveyed in the form Martec conveyed them - in italics, underlining, or capitals with little apparent rationale for the choice between them.}
management and technological resources, and the Australian market as a worthwhile part of the increasingly integrated world wide industry. *The alternative is for Australia to become an automotive backwater"* (MIP, October, 1974: 15).

Martec's proposals to facilitate intra-industry trade and specialisation are of particular interest from the perspective of this study. But it should also be noted that they were embedded in a set of proposals which responded to the difficulties then faced by the industry in a highly protective and unnecessarily interventionist way. Martec proposed two alternative approaches. One involved the Commission's tariff-only regime with a variety of improvisations which unambiguously increased protection. These included higher tariffs on some components as well as quantitative restrictions on CBUs and outright prohibition of some imports such as transmissions. This alternative also involved subsidies for export and for research and development (MIP, October, 1974: 18). It is not clear whether Martec felt that its most protective recommendations were good policy or whether it felt them necessary to meet the IAC's terms of reference. In any case it is hard to justify Martec's proposals for quotas or prohibitions on imports. For instance, Martec failed to explain why it was necessary to provide Australian producers with a share of the domestic market which was guaranteed - to 100 per cent in the case of transmissions - to ensure production in Australia. Nevertheless, Martec did warn that it felt that the total subsidy bill and the risk of miscalculating the right mix of all measures was high with this approach.

Martec's alternative approach was a rationalised local content plan. Here it suggested that plan administration be made more transparent and accountable with the scrapping of the 'non-reversion' rule, company averaging of local content with firms encouraged to participate in overseas complementation plans "through Australian export activity generating credits for additional duty free admissions". Encouragement should also be given to "the export of such automotive services as tooling, design, technological assistance, financing, and management expertise". The local content plan would operate behind a "sufficiently high tariff barrier to encourage plan participation by a reasonable number". Martec pointed out that additional objectives set out in the Commission's reference would require further programs some of which would require "possible subsidy" (MIP, October, 1974: 20-21).

### 8.3.2 Exports, Intra-Industry Trade Facilitation and the IAC

As the previous chapter demonstrated, the Commission's rejection of export assistance for the automotive industry took place much more by default than design. The Commission did address the issues slightly more directly when it subsequently defended
its report. Responding to SIDCAI's inclusion of export credits in some of its options, Rattigan claimed that:

Policies to stimulate export demand were . . . rejected as a major element of any solution.\(^70\) The likely gains in market volume seemed small and the cost to the Australian taxpayer of subsidising the purchase of cars by foreign consumers outweighed the benefits the Australian consumer would gain from lower unit costs made possible by greater volume of production (Rattigan to Steele: 2).

Rattigan's defence of the IAC's refusal to recommend export assistance was similar in form to the 'in-principle' case against tariff compensation - made possible by eliding the strengths of the opposing case. An objection to tariff compensation 'in-principle' could only be made by ignoring the strengths of the tariff compensation argument - indeed its essence - which centred on the constrained nature of the policy making situation and the contribution one might make to reform by doing several things simultaneously. The 'in-principle' case against tariff compensation was built on replacing this conception of the policy making situation with an expurgated one in which it was imagined that policy makers could choose between first and second best alternatives (cf § 3.4.2; 3.4.3 above). Rattigan's comments above likewise treat the case for export assistance as one to be determined essentially in isolation from other policies. In such a context it was unsurprisingly rejected. But just as the case for tariff compensation could only be comprehended in the context of continuing tariff assistance, the interesting questions here emerge by reference to analogous considerations - namely the widely accepted need for continuing automotive tariff assistance into the long term. Why did the IAC recommend long term 25 per cent nominal assistance rates to import replacement and none to export? If this level of assistance might have underwritten new investment in light car manufacture as the IAC seemed to think it might, would greater export activity not be possible at lower cost? Might more exports have met the political constraints embodied in the terms of reference at lower rates of assistance? These questions were never addressed.

Of four options being considered by SIDCAI, 'Option Two' was more complex than the IAC's proposals but involved a similar rate of assistance. As the IAC put it, "The most significant difference" between the two was the former's inclusion of an export credit

\(^{70}\) I have been unable to find any clear reference to the usefulness or otherwise of export assistance in the Commission's working papers or report. By contrast the Commission paid considerable attention to developing a range of alternatives to its eventual recommendations, all of which would have extended inwardly oriented assistance beyond the level offered by the Commission's preferred tariff only regime (Working Paper A12: 27ff; and see Working Paper "Tariff Proposal, Mark II").
scheme. Rattigan's response to this was to claim that such assistance could provide those local manufacturers able to make export sales with opportunities to earn "a much higher level of profits" (Rattigan to Steele, Attachment Two: 9). This response with something of a portent of the Commission's response to export facilitation a few years later. It focused on one possible risk associated with the alternative without seriously assessing either the potential benefits from the proposal, or even the seriousness of the risk. It drew attention to the unattractive initial effect of export assistance in swelling producers' profits. But it ignored what its own framework would have predicted would be the two likely attractive second round effects: increased export activity and/or price reductions to consumers arising from competition between exporters earning supernormal returns. As would be the case in its subsequent inquiry into the industry, it analysed export credits according to an implicitly short term perspective. Those who opposed the 25 per cent tariff cut argued that it would swell the profits of importers rather than reduce prices. In the short term this argument probably had some merit. But supporters of tariff reform tended to focus on the scope for importers to compete their newly won profits away in the medium to long term (interview with F. H. Gruen).

The Commission's response to Martec's proposals for export assistance was somewhat more extensive. It focused tellingly on the inconsistencies between Martec's advocacy of intra-industry trade and specialisation and its more protectionist proposals which would implicitly penalise specialisation (IAC, "Martec", 1974, Attachment Two: 3). But the Commission's fundamental rhetorical strategy was to place the onus of proof on its critic rather than meet the strengths of Martec's argument. On the matter of export demand the Commission softened the language with which it described its predictions whilst failing to concede anything of substance. It "did not wish to minimise the difficulties" likely to be experienced on export markets in the future but added, "Martec has not produced any evidence that this present level of exports could not be at least maintained in the long term" (IAC, "Martec", 1974: 6).

In fact as discussed above, Martec had presented some, albeit fragmentary, evidence to this effect. But the Commission had failed the very same burden of proof which it now imposed on Martec. As Martec pointed out, the Commission did not substantiate its own claim that exports could be maintained (IAC, "Martec", 1974: 11). The Commission downplayed those specific matters which Martec had itemised. "Other than the sales tax measures (discriminating against medium cars) introduced in New Zealand recently, [it was] not aware of any other development which would alter its assumption [sic] of exports being maintained at about their present level in the longer term (IAC, "Martec", 1974: 5, emphasis added). The Commission conceded that the recent New Zealand
measures would adversely affect medium car exports but commented that "insufficient is known of the price elasticity of demand in New Zealand to judge their effect" (IAC, "Martec", 1974: 5). New Zealand accounted for 50 per cent of all Australian automotive exports. In ignorance, the Commission gave itself the benefit of the doubt.

8.3.3 Contradiction without Engagement

The Commission was less than searching on the fundamental issues of the design of assistance in the presence of intra-industry trade and specialisation. Martec's focus on the threats and opportunities posed by world wide sourcing and the resulting 'complementation' arrangements were given short shrift, with the IAC arguing that its own recommendations would "provide the necessary flexibility" for local manufacturers to participate in any complementation scheme where there was "mutual advantage" (IAC, "Martec", 1974: 5). Yet, as the Commission itself commented in a later discussion paper about export facilitation, the local content scheme placed a "constraint on a manufacturer wishing to participate in a complementation scheme" because of the costs it imposed on "the extra imports of components which might be part of a complementation arrangement" (IAC, "EF Discussion", 1979: 3-4). *Mutatis mutandis*, the same arguments apply to a tariff-only regime. As the Commission conceded in its comparative table of the various options being considered by SIDCAI, the "export credit scheme could facilitate regional complementation" (Rattigan to Steele, Attachment Two: p. 4 of Chart One).

The extent to which the discussion took place without reference to the changes taking place in the Australian economy is also remarkable. There was virtually no discussion of the rapid deterioration in the position of vehicle manufacturers which was taking place when the IAC was collecting its information. Leyland indicated for instance in late 1973 that the revaluations of the Australian dollar had led to a cessation of exports to Hong Kong (IAC, PMVs, 1974, Transcript: 1784). Things got progressively worse as inflation accelerated through 1974 (see § 8.2.1 above). Three weeks before it finished its report, a letter from an importer of small cars commented that "the energy crisis has shocked the industry to the core and caused a major change of attitude, as to the concept of vehicle best suited for the motorists for today and tomorrow" (Letter, 24th June 1974).

The encounter between the IAC and its opponents after the IAC had reported and accordingly had something to defend certainly provided an inauspicious setting for cooperative dialogue. Nevertheless the Commission's defensiveness ensured that the debate never narrowed differences or refined positions. The Commission ended its
critique of the Martec report by arguing that a number of charges made by Martec were "untrue". It had not, as Martec alleged, totally ignored the foreign domination of the industry, regional complementation, exports of components and services or the economic evolution of the industry. The Commission cited a (small) number of page references to prove each point (IAC, "Martec", 1974, Attachment Two: 8-9). This was contradiction without engagement. As the previous chapter has demonstrated, Martec's claims were essentially correct. What mention the Commission made on those matters it made in passing and seemingly for the sake of completeness. More often than not the issues it noted did not enter its thinking in an important way.

The most substantial point made by Martec was that Commission's recommendations took insufficient account of specialisation in production. Here the Commission commented indignantly that specialisation of production was "discussed throughout ... and is one of the central features of the report" (IAC, "Martec", 1974, Attachment Two: 9). But the Commission failed to acknowledge - perhaps it did not appreciate - that its analysis of the economics of the automotive industry largely ignored product differentiation between vehicles of similar technical specifications (see § 7.4.3.3 above). This crucial field of specialisation was a central feature of Martec's report. Likewise, although it accepted in an appendix to one of its interdepartmental letters that export credits could facilitate regional complementation (see above), its comments on its own proposals failed to concede that export credits offered a way of facilitating specialisation which was qualitatively superior to its own tariff only recommendations (see Chapter Five above).

8.4 The Aftermath of the 1974 Report

The decision on the 1974 report came after months of political infighting - involving extensive involvement in lobbying and decision making by automotive firms, unions, the Whitlam Ministry and the ALP Caucus. It was a rout for the IAC. Fairly soon after the release of the IAC report, PM&C came to the view that the IAC report was politically untenable. It rapidly became disenchanted with the IAC's report. PM&C saw the report as unhelpful to those like itself who were unprepared to implement the report's central recommendations, but wished nevertheless to salvage something from the political wreckage which threatened (Warhurst, 1982: 194). The subsequent IAC contributions

71 The Commission did include a short section in its report providing an option for the Government should it regard itself as bound by the commitment of the previous Minister, Mr Anthony to extend the local content plans till 1979. The option however was essentially to delay the implementation of the
likewise provided little to assist policy makers develop policy priorities based on contemporary developments in the industry and an appreciation of what was worst about existing arrangements. There was a tension between the Commission's self styled role as the provider of objective transparent information, and its championing of one particular approach to policy.

Rattigan had previously objected to a reference seeking advice from the Tariff Board on policy options for colour television manufacture in Australia. The Government had contemplated sending a reference requesting the Board to advise on policy options to achieve Australian manufacture of colour televisions at low, medium and high local content respectively. Rattigan resisted this because he considered that it restricted the Tariff Board's independence. Amongst other things Rattigan argued that the reference might "force the Board to carry out some work which it might regard as unnecessary" (1986: 150-1). But it is hard to see how such a reference is not consistent with the framework for which Rattigan had striven - namely one where the Commission gave objective and transparent policy advice to governments on the cost and benefits of policy alternatives with governments themselves determining policy in the light of that advice.72

The Commission's calculations of implicit subsidy equivalents for the four options under active consideration by SIDCAI indicated that Option Two was vastly superior to the alternatives. The assistance it offered was "basically similar to that projected under the Commission's recommendations" though component, assembly and exports did better than they would have under the IAC's recommendations (Rattigan to Steele, Attachment Two: 9). Yet the Commission expended little effort highlighting this or offering its conditional support for Option Two in the event its own recommendations were rejected report until 1979 (IAC, PMVs, 1974: 171-2). Short of this, there was little guidance for those looking for useful reform options to the IAC's approach.

72 David McBride, a Commissioner during Rattigan's Chairmanship - had a similar aversion to 'information' reports - reports without policy recommendations - although he had no problem with "the odd information report".

There was a danger with the introduction of information reports because for many years some senior public servants had attempted to change the IAC into a body that just did the analyses and calculations. These had to be handed over to others who would make the recommendations. If every report became an information report it would be the end of public scrutiny, transparency and independent disinterested policy advice (McBride, 1994: 19).

Without advocating a move toward more information reports, it is far from clear why constraining the adviser to providing information and analysis would be the end of public scrutiny, transparency and independent disinterested policy advice.
in the deteriorating economic and political circumstances. Given this, and with the IAC's recommendations out of contention, SIDCAI turned to the industry for advice and the decision gradually converged on SIDCAI's most protectionist option - Option One (Warhurst, 1982: 196-7).73

As the IAC conceded, even Option One involved significant, if not spectacular structural adjustment within the industry (Rattigan to Steele, Attachment Two: 1). It rationalised the existing multiplicity of local content schemes into one scheme which required participating firms to achieve 85 per cent local content averaged across their whole production. And, it provided that, upon achieving 85 per cent local content, firms would only qualify for 10 of the remaining 15 per cent imported content duty free, the other five per cent of imported content attracting full rates of duty. Tariffs on built up vehicles were to rise to 35 per cent subject to a 'trigger-tariff' of 45 per cent in the event that CBU imports occupied more than 20 per cent of the market. The complementation program would continue. Although it would continue to be constrained to a limit of five per cent of local content, the IAC's comparative 'chart' of options suggested that it might be administered more liberally than it had been previously. In addition the 'non-reversion' rule would be removed (Rattigan to Steele, Attachment Two, Chart).

As Option One passed through the chaotic decision making processes of the Whitlam Government, it took on progressively more protectionist baggage. Against Whitlam's wishes, some changes were made to improve the position of specific component producers such as Borg-Warner in Albury and Repco Bearing Company in Launceston. The Prime Minister's press statement announcing the new arrangements also baulked at limiting vehicle manufacturers access to duty free components commenting that they had "yet to be finally determined" (Whitlam, 1974: 2, 3). And the 'non-reversion' rule - a monument if ever there was one to the 'straight-jacket' of Australian post war protectionism - was resurrected in caucus on the motion of Joe Riordan and a young ALP backbencher, Paul Keating (Warhurst, 1982: 205).

8.4.1 The IAC's Projections in Retrospect

If the government decision was a rout for the IAC, so too was the way events treated its projections. All of its major projections concerning the extent of total domestic and

73 The IAC estimated the subsidy equivalent of Option One at $2,900 million per annum. By contrast the IAC's proposed regime involved a subsidy equivalent of $1,400 million per annum. The next most protectionist option after Option One was Option Four which the IAC estimated as providing assistance of $2,200 million in subsidy equivalent terms (Rattigan to Steele, Attachment II: 5 of Chart).
export demand for vehicles, the composition of that demand and the consequent employment implications were disastrously wrong. The forecasting performance of the IAC's critics was not in all respects better than the IAC.74 Nevertheless the pessimistic burden of the IAC's critics' message was comprehensively borne out. Total demand for cars collapsed in an unprecedented way both domestically and on the export market and demand swung much more decisively towards small vehicles than the IAC forecasts envisaged. The annual domestic car market fell by 10 per cent from 476,000 to 430,000 units between 1974 and 1977 (IAC, PMVs, 1981: 15). The IAC had projected that sales of new cars would rise by between 29 and 35 per cent to between 612,000 and 642,000 by 1980 and had stuck to its forecast when challenged by SIDCAI in October 1974 (Rattigan to Steele, Attachment One: 1). In fact sales in 1980 were still some six per cent below the 1974 figures at 446,000 with no signs of an upturn at the time of the IAC's next major inquiry report in 1981 (IAC, PMVs, 1981: 34).

In 1973 medium, upper medium and luxury vehicles occupied 53 per cent of the car market (IAC, PMVs, 1974, Appendix Seven: 18). The IAC had predicted that, by 1980 the domestic market share of medium and luxury vehicles would have declined to 44 per cent. The Commission said that it "could not agree" with the South Australians, who had argued that the car market was moving towards a situation in which the three major vehicle classes - small light, large light and medium - would each occupy approximately one third of the market, with medium and luxury vehicles occupying 38 per cent of the market (IAC, "Evaluation", 1974, Attachment One: 9). In fact in the first four months of 1975, large light models took 36 per cent of the market, small light cars took 25 per cent of the market with medium sized vehicles taking almost exactly one third of the market. The combined market share of medium, upper medium and luxury cars was 39.4 per cent (The Melbourne Herald, 17th July 1975: 4).

Martec's and the industry's prediction that exports would collapse was also borne out by events. In current prices, exports fell from $170 million in 1973 to stagnate at $73 million in each of the three years from 1976 to 1978 before recovering to $124 million by 1980 (IAC, PMVs, 1981: 243). Given that vehicle prices rose by nearly 100 per cent

74 Given that their predictions were more pessimistic than their adversary and that the market was going into a lengthy downturn, the IAC's critics were generally more accurate than the IAC. However their pessimism sometimes 'overshot' the mark to such a degree that their predictions were further from the ultimate outcome - in a pessimistic direction - than the IAC's were off the mark in an optimistic direction. Thus for instance, Martec's prediction that small cars would occupy "closer to 80 per cent" of the market was incorrect. The small car share in 1980 was much higher than the IAC had predicted, but it was a little closer to the IAC's prediction than it was to 80 per cent (see below).
during the period (IAC, PMVs, 1981, "Draft": 43), the real value of exports would have fallen against their 1973 level by about three quarters by 1978 and by significantly more than half by 1980. The consequent fall in Australian automotive production had significant effects on employment. Little more than a month after the Government had announced its decision on the IAC's 1974 report, the 'big three' vehicle manufacturers announced that between seven and a half and eight and a half thousand workers would be retrenched (IAC, PMVs, 1975: 1-2). Productivity improvement and continuing poor sales saw employment continue to fall. Where the Commission had predicted a fall in employment between 1974 and 1980 of 2,000 comprising the removal of 15,000 jobs and the growth of 13,000 new ones (IAC, PMVs, 1974: 165), employment actually fell by nearly 15,000 from 90,500 to 76,000 between 1973-74 and 1979-80 (IAC, PMVs, 1981: 53).75

75 In some respects it can be argued that the Government's failure to implement the IAC's recommendations deleteriously affected the accuracy of the IAC's projections. This is most true of the IAC's prediction of the total Australian domestic demand for vehicles. Given that the Government's regime would have led to higher prices, total Australian vehicle demand would have been greater under the IAC's recommendations. Nevertheless in 1981 the Commission attributed the decline in registrations to "factors such as generally depressed economic conditions and increases in petrol prices" (IAC, PMVs, 1981: 34), neither of which were affected by automotive industry policy.

The Commission's model assumed 4.6 per cent annual GNP growth in the years from 1975 to 1980 (IAC, PMVs, 1974, Papers, Volume 3, §2.5.2.1), whilst the economy managed just over 3 per cent (ABS, National Accounts, 1989-90). Failure to adopt the Commission's recommendations would probably have reduced the extent of the swing towards light cars. Because quotas were imposed on the volume rather than the value of automotive imports, they produced disproportionate increases in small car prices (IAC, PMVs, 1981: 90, 159). The Commission's recommendations might have provided exporters with greater flexibility to increase imported content than the plan which was imposed, although, as has been argued, IAC working documents indicate some uncertainty about whether the imported content of medium cars would have increased under the Commission's proposals. The effect, if it existed would have been small in any case (see § 8.2.1.1 above). As a matter of fact medium cars continued to be assembled at about 95 per cent local content for many years, notwithstanding the ability of companies to move towards a company average of 85 per cent local content (personal communication with Ford and GMH). One could argue that the IAC recommendations would have imposed greater price disciplines on Australian medium vehicles than the Whitlam Government's plan and that this would have stimulated demand for Australian vehicles sufficiently to actually increase employment. But it seems much more likely that the IAC's recommendations would have led to greater automotive labour shedding than the more protective arrangements which were adopted.
8.4.2 The IAC Revisits the Scene: Export Credits are Abolished

The announcement of over seven thousand prospective retrenchments in the industry in December 1974 led the government to impose quotas on imports to apply from February 1975 (IAC, PMVs, 1975: 1). In that year in July the Government sent the IAC a reference for report in less than four months requesting advice on "whether import restrictions . . . should be continued, and if so at which level and for [how long]" (IAC, PMVs, 1975: Appendix 1). The report was both brief and modest in its reformist ambitions. Although it reiterated the Commission's in-principle objections to quotas (IAC, PMVs, 1975: 77), it nevertheless recommended that quotas remain in place at the then current levels until the end of 1976. It recommended that 45 per cent tariffs should continue to apply after that time until the end of 1977 whereupon the 'trigger tariff' mechanism should be allowed to come back into operation in the (now unlikely) event that domestic manufacturers regained sufficient domestic market share (IAC, PMVs, 1975: 80).

Of particular interest here, however, is that the Commission ventured somewhat outside the wording of its terms of reference to offer some suggestions for incremental reform of the administration of the local content plan. The Commission recommended that the non-reversion provisions of the current plan be removed (IAC, PMVs, 1975: 47). Its comments on complementation were, as they had been just over a year before, maddeningly ambiguous. The earlier export credit plan had been replaced by one which was only marginally less intensively supervised by the industry department,76 and which was also limited to five per cent of local content although it was to be reviewed in 1976 and every two years thereafter "with a view to possible increase" (IAC, PMVs, 1975, Appendix Six: 7). The Commission noted most producers' criticism of the uncertainties to which the plan's multiple criteria gave rise and added that "not all complementation arrangements are necessarily in Australia's best interests. Some may merely be disguised export subsidies". The Commission concluded that there was, "[c]onsequently . . . some justification for a case-by-case approach to determining

76 Replacing the pre-1974 export credit arrangements were new ones which required that complementation arrangements satisfy a range of criteria in advance in order to qualify for export credits. Complementation concessions would be provided where they increased economies of scale, promoted specialisation in component production, encouraged common sourcing of components and improved the prospects of continuing reciprocal trade. Nevertheless, like the old plan, the new plan required those seeking complementation concessions to ensure that employment changes took place in a "manageable way" (IAC, PMVs, 1975: 36-7).
eligibility for concessions" (IAC, PMVs, 1975: 47). (The scheme was already administered on a case-by-case basis although not necessarily according to criteria of which the Commission would have approved.) The Commission's next sentence appears to be a non-sequitur:

To overcome the problem of uncertainty, yet to retain the facility to encourage complementation that can be shown to be in the nation's interest, the Commission suggests that full duty concessions be available under the plan without the need to pursue complementation arrangements (IAC, PMVs, 1975: 47).

This proposal abolishes the export credit scheme. At the same time, it lowers the costs of assemblers which as the Commission conceded increased effective assistance to vehicle manufacturing for the domestic market. The proposal transfers some of the assistance otherwise available to exporters to assembly activities which were at the margin of viability under the previous arrangements - those requiring over 60 per cent effective assistance to remain viable (IAC, PMVs, 1975: 48).77 And although the Commission did not acknowledge it, an export credit scheme on its own would have been welfare improving given the quantitative restrictions on vehicle and component imports (see § 5.6.2.1 above).

Again the IAC's treatment of these issues was a portent of its approach six years later, when it showed itself prepared to bid up the level of assistance to import replacement so as to avoid subsidising exports. Yet immediately following its proposal to effectively abolish the complementation scheme, the Commission commented that "[t]he existing policy on complementation could be maintained with the added condition that one of the tests of desirability of any complementation proposal must be its likely effect on the overall viability of the manufacturing plan" (IAC, PMVs, 1975: 47). In the context of the Commission's discussion it is not clear what it had in mind. Be that as it may, when the Fraser Government came to act on the Commission's report some five months later,

77 The Commission calculated that its proposals would increase effective assistance to locally produced vehicles supplied to the domestic market from 61 per cent to 64 per cent assuming that tariffs were at 45 per cent. In fact the current level of assistance was higher than this because of quantitative restrictions on CBU imports and the amount by which the changes would have increased that figure would have been correspondingly larger had the Commission based its estimates on the existing quota constrained situation. Note however that the proposal unambiguously reduces assistance to component suppliers, who lose what assistance they may have received from export credits, but face the same level of potential import competition as if the assemblers were fully utilising their 5 per cent export credit entitlement. The Commission also proposed to rectify some administrative procedures within the local content plan which operated in a very discriminatory way against exports (IAC, Passenger motor vehicles, 1975: 49).
it "accepted the IAC recommendations that duty concessions be available under the plan without the need to pursue complementation arrangements, that is, existing manufacturers basic by-law concession under the plan be increased to 15%." It added that given this extension of access to imported content "complementation concessions will no longer be available" (Cotton, 1976: 8-9).

The extension of access to imported components also helped dig the local industry deeper into absurd production patterns. The established manufacturers continued to manufacture medium sized vehicles at levels significantly above the company average requirement of 85 per cent, which enabled them to assemble small vehicles and remain within their 85 per cent local content company average (IAC, PMVs, 1981: 55). But they were not permitted to import fully built up vehicles with their surplus content. Accordingly, they 'spent' their surplus local content assembling imported component packs. As described above (see § 7.3.1), the packs frequently cost the manufacturers about as much (and sometimes more) to import duty free as the equivalent built up vehicles did (personal communication with Ford and GMH). Thus the relative profitability of the most efficient activities in the industry - the manufacture of medium vehicles - came to cross subsidise the least efficient activity - adding little (or sometimes negative) value to imported components by assembling them into vehicles.
What, in 1979, the past having been what it so deplorably was, is the correct policy for the government to apply to the Australian motor industry? We may perhaps be content to acknowledge that we cannot at all easily answer the question. Perhaps after all there is some place for the point of view that the countryman came to after trying so hard to answer the visitor's inquiry how to get to X: 'If I wanted to get to X, I wouldn't start from here'. In other words: 'Your guess may be as good as mine'.

Davidson and Stewardson, 1979: 192

Where the IAC had largely overlooked the issues arising from intra-industry trade in the mid 1970s, by 1979 there were strong disciplines requiring it to examine the microeconomics of intra-industry trade facilitation. Firstly, having decided to introduce an export credit scheme, the government required the Commission to make recommendations on the operation and possible extension of the scheme. Secondly, and not surprisingly, inquiry participants themselves sketched compelling analyses of the microeconomics of export credits and of ways in which export credits could complement traditional trade liberalisation through tariff reform. Thirdly, in the wake of the hostility to the Commission arising from the disappointments of the mid 1970s, the Fraser Government introduced S 23A of the IAC Act. This pressed the Commission to provide analysis of a range of issues in each of its inquiries. The Commission had typically focused on ways of bringing the industry within the fold of manufacturing industries enjoying more normal levels of assistance and it had pointed out along the way how tariff-only assistance would improve allocative efficiency within the industry. But S23A(c) now explicitly required the Commission to consider the 'meliorative theme' of "whether . . . the structure of the industry can be improved and, if so, the manner in which, and the measures by which, the improvement can be achieved and the consequences of such improvement".

As this chapter demonstrates, notwithstanding all this, the Commission failed to engage seriously with the issue of intra-industry trade facilitation policy or with the views of those who had proposed a means of mutually accommodating the need for both inter-industry and intra-industry trade liberalisation. Sections 9.1 and 9.2 introduce the unusual circumstances of the inquiry. The 1979-81 inquiry lasted nearly three times the 10 months taken by the previous inquiry. Nevertheless, as section 9.3 outlines, the latter inquiry actually fell short of the - albeit limited - level of microeconomic understanding which the 1973-74 inquiry had achieved. This failure of micro-economic
vision and analysis went hand in hand with increasing emphasis on quantitative general
equilibrium modelling despite concerns within the Commission regarding its relevance
and accuracy. Sections 9.4 - 9.6 explain how the Commission decided against non-
traditional methods of trade liberalisation (including export credits) largely by imposing
upon them a burden of proof which it was impossible for them to meet.

The last section shows a few chickens coming home to roost and so provides a fitting
conclusion to this chapter and the three which precede it. The Commission's failure to
understand properly the implications of the locational complementarity between assembly
and manufacture led it to make recommendations which would have perpetuated
assembly within Australia at near infinite rates of assistance. Also, since the difficulties
of the mid 1970s, the Commission had been successful in engineering a change in
institutional arrangements whereby it would publish a draft report for public comment
before its final report. Where it changed its recommendations between the draft and the
final reports as it did in this case, its own priorities at the margin - the tradeoffs it made
between competing values - were made manifest. On deciding to increase the level of
assistance provided in response to industry doomsaying about its draft report, it chose to
recommend an increase in assistance to import replacement but it did not revisit its
recommendations on export facilitation. This was despite evidence that had export
facilitation been extended, lower automotive tariffs might well have been possible.

9.1 Introduction

After the 1975 report and the consequent 1976 changes to the plan (see § 8.4.2 above),
there were several other IAC reports on the industry in the late 1970s (IAC, PMVs,
1981, "Draft": 12). Like the 1975 inquiry however, they were typically focused on
relatively minor matters relating to the administration of the local content plan and the
quota system. The 'trigger tariff' mechanism introduced in late 1974 increased tariffs by
10 percentage points to 45 per cent. It proved unable to ensure a hoped for 80 per cent
market share for domestic manufacturers and so quotas were imposed in February 1975.
They remained in force - except for six months following the 1976 devaluation - until the
1979-81 inquiry and, as it turned out, beyond it (IAC, PMVs, "Draft": 67). In the 1978
Budget, the Federal Government helped itself to some of the rents now being earned on
quota entitlements by increasing the tariff on built up cars by 12.5 percentage points to
57.5 per cent. Even so, import penetration did not fall below the 20 per cent of the
domestic market mandated by the quota system (IAC, PMVs, "Draft", 1981: 72).
9.1.1 The Coming of the 'World Car'

The achievement of the benefits from the 'world car' concept will depend on the ability of the manufacturer to convince governments in the subsidiary countries to remove or modify any protective barriers which induced the establishment of that manufacture in the first place.

The IAC, PMVs - EF, 1979: 9

By the late 1970s the American automotive manufacturers had decentralised production and design to their major subsidiaries. Accordingly, wherever scale permitted, local subsidiaries tended to design and build their own vehicles at high levels of local content. GM, and Ford had very different model ranges in Europe and America (Automobile Club of Italy, 1979: passim), and since the early seventies their major car lines in Australia had been predominantly locally designed and manufactured at over 95 per cent local content (IAC, PMVs, 1974, Appendix Seven: 22). Then, in an effort to respond to the Japanese threat, both firms were pioneers in the 'globalisation' of production. By the late 1970s the European Ford Fiesta was a study in 'regional complementation'. Its engine blocks were made in the United Kingdom, its transmissions and axles in France, its carburetors and distributors in Northern Ireland and its body panels in West Germany. Its engines were assembled in Spain (IAC, PMVs, 1981: 26).

The principles of 'world car' manufacture were those of 'regional complementation', except that complementation took place across the entire globe. Participating affiliates would accordingly specialise in the design and/or production of some components at world scale. If they were assembling for domestic or regional markets they would also import a significant amount of their components from other affiliates who would likewise be manufacturing at world scale. GM announced its first major 'world car' - code named 'J-car' - in late 1979 (AFR, 3rd, September, 1979: 10). It was aimed at the large light market in which the Japanese had been so successful. It was to be co-designed by GM in the United States and its subsidiaries and affiliates around the world, which would also participate in the manufacture of the vehicle. Ford followed suit announcing something similar one year later.
9.1.2 Export Credits Again

The Government, for its part, is convinced that, given the small domestic market for motor vehicles in Australia, the only real and effective way that the industry can improve its cost structure is through closer integration with the world industry and, of course, the export opportunities... this will provide. International developments involving the production of world cars are providing major export opportunities which Australia cannot afford to let slip and which must be grasped now.

The Industry Minister Philip Lynch introducing the export facilitation scheme, 22nd February 1979, IAC, PMVs, 1981: 83

Between April and June 1978, both Chrysler and Nissan urged the Government to introduce an export credit scheme within the local content plan. Anxious to avoid further significant changes to the plan until it had run its course by the end of 1984, the Government rebuffed them. Nevertheless the proposals were developed further within government and in October some possibilities were considered by Cabinet, although no immediate changes were made to the plan. There followed an overseas trip by the then Industry Minister, Philip Lynch, who returned from discussions with a range of 'parent' companies of Australian vehicle producers enthusiastic about the possibility of Australia's participation in major 'world car' projects (AFR, 3rd September, 1979: 10).

The pace of events quickened as Lynch received what was in effect an ultimatum. GMH proposed to build an Australian plant to manufacture four cylinder engines for the J-car. Because it would power a 'world car', the engine would be produced at world economic scale of 250,000 units per year, and because the domestic market could absorb less than half of these engines, the remainder would be exported to GM affiliates around the world. GMH claimed that the investment could not proceed without some export credit plan similar to the previously existing scheme (AFR, 3rd, September, 1979: 10). Early in the new year GMH gave the Government a deadline of the 28th of February for a decision (AFR, 16th February 1979: 5).

On the 22nd of February the Government announced a rationalised export credit scheme called export facilitation. In place of the previous labyrinth of restrictions, the new scheme specified that export credits of up to five per cent of local content could be earned and used by any vehicle manufacturer without restriction (IAC, PMVs, "Draft": 70-71). The Government warned that despite its benefits, the new arrangements "could lead to a reduction in the range of components presently produced" as increased exports led to increased imports (IAC, PMVs, 1981: 83). One month later the Government sent a complex reference to the IAC requiring two separate reports. The first, due in six
months, would explore the administration and possible extension of export facilitation beyond the five per cent limit. This gave the Commission the freedom to recommend against extensions to the scheme, but not against the scheme altogether. The second report, due within twelve months, was to report on 'Post 84' assistance arrangements for the whole automotive industry (IAC, PMVs, 1981: 187-8).

9.2 The Inquiry

As ever, this was not to be a 'normal' inquiry. It occurred whilst the decline of the industry was dramatically manifesting itself. After half a decade of stagnation, 1980 saw a significant downturn in domestic demand (IAC, PMVs, "Draft", 1981: 35) setting off significant labour shedding within the industry (AFR, 19th March 1980: 1-4). The most notable industry rationalisations were the closure of GMH's assembly plant at Pagewood in Sydney (IAC, PMVs, 1981: 55) and the collapse of Chrysler Australia. Chrysler was taken over, but significantly scaled down by Mitsubishi (The Age, 13th August, 1980). This, the politically charged circumstances of the original reference, and the structural change which export facilitation threatened to wreak, ensured that the whole inquiry was charged with political campaigning and intrigue. While the IAC conducted its inquiry, the industry continued its lobbying and the Government continued its attempts to craft the plan to stimulate investment in the industry (eg see AFR, 20th February 1980: 1, 2, 5; 8th March 1980: 9, 16).

In late 1979 the Commission's interim report on export facilitation recommended against extending export facilitation beyond five per cent and recommended against component suppliers participating except as suppliers to the vehicle manufacturers. The Commission also requested and was granted a nine month extension of time for the final 'Post 84' report to improve its data and deepen its analysis. Implicitly rejecting some of the Commission's interim advice to constrain export facilitation, the Government announced an extension of export facilitation from five to 7.5 per cent of manufacturers' turnover, and required a further interim report on options for allowing specialist component manufacturers to participate in export facilitation (IAC, PMVs, 1981: 189). Required, against its earlier advice, to recommend arrangements which would allow component producers access to export facilitation, the Commission recommended component suppliers have access to the scheme without limit on their own account, and that trade in export credits be allowed. Each of the Commission's interim reports were preceded by draft interim reports and there were only fairly minor changes between the drafts and the final interim reports.
The draft report on "Post '84' Assistance Arrangements" considered the introduction of a tariff-only regime desirable in the long term. However, to mitigate the cost of duty on components to vehicle manufacturers, the Commission proposed a medium term tariff regime which permitted vehicle manufacturers to import 10 per cent of the value of their production duty free. The draft report recommended that the new regime be introduced immediately the old plan expired in January 1985 with tariffs set at 60 per cent falling in annual five per cent drops to 35 per cent by 1990 (IAC, PMVs, "Draft", 1981: 154). Following howls of protest, the IAC moderated these proposals in its final report. It proposed that the starting tariff for 1985 remain the same at 60 per cent, but that the 1990 'medium term' target - which by this stage was still nearly nine years away - be changed to 50 per cent tariffs (IAC, PMVs, 1981: 144).

9.3 The Micro-economics of the Industry

One of the weakest areas of the report is likely to be the treatment of the probable consequences of implementation of the Commission's proposals.

Minute, 21st May, 1980: 8

It is hard to be sure what industry structure would evolve from the Commission's recommendations.

IAC, PMVs, 1981: 133

The following sections explore two distinct but related issues:

1) how little the Commission knew, and how well it understood the fact of its own ignorance and

2) how, in such circumstances the Commission went about designing and arguing the case for a preferred reform option.

The 1979-81 inquiry replicated many of what Chapters Seven and Eight argued were its 1974 predecessor's weaknesses of micro-economic vision. As with the earlier report, the later report gave the reader little sense of the likely future industrial evolution of the Australian industry. There was some reportage concerning globalisation of automotive production and the increasing prominence of Japan, the entry of Nissan and Toyota in the 85 per cent local content plan and major events such as the closure of Pagewood (IAC, PMVs, 1981: 55, 81). However, as with the report's 1974 predecessor, there was virtually no exploration of the scope for beneficial product differentiation for the Australian industry, either domestically or offshore.

The latter report devoted a smaller proportion of its energies to the analysis of economies of scale than the 1974 report. Nevertheless it persisted in the earlier report's focus on
the highest levels of scale possible in larger markets (IAC, PMVs, 1981: 22-3), rather than any analysis of scale economies which was pertinent to the Australian context. It likewise used a concept of "optimal scale of output" which had been arbitrarily defined within the economics profession - that is without reference to the particular context in which the Commission was now using it (IAC, PMVs, 1981: 61-65). Like their 1974 predecessor, the 1979-81 reports mentioned in passing but did not focus on those examples in the world industry - most notably the Swedish and Canadian industries - which might have provided particular insights into the issues facing the Australian industry. At that time SAAB was viable in both domestic and export markets despite an annual volume of about 82,000 units - well below the Holden's volume from the 50s to the late 70s and a only a little above it in the early 80s (IAC, PMVs, 1981: 22-3, 5, 64; FAPM, Letter to the IAC 27th April 1981: 4).

In addition, despite their greater size and time in preparation, the latter reports provided significantly less insight into the structure of the industry than their predecessor. Where the 1974 report showed some appreciation of the locational interdependence between assembly and component manufacture, the later report comprehensively mishandled the issue (§ 9.7.2 below). And the earlier report analysed the vehicle building sector as essentially five sub-sectors - small light, large light, medium, upper medium and luxury - each with its own level of cost competitiveness against imports. The earlier report described the likely effect of its recommendations as being substantial rationalisation of both vehicle building and component manufacturing sectors, in each case sketching how it thought each sector would be affected (IAC, PMVs, 1974: 167).

Although I have criticised its inaccuracy and inadequacy in important respects, the information the earlier report provided was nevertheless important and useful to public policy making and, it seems reasonable to assume, integral to the Commission's determination of its own proposals. By contrast the 1981 report failed even to provide its readers with a record of the relative changes in the Australian industry's market share in the various vehicle classes in the recent past (cf IAC, PMVs, 1974, Appendix Seven: 18). And, as far as assessing the relative competitiveness of different sectors of the industry was concerned, the 1981 report failed to proceed very far at all beyond a frank confession of its own bemusement. "It is difficult to resolve the question of the relative disadvantages of various automotive production activities" (IAC, PMVs, 1981: 97).  

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78 The Commission did mention in an appendix that evidence indicated that competitiveness improved with vehicle size (IAC, PMVs, 1981: 302). But this plays little role in the Commission's analysis of the industry or of its analysis of the effects of its recommendations.
9.3.1 What Kind of Competitiveness Shock?

Under existing measures, competitiveness of domestic automotive production declined alarmingly in the 1970s.

The IAC, PMVs, 1981: 6

There were other important motives in the Commission's eye, not because of its inability to answer questions it had put to itself but because of its failure to conceive the questions. The extent to which the industry's falling market share reflected a 'relative cost' or a 'product variety' shock was a question of considerable policy significance, particularly given the necessity to report on export facilitation. For the more the industry's worsening performance could be attributed to a 'product variety' shock, the more compelling became the case for pursuing intra and inter industry trade liberalisation simultaneously (see § 5.7.3 above). As the 1973-74 inquiry made clear, the industry was most competitive in the manufacture of medium vehicles. Since then, demand had swung strongly towards smaller vehicles in both domestic and export markets, and the industry's market share had declined in both markets accordingly. In its 1979-81 inquiry the Commission did not seriously explore this issue. However, in the absence of any explanation to the contrary, its frequent references to declining domestic competitiveness appear intended to refer to the relative supply cost and quality of Australian production (IAC, PMVs, 1981: 6, 49).

One can confidently conclude that the falling market share of the industry was, to a considerable, if not necessarily exclusive extent, the result of a 'product variety' shock. Some evidence suggests that the cost competitiveness of medium car manufacture in Australia had not changed substantially since 1974. The market share of Australian medium vehicles in 1979-81 had not fallen below the 95 per cent market share enjoyed in 1974, and indeed had not fallen below this figure many years later under significantly lower levels of (near tariff-only) assistance (Martec, 1979, Unnumbered Chart, "Six Cylinder Cars"; Automotive Industry Authority, 1989: 16). This had occurred even though market sharing tended to favour the import of high value (generally larger) vehicles over low value vehicles (IAC, PMVs, 1981: 90).

One important piece of GMH evidence the Commission published in 1981 compared the cost of a German and an Australian six cylinder sedan which indicated that the Australian vehicle enjoyed a 23 per cent cost advantage over the German vehicle - a figure which suggests some continuity with, and if anything, improvement since, the earlier report (see § 7.4.3.2 and IAC, PMVs, 1974; Working Paper B7, Table Three - where the corresponding figure for the mid 1970s was a cost advantage to Australia against Europe.
of about 10 per cent before correcting for differences in specifications). And there was clearly potential in the industry for substantial export expansion at relatively low levels of cost disability (see below § 9.5.3.1). On the other hand, there are some reasons to suspect that, over the 1970s, the cost competitiveness of Australian medium vehicles continued to decline against Japan, where labour productivity within the industry had doubled (*The Economist*, 9th April, 1994: 80) and the real price of cars had fallen by nearly 40 per cent (IAC, PMVs, 1981: 45). However, because Japanese policy discriminated strongly against the domestic sale of larger vehicles, Japan was still concentrating its energies almost exclusively in the area of vehicles which were smaller than Australian medium sized vehicles (Automobile Club of Italy, 1979, "Japan").

### 9.3.2 Computable General Equilibrium Modelling and the Microeconomics of the Industry

The analyses which are feasible would only serve to demonstrate the workings of the ORANI model, and their results would have only a tenuous relationship to projections of the effects of the [Commission's] proposals. Finally, the capacity to rectify these deficiencies seems limited. It may be possible to further disaggregate the model's treatment of the industry. However, even if detailed cost disadvantage data are made available by witnesses, it is doubtful that any acceptable evaluation of assistance would be possible.

**Minute circa. October 1979: 6**

The lion's share of quantitative analysis of the state of the industry and its likely prospects under the Commission's recommendations, was done within the framework of the computable general equilibrium model of the Australian economy, ORANI. ORANI was itself part of the larger Commission-sponsored IMPACT project with headquarters at Monash University. The issues as they arose in the 1979-81 inquiry comprise a small part of a larger story about how the Commission's pioneering of computable general equilibrium modelling affected its capacity to understand and model economic developments at the industry level.

General equilibrium modelling allowed the Commission to tell the important story about the way in which - given certain assumptions - contraction of uncompetitive activities led to expansion elsewhere in the economy (*eg* see IAC, PMVs, 1981: 158). On the other hand the inherent difficulty of the modelling task raised questions about the realism of the model and the accuracy of its parameters. And ORANI contributed little to modelling what was happening *within* industries although, with sufficient effort, micro-modelling of structural change within industries could be grafted onto ORANI (Powell, 1979: 14). Given this, and the fact that ORANI was an import to the Commission from academia,
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its introduction generated major controversy both inside and outside the Commission. Those hostile to heavy reliance on ORANI argued (amongst other things) that it:

- was frequently used in methodologically invalid ways given the issues it was required to elucidate, its structure and the way in which it was configured for individual exercises
- operated at such high levels of aggregation, and on sufficiently outdated input/output tables, that it was frequently misleading in its conclusions
- operated with a parameter file which was biased in favour of free trade - with implausibly low elasticities of import substitution and implausibly high elasticities of export demand and supply (Cronin, 1979).

Accordingly, the inquiry took place at a time of internal tension within the Commission. That tension erupted into a series of angry minutes to the Chairman in late June 1979. At issue was the extent to which ORANI was useful in simulating the effects of the current assistance regime and its proposed alternatives. The consensus reached within the Commission was that ORANI was inadequate for the task of analysing responses within the automotive industry to different assistance scenarios - or at least added nothing to what a more partial ad hoc intra-industry analysis might accomplish (see Minutes dated 26th, 27th, 28th June and 4th, and 5th of July 1979). In this atmosphere, it appears that Commission staff responsible for quantitative work were anxious to place on the record their reservations about the difficulties they faced.

A working note was skeptical not just of predicting the future, but even of analysing the present. Firstly, sufficiently reliable and disaggregated data was impossible to come by. The cost structure of component manufacturers was "of major interest". Yet there was hardly any data available. Secondly, even if data were available, it was "doubtful that . . . the Commission would have the information or analytic capacity to model the evolution of the structure of the industry". The note concluded that "the most intractable and important problem" was evaluating the current assistance arrangements:

It seems that the complexities of the package, and the interaction between the effects of market sharing and [the] local content plan largely defy analysis. . . . in the absence of any capacity to model the effects of the proposals within the industry, the remaining approaches offer very little towards meeting the [analytic] objectives presented above (Working Note, Approx October 1979: 3-4.),79

79 The Commission attributed its modelling difficulties to the fact that the protection arrangements comprised two interacting systems of quantitative restrictions - market sharing for vehicles and a local content scheme for components. Clearly this complicated the theoretical and empirical problems of determining who got what levels of assistance from the package. Where one is seeking to determine the
The decision to proceed produced an internal minute with the flavour of a bureaucratic 'note for file', apparently motivated to place certain matters 'on the record' in the event of future misunderstandings or recriminations:

Commissioners consider that a quantitative answer must be provided for the reporting requirement. You consider that it would not be acceptable for the Commission to claim that it had too little information to allow a useful quantitative answer to be provided with any confidence, even if this were your judgment (Minute, 9th October 1979: 1).

The minute proposed, and as the various reports show, Commissioners agreed, that published simulations should be based on "best estimates but with appropriate qualification" (Minute, 9th October 1979: 1). A subsequent minute sent about a month later was if anything, even more skeptical of the scope for ORANI in its current form to model the changes the Commission was contemplating. Noting that ORANI required estimates of the changes in assistance associated with any recommendations the minute commented: "At the moment I have no idea of what assistance is afforded by the various assistance measures applying to the industry and I can provide no best guess of the changes in assistance implied in any proposed recommendations". The minute continued that ORANI modelling would fail to take into account the disparities of disability within the component producing sector (it did not mention the disparities of disability in the vehicle manufacturing sector) and that it took no account of economies of scale. The relevant section concluded "This approach to measurement of effects does not, in my view, meet the requirements of the Act. Also, it provides answers which may be quite misleading" (Minute, 2nd November, 1979: 2).

The Commission's public modelling of the effects of its recommendations was done in essentially the way against which this minute warned. It would have been possible to have grafted a model similar to the implicit model used in the 1974 report into the ORANI model for the purposes of the 1979-81 inquiry. Had this been done the industry would have been modelled as at least three sub-sectors of vehicle manufacture and one or maximum protective effect at the margin of viability, it is clearly more straightforward to do this with tariffs than with quantitative restrictions. Also it is easier to estimate the protective effect of a single instrument rather than two interacting ones. Yet the essence of the problem was the non-uniformity of the incidence of protection - many firms used much less assistance than the industry's protection made available at the margin (IAC, PMVs, 1981: 95). The Commission would have faced essentially the same problems had the industry been protected by - say - an 80 per cent tariff only regime. Without measuring the competitiveness of each major activity in the industry, it would have been virtually impossible to know the distribution of the incidence of such a tariff on different activities within the industry.
more of component manufacture, each with its own level of competitiveness. However, this was not done. The industry was modelled according to categories which seem to have more to do with the Commonwealth Statistician's classifications for its industry production series than on any judgment about where it was most fruitful to distinguish between different activities for the purposes of the modelling exercise at hand. The three sub-industries used for modelling were 'vehicle assembly', 'component manufacture', and 'other' products not under reference (IAC, PMVs, 1981: 155, 325). Thus the commitment to the econometric sophistication embodied in ORANI went hand in hand with an unusually crude evaluation of the effects of policy alternatives on the industry. The 1974 report had based its assessment of the effects of its recommendations - and presumably the recommendations themselves - on a loose commonsensical empiricism oriented around the estimated approximate cost competitiveness of the industry's various sub-sectors. By contrast the later report worked with a picture of the industry which was both much vaguer and much more aggregated. As the report explained plaintively:

[T]o operate the model, an estimate of the expected change in the price of competing imports attributable to the recommendations is required. This estimate serves as the initial disturbance from which the effects flow. To determine this change, estimates are required, for both motor vehicles and ... components, of the proportion by which the landed duty paid price of imports is increased by the existing and recommended assistance arrangements. As stated earlier, this is a formidable task, particularly for the components industry. To represent this situation by a single 'average' is an unfortunate but unavoidable simplification (IAC, PMVs, 1981: 156).

The 1974 report's estimates of cost disability could be used to suggest critical points at which the various sub-sectors of the industry would face substantial rationalisation as assistance was withdrawn. By contrast the modelling in the 1981 report assumed that vehicles and components were each produced at uniform levels of cost disability against imports, and that the elasticity of substitution of imports for domestic production was uniform at all levels of import penetration. With the elasticity of import substitution, the initial level of import penetration and the change in import prices each specified, ORANI would then generate the predicted change in import penetration by way of a simple linear relation between the three parameters (Bureau of Industry Economics, 1981: 3).

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80 The two categories under reference correspond with ASIC 3211 and 3214 whilst 'other' corresponds well with 3212 and 3213. The method of disaggregation of the industry is explained at greater length in Hagan et al 1980, however I have been unable to obtain a copy.
Thus, within the model there was no possibility that, despite its 95 per cent domestic market share and strong price competition from smaller vehicles, the Australian medium car manufacturing sub-sector might have competed away a substantial proportion of its tariff assistance. And there was no allowance for the possibility that the substitutability of imports for domestic production might be different in different sub-sectors of the market. Yet this flew in the face of intuition. Toyota made Corollas in Australia - and higher quality Corollas in Japan! Something similar could be said for most of the Australian manufactured and assembled small and large light vehicles. The Falcon and the Holden on the other hand, were much less comparable with any imports to Australia.81 Assuming that these vehicles were also more cost competitive than Australia's light vehicles, the elasticity of import substitution emerges as a function of import penetration.82

9.4 Burdens of Proof: Recommending Policy under Uncertainty

Some domestic component production appropriates considerable assistance through the Plan - implied nominal rates of the order of hundreds of per cent at the margin of existing local content requirements according to some evidence. However the Commission does not know who gets what or how much.

Minute, 21st May, 1980: 3

Given its ignorance, the Commission was required to design a reform program with relatively little idea of its consequences - a particularly invidious position given the Fraser Government's demonstrated timidity concerning tariff reform and the consequent requirement in the Commission's terms of reference to avoid "undue disruption" (IAC, PMVs, 1981: 187) and to report extensively on the likely effects of its recommendations. The Commission decided that the Government's desire to avoid 'undue disruption' necessitated considerable gradualism in approaching the ultimate objective of a tariff-only regime for the industry at rates similar to other manufacturing industries. It accordingly

81 No imported vehicle offerings had the same designs as the Australian medium vehicles and those offered at competitive prices - the Toyota Crown and Nissan 280 C were each significantly smaller in body dimension and engine displacement (Motor Manual, May, 1981: 17).

82 In principle the aggregate 'industry' elasticity parameter would, if properly estimated, aggregate the elasticities of substitution within the various sub-sectors. Nevertheless the conditions under which such a procedure might be regarded as methodologically valid are discussed in Cronin, (1979: 4). They include the requirement that import penetration is similar in all sectors of the market - a condition which is egregiously violated in this case.
decided upon recommending a 'transitional' regime to last until 1990 with a view to further reform subsequently (Minute to Commissioners, 21st May, 1980: 2). Yet what form should the transitional arrangements take? A staff minute completed at the end of November 1979 set out three broad strategies towards achieving lower and more uniform levels of assistance:

A. a direct move to tariffs - a tariff-only or near tariff-only regime - at relatively high rates which would be subject to subsequent review and reduction;
B. phasing out local content provisions; and
C. increasing export facilitation (Note, 21st December, 1979: 1).

Option A was attractive to the Commission because it was "an explicit move in the right direction away from too much government intervention and rules. Levels of assistance would be explicit and measurable". Yet as the minute commented, there were difficulties in implementing Option A in a sufficiently gradualist way to meet the terms of reference and the political exigencies of the day. A tariff-only solution would appear to be a "big change in assistance and indeed might be" (Note, 21st December, 1979: 1). If Option A met the Commission's predilections, Options B and C probably better met the Commission's terms of reference. Option B would have been better equipped to avoid "undue disruption" (see below). And Option C involved greater neutrality of assistance between domestic and export markets and so more efficiently met the reference's call for policies to "attain greater competitiveness in both domestic and export markets" (IAC, PMVs, 1981: 187) and 23A of the IAC Act's requirement to determine means of improving industry efficiency. As argued in the next section, Option C might also have permitted faster tariff reform.

However, in effect the Commission required options B and C to satisfy a 'burden of proof' if it were to displace Option A. The following sections argue that, in both cases, the very possibility that such a burden might have been discharged was effectively foreclosed. Option C was the first to be eliminated and accordingly is dealt with first.

9.5 Export facilitation

I find the idea of a Japanese car manufacturer importing components from Australia rather revolutionary.

Mr Seear, IAC Commissioner on 1979-81 inquiry, Transcript: 471

After outlining some of the potential attractions and dangers of export facilitation in 1979, this section explores the Commission's 'in-principle' objection to the scheme.
Chapters Six to Eight above have documented the Commission's failure to engage with those who it saw as tainted with protectionism and special pleading. In the 1979-81 inquiry the Commission failed to engage with traditional allies whose special interest as inquiry participants came only from their shared desire with the Commission to reduce automotive protection. Two submissions from rural groups strongly supported export facilitation in the context of tariff reform in essentially the terms set out in Chapter Five above. But, beyond its in-principle objections, there was little, if any response from the Commission.

9.5.1 A Sword for or a Shield against Structural Reform?

[Option C] could really hit the component boys. . . . It clearly encourages restructuring although how far this would be sensible depends upon our ability to produce low cost exports.

Note, 21st December, 1979: 2

The Commission knew it faced an uphill battle in achieving significant structural reform in the industry. A May 1980 Minute to Commissioners commented concerning one possible incarnation of Option A, that it was "very similar" to the unsuccessful recommendations of "the 1974 report" which were "reiterated . . . in the various later reports with a singular lack of success". Even if the Commission's analysis improved and the Government was more aware of the pitfalls of local content schemes than it had been before, "the chances of success are probably still not too high. . . . It is also likely that the Commission will be criticised for its apparently 'hard' line on motor vehicles and components in comparison to its 'soft' line on TCF . . . Of course, if the Government rejects a relatively 'soft' TCF report, where that would leave a 'hard' motor vehicle . . . report is anyone's guess" (Minute, 21st May, 1980, 2). In this context Option C had strong attractions. It had the various benefits in political economy explored in § 5.8.1 above.

Like ORANI, but in a more concrete way, export facilitation provided a response to that protectionist rally cry - "where are the new jobs coming from?". For, as an IAC minute noted, increasing imports were generated by increasing exports which could be specifically identified (see passage cited in § 5.8.1). And as an IAC minute pointed out, it had "the benefit of appearing to be a government preferred option" (Note, 21st December, 1979: 2). A Government generally timid about structural change had been forceful in its support of export facilitation and frank about its capacity to rationalise the industry notwithstanding strong resistance from component suppliers and the Labor Opposition (IAC, PMVs, 1981: 83, AFR, 16th November, 1979: 15 The Australian,
14th February 1980: 3).83 Indeed, one Commission minute suggested that by extending export facilitation to 7.5 per cent of turnover, the Government had gone about as far as public opinion would permit in reducing the local content of the 'Australian car' (IAC, Minute and Note, 16th April 1980: 14).

The promising politics of Option C were well underscored by the fact that while the local manufacturing industry was united in its opposition to Option A, there was significant support within the industry for Option C. GMH, Nissan and Chrysler supported structural change through export facilitation (AFR, 16th February 1979: 5). The Federation of Automotive Products Manufacturers (FAPM) - the component industry's lobbying association - had characterised export facilitation as a "prescription for disaster" in the hands of the vehicle manufacturers. Nevertheless when the Government initiated the second interim report from the IAC, well over half FAPM's members voted in favour of extending export facilitation to specialist component manufacturers (AFR, 18th March, 1980: 5). In addition to the contribution it could make - along with tariff reform - to improving allocative efficiency, export facilitation satisfied the political logic of divide and conquer. While tariff reform set the most efficient industries against the least efficient, export facilitation had a similar effect within the industry. The most efficient manufacturers would be able to gain at the expense of the least efficient.

Judging from these comments in Commission documents, and by the Fraser Government's actions, export facilitation was probably the most politically implementable means of securing substantial structural adjustment within the industry. It also possessed prophylactic qualities. For if quantitative restrictions on imports remained or were reimposed in the future, export facilitation would prevent such measures leading to the massively costly diversification of production to which they had led in the 1970s. GMH's engine plant illustrated that, whether or not Australia would ever become competitive at free trade, automotive products could be exported in large volumes and at relatively low levels of disability (see § 9.5.3.1 below). Accordingly, in the event that quantitative restrictions were imposed, the additional assistance they accorded could be captured by relatively low cost exporters, with the credits thus earned being used to supply the domestic market with imports. Given that several manufacturers were in a position to expand exports at relatively low cost (see § 9.5.3.1 below), one could expect that domestic competition between them would see most of the

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83 As Richard Johns put it recently, "FAPM and powerful member companies such as Repco had been instrumental in achieving local content provisions in earlier plans but they could not stop export facilitation" (1994: 195).
gains available through export facilitation being passed on to consumers (see IAC, PMVs - EF, 1979: 13; IAC, PMVs, 1981: 95).

9.5.2 The Commission's Approach to Export Facilitation

Export facilitation will increase Government involvement in the industry and add to the complexity of the package.

IAC, PMVs, 1981: 5

Given the Commission's ultimate goal of a tariff-only regime, and its knowledge that even GMH's world scale engines would require some level of export subsidy (IAC, PMVs, 1981: 102), the Commission was intuitively hostile to export facilitation. Whatever its economic justification, export facilitation also loomed as a dangerous experiment in political economy. An internal minute commented that export facilitation raised "the issue of whether government would, in practice be 'locked in' to continuing responsibility for the support of the industry" (Draft, 9th October 1979: 8.17). The Commission also saw export facilitation as inextricably part of the 'interventionism' of the plan. As an early draft of the final 'Post 84' report commented, the objective of export facilitation was international integration and this was incompatible with the inward orientation of the local content scheme. Export facilitation was seen as "second best" tinkering with the existing package of assistance (Draft, 9th October 1979: 8.17).

The Commission realised the merit of export facilitation in the presence of quantitative restrictions because export credits increased import penetration. But within the tariff-only regime towards which it was striving, export facilitation on its own could operate as a pure export subsidy (see § 5.6.2.2.2 above). Yet it was not necessary to conclude from this that export facilitation was inextricably tied to a local content plan. It is just as administratively easy to attach export facilitation to a tariff regime as it is to attach it to a local content scheme. And as various participants pointed out (see below § 9.5.3), where export facilitation on its own implied increased assistance, the appropriate response was to lower assistance with further tariff cuts rather than abandon a scheme which had attractions for as long as protection - in any form - remained (see § 9.5.3 below).

Ultimately, the Commission justified its hostility to export facilitation on the grounds that it could see "no reason why" exports from the automotive industry should have . . . "a greater claim on community assistance than is provided to exports generally" (IAC, PMVs, 1981: 9). As was the case with the 'in-principle' case against tariff compensation and with Rattigan's depreciation of the export credits in SIDCAI's Option
Two in 1974 (see §§ 3.4.1 and 8.3.2 above), the argument is wholly unobjectionable as a consideration - a meliorative theme. As the ultimate reason for rejecting export facilitation it is as irredeemably partial as any 'in-principle' rejection of tariff compensation.

Indeed it is largely arbitrary even on its face. For there are any number of plausible 'benchmarks' against which one could compare the level of assistance to automobile exports - zero, assistance available to other exports, to manufacturing generally or to the automotive industry. Each of these, and other benchmarks besides, could claim some support from the principles of economics and/or of political economy. Certainly, when the Tariff Board was faced with a similar requirement to make recommendations consistent with the prosperity of an industry in its 1971 shipbuilding report, it had seen the appeal of applying export assistance to match the rate available to import replacement (see § 3.3.1 above). And as one increases the proposed level of assistance to automotive import replacement, as the Commission did, the appeal of the first and second benchmarks above fades, or at least requires more thorough defence. It becomes progressively harder to explain why one would want to discriminate against developmental and adjustment opportunities within the industry which involve export as opposed to import replacement.

9.5.3 The Interim Report on Export Facilitation

The NFF views an export facilitation scheme as not only a means of increasing the competitiveness of the industry but also a mechanism which facilitates the lowering of general levels of protection enjoyed by the automotive industry.

A. J. Robb, National Farmer's Federation, IAC, PMVs, 1981, Transcript: 137

The material presented in this chapter suggests that, without the constraints imposed by its terms of reference, the Commission would have recommended against the export facilitation scheme altogether. Constrained by the reference however, it set out the criteria against which it would determine its recommendations on export facilitation. They were:

1) efficiency in resource use
2) avoidance of undue disruption
3) practicability of administration
4) consistency with the current local content plan and
5) equitable treatment between members of the industry (IAC, PMVs - EF, 1979: 15).
As it had insisted in its 1974 correspondence with SIDCAI, the IAC was preeminently concerned with the first of these criteria - the efficiency of resource use - particularly in the medium to long term (Warhurst, 1982: 203-4). This was true in the 1979-81 inquiry as well, and the circumstances surrounding the 1979 inquiry and the terms of reference suggested that the government wanted similar advice on the long term efficiency implications of export facilitation - if not in the interim report, then certainly in the suite of reports of which it was a part. Yet, as this sub-section shows, the first criterion received short shrift. The Commission justified its recommendations on export facilitation by reference to the other four criteria.

An appealing response to the multiple dilemmas raised by these criteria was supplied by two submissions from economists representing two rural groups, Ian Wearing, from the Australian Woolgrowers' and Graziers' Council and Andrew Robb of the National Farmers Federation (NFF). Both were sympathetic to the Commission and whilst their free trading *bona fides* might have been compromised in Commission inquiries into agricultural assistance, in this inquiry their sectoral interest in rationalising the automotive industry and reducing its assistance, was wholly coincident with the Commission's objectives. Both submissions ran to just a few pages and sketched what Schumpeter might call an intellectual 'vision' of export facilitation and its potential role in trade liberalisation - an intuitive 'pre-analytic' grasping of relations and inter-relations the details and possible logical structure of which had yet to be carefully 'worked over' and subjected to theoretical scrutiny (Schumpeter, 1954: 41).

Both were strongly supportive of export facilitation in the context of tariff reform arguing that whether or not it was the least cost means of improving the automotive industry's competitiveness, it offered "a unique opportunity for the local industry to become better integrated with the world industry and thus reverse the inward looking approach" which had "plagued [it] for decades" (IAC, PMVs, 1981, Transcript: 132-7). The "desirable principles" were identifiable. "The limit [on the scheme] should be gradually extended to ensure that all opportunities for achieving economies of ... specialisation may be encouraged" (IAC, PMVs, 1981, Transcript: 132-7). And both submissions insisted that the scheme should not be considered as an alternative to tariff reform but as its complement (IAC, PMVs, 1981, Transcript: 132-7; Australian Woolgrowers' and Graziers' Council, [hereinafter "Australian Woolgrowers"], 1979: 1, 3). Despite its brevity, the Woolgrowers' submission showed how, provided the possibility that export facilitation would increase assistance was met with complementary tariff cuts, all the major administrative and equity issues could be adroitly dealt with by extending and liberalising the scheme. To this end the submission argued against all
arbitrary restrictions on the earning, use and transferability of credits, although it conceded some possible limit where resulting change might be disruptive (Australian Woolgrowers, 1979: 1, 3).

Perhaps partly because of the short six month time it had to complete the first interim report, the Commission expressed itself tentatively. It was "reluctant to recommend extension of the scheme" outside the context of its more general inquiry into the industry (IAC, PMVs - EF, 1979: 16). These instincts took the Commission in the opposite direction to that taken by the rural interest groups. With a few exceptions it recommended restricting the scheme as far as possible to the scope that had already been mandated by government decision. It recommended that upon their introduction, export credits only be earned for exports which were additional to each vehicle manufacturer's previous export performance, as measured against a proposed 'base year' of 1979. As the Woolgrower's submission implicitly pointed out, this recommendation clearly discriminated against those firms which were already most export-oriented:

> After all, one objective of this exercise should be to see that greater rewards go to the more efficient producers. They are more likely to be the ones that are already exporting (1979: 2).

Likewise the Commission recommended confining the scheme to the five per cent limit previously set by Government. And it recommended against vehicle importers and specialist component producers being given direct access to the scheme. (Specialist component manufacturers could however manufacture products for export by the vehicle manufacturers who would in turn qualify for export credits for those exports.) The draft interim report recommended that only exported components be eligible to earn export credits and that those credits only be eligible to import components duty free. The justification for doing this was the largely unargued assertion that "exports of CBU vehicles are not likely to increase significantly as a proportion of total vehicle production. Hence their inclusion would not greatly assist the achievement of the scheme's objectives" (IAC, PMVs - EF, "Draft" 1979: 14). It is unclear why it should be necessary for built up exports to "greatly assist" the scheme's objectives to qualify for inclusion.

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84 After the disappointment of its 1974 automotive report, the Commission had taken to publishing a draft report for public comment before issuing its final report. This meant that its draft report on export facilitation would have taken shape within two or three months from the time receiving the reference. This timetable would obviously have left much less time for research, thought and re-drafting than the Commission had taken in its 1973-4 inquiry. The reference required the Commission to publish draft reports of each of the reports it requested (IAC, PMVs - EF, 1979, Appendix 1).
The final report partly relented, conceding that "[i]n general, to encourage efficiency gains, export credits should be able to be used as best suits the participants in the scheme". As the rural submissions had shown, as this kind of reasoning is extended it argues for further liberalisation not only of the earning of export credits but of their use, and beyond that to the gradual dismantling of export facilitation either through complementary tariff reform or through extension of the scheme to other industries. As the Woolgrowers put it, free trade was the "logical extension" of complementation (1979: 2). Nevertheless the Commission invoked the fourth and fifth of the criteria set out above to prevent the further extension of these arguments. It continued to argue that importing built up vehicles under export facilitation would be "inconsistent with the plan" and accordingly inequitable towards other importers who were required to pay tariffs and qualify for quota (IAC, PMVs - EF, 1979: 20). The Woolgrowers' submission had shown how extending and liberalising export facilitation could deal with many of the problems of consistency, efficiency and equity, arguing that the price of export credits would "rise to the point where windfall gains from importing CBU vehicles would just be eroded":

Furthermore, such transferability would greatly increase the probability of complementation credits leading to the optimum mix of [imported and/or exported] components and CBU vehicles from the point of view of industry efficiency, and promoting maximum benefit to the industry as a whole (Australian Woolgrowers, 1979: 3).

The Commission made little mention of transferability in its interim report. However in discussing whether or not component manufacturers should be allowed access to the scheme, it did consider permitting component manufacturers to earn and trade in export credits subject to their being ultimately used by manufacturers. (The Commission could not otherwise devise arrangements which limited the extent of the scheme to that mandated in its terms of reference - five per cent of vehicle manufacturers' turnover.) The IAC commented that it could see "no objection in principle to such arrangements as they should further encourage specialisation. However, in the short run, this facility may lead to an unacceptable rate of reversion from local to imported components in Plan vehicles" (IAC, PMVs - EF, 1979: 25). It accordingly recommended against specialist component manufacturers being able to earn or to transfer export credits.

9.5.3.1 Fastidiousness without Engagement

In effect, the multiple criteria by which the Commission justified limitations on export facilitation displaced the IAC's traditional central concern with the medium to long term allocative efficiency. The Commission failed to focus on allocative efficiency in its
evaluation of export facilitation. What quantitative work it did was directed towards estimating the disruption to which export facilitation might lead. The "very rough" estimates made by the Commission indicated that the first five per cent of export facilitation would produce a net loss of between about 1,300 and 2,200 jobs. Because Nissan and Toyota were entering the local content plans at this time, this job loss would in fact be outweighed by their local expansion (IAC, PMVs - EF, 1979: 35-7). In the 'Post 84' report, the Commission opined that whatever rate of structural change would constitute undue disruption was "largely subjective" (IAC, PMVs, 1981: 141). But it took a different view in its interim report on export facilitation arguing that "although the effects of the scheme, even in its minimum form, are uncertain, the disruption to employment could be significant" and that accordingly there should be no increase in the limit before 1984 (IAC, PMVs - EF, 1979: 17). The Commission's fear of "undue disruption" in this case - a re-distribution of up to 2,000 jobs within the industry from 1980 to 1984 - contrasts with scenarios in its draft 'Post 84' report which envisaged the loss of between 14,000 and 16,000 jobs in the industry from 1985 to 1990 as a result of the Commission's recommendations.85

The Commission was not only leaning heavily on criteria which were traditionally invoked by protectionists and advocates of tariff compensation - those of avoiding 'undue' disruption, consistency with other arrangements and equity between sectoral interests. Its reasoning moved decisively away from a form in which the costs and benefits, risks and opportunities of policy alternatives would be argued, estimated and/or weighed, even in principle. In its place was analysis in which the burden of the argument was carried rhetorically as it were, with an onus of proof being imposed upon export facilitation.

The Commission noted that export facilitation would only improve resource use if the export activities it generated were "relatively efficient. To replace high cost domestic component activity with high cost export component activity would bring little gain to the community" (IAC, PMVs - EF, 1979: 13). In fact the Commission was presented with strong evidence, which it accepted, that the opposite was the case: ie that exports could be achieved at relatively low disabilities and that under export facilitation they would

85 These figures are based on the percentage employment changes in tables 9.1 and 9.2 in the draft report (IAC, PMVs, "Draft", 1981: 139, 143), and the breakdown of 20,000 employees in vehicle assembly and 45,000 in component manufacture provided in the final report (IAC, PMVs, 1981: 54). The draft report does not provide a satisfactory breakdown of employment in the two sub-sectors. In any event, if it did, the total job losses calculated would be slightly larger because industry employment fell between the publication of the draft and the final report.
displace much less competitive activity. GMH, Nissan and Chrysler all proposed exporting items with relatively low levels of disability given existing arrangements. In addition to GMH's world scale engine plant, Chrysler and Nissan intended to move towards greater utilisation of their existing capacity, suggesting that the marginal cost of such exports would have been low. Thus, although these projects might require some assistance, the Commission observed that they were all "consistent with the objectives" of the scheme (IAC, PMVs - EF, 1979: 13). And in reporting that exports would require assistance, the Commission did not consider the negative assistance which automotive protection would have provided automotive exports under the existing arrangements - or those proposed by the Commission (see § 5.7.2 above).

On the other hand, although "very little information was available" on the disabilities of component manufacture for the domestic market, the Commission commented that "at the margin of local content requirements, it appears they are quite high". GMH proposed to export from a world scale plant and claimed that full access to export facilitation would enable it to reduce the cost of building a car by $1,000 or over 10 per cent. This suggested that the incremental export production induced would be of much lower disability than the production for the domestic market it displaced. The Commission went on to quote evidence from GMH and Chrysler which had components varying in price disability from 21 per cent to 207 per cent (IAC, PMVs - EF, 1979: 2, 13, 11).

The Commission concluded from this that "the scheme will at least encourage a movement of resources in the right direction". Yet it went on to argue that "the total cost of assistance may be high relative to the net benefits . . . obtained. In some instances the scheme may attract resources into high cost exporting activities" (emphasis added). (The Commission's recommendations to restrict the transfer of credits substantially increased the likelihood of this happening). Concerning the potential of export facilitation to help rationalise the industry, the Commission commented that it was "not necessarily the most appropriate means of achieving" international competitiveness for the industry (IAC, PMVs - EF, 1979: 13-14; emphasis added). On the question of facilitating international intra-industry integration in the context of protection, the Commission concluded equally evasively:

It is not clear whether the most appropriate method to facilitate participation in world car production is to modify the arrangements of the local content plan and whether the export facilitation scheme, in conjunction with other assistance measures which currently apply to the industry, will encourage resource movements in the direction of greatest possible efficiency gains (IAC, PMVs - EF, 1979: 16 emphasis added).
This was what the Government had requested the Commission to *make* clear.

**9.5.4 Quantitative Analysis and Export Facilitation**

A minute of late June 1979 indicated that an ORANI run had simulated the effects of export facilitation. It had simulated an increase in investment in engine manufacturing facilities and in engine production and a decrease in component production. The cost reductions which export facilitation would have generated were reflected within ORANI as a fall in the prices of Australian produced vehicles. The minute concluded that the model was working well and that technically, the results were at least superficially encouraging. However it continued:

> I suspect that the magnitude of the effects will not be regarded as credible. For example, the simulations show that GMH's engine production will provide about 7,000 new jobs in the economy. Even GMH does not claim this. A more accurate data base may overcome this problem to some extent (Minute, 26th June 1979: 1).

Whether or not the simulation was reasonable, GMH's failure to claim more for its investment was hardly surprising. GMH's claims were based on simple estimates of the jobs their engine project would create within GMH and its suppliers and the jobs which would be displaced by the resulting increased imports under export facilitation. Far from being a general equilibrium study which might trace the benefits from lower vehicle prices, *à la* ORANI, the GMH study did not even use input/output multipliers (IAC, PMVs, 1981, Transcript: 177). Yet because of the strong intra-industry labour productivity gains produced in the simulation - which were also reported in the interim report (IAC, PMVs - EF, 1979: 37) - lower prices to consumers of motor vehicles are likely to have been the major determinant of the ORANI result.\(^{86}\) However the Commission published an ORANI simulation of export facilitation which had been changed since this early version.

The Commission's published ORANI analysis of export facilitation was short run modelling. In its usual short run mode ORANI was still capable of capturing important economy wide gains from the intra-industry productivity improvements offered by export facilitation. The typical short run simulation ruled out changes in industries' capital stock but nevertheless assumed that cost changes produced price changes to which firms and consumers responded which in turn affected the labour market (Dixon *et al*, 1982: 39, 65 cf IAC, "Concessions", 1987: E - 10, 22). However the simulation

\(^{86}\) The original ORANI simulations themselves are not in the archived records relating to the inquiry. If they exist I have not found them.
of export facilitation which the Commission published in its interim report allowed no markets to respond to the productivity improvement generated by export facilitation and so simply generated about 2,000 job losses with no other modelled gain to the community (IAC, PMVs - EF, 1979: 37). This was ORANI in ultra short run mode. Indeed, since ORANI was built to illustrate relationships between markets and no such relationships were illustrated, one might wonder about the extent to which this could be regarded as an ORANI simulation at all.

Generally speaking, the shorter run the simulation, the less it takes account of the benefits of trade liberalisation. For as discussed in earlier chapters, within the classical and neoclassical tradition generally and within ORANI, the benefits of structural change come precisely from the short term costs which it entails. Resources initially devoted to high cost activity cannot find their way to low cost activities until they are dislodged. The longer run the ORANI simulation, the more fully resources - in particular capital and labour - can move to their most productive uses. The ultra-short ORANI run of the first interim report on export facilitation - the only modelling of export facilitation the Commission ever published - provided a quantitative estimate of the losses from reform, in the form of displaced labour, but remained silent on all its potential benefits.87

9.5.5 The Interim Report on Export Facilitation for Specialist Component Producers

In its second interim report, the Commission did not disguise its misgivings about export facilitation. And it continued to recommend against importing built up vehicles under the scheme (IAC, "Components", 1980: 23). Nevertheless it appreciated that, should component manufacturers be given access to export facilitation, limitations on that access could have perverse effects. Limits expressed in terms of firm turnover or domestic sales would "penalise a more export oriented producer with a low level of domestic sales, relative to a largely domestically oriented producer which makes only marginal exports". Allowing transferability of credits also recommended itself in these circumstances as the component manufacturer best suited to achieving export sales was

87 In a sense the modelling measured one benefit of export facilitation - namely the productivity improvement which led to the job losses in the first place. However, in ultra-short run mode these 'productivity improvements' were not productivity improvements at all from an economy wide perspective. For they entailed reducing the productivity of labour from low levels to the zero levels implied by idleness. This was precisely the argument against which the IAC laboured in the years after growth stalled in the mid 1970s. Opponents of tariff reform argued that dis-employment created by tariff reform would not lead to re-employment elsewhere in the economy.
not necessarily the firm with the greatest need for the resulting duty free imports (IAC, "Components", 1980: 21-2).

Of course, as the Woolgrowers' submission had implied, the same arguments applied to vehicle manufacturers. At the time the export facilitation scheme was introduced and for a long while after that, Toyota and Nissan had very little export capability, although they were able to 'buy in' some components from Australian component suppliers for export (personal communication with Toyota and Nissan, 1983). But in addition to being more obviously specialised than the vehicle manufacturers, specialist component manufacturers were also more numerous. And as the number of participants in the export facilitation scheme grew, it would probably become progressively less easy to detect and/or prevent commercial arrangements designed to subvert any limits which the Government might place on the earning or the use of export credits. If for instance, a component manufacturer had reached its limit, it could sell products to another component manufacturer to enable it to export them and thus qualify for export credits.

For these reasons, and against the requests of most specialist component producers themselves, the Commission favoured free transferability of credits between component producers and between component producers and plan participants. It also preferred unlimited export facilitation for component producers. If a limit were felt to be appropriate, the Commission favoured a high one - such as 50 per cent of individual component manufacturers' turnover. Yet having gone this far against the spirit of the restrictions on the scheme it had originally endorsed, the Commission was unprepared to recommend against its letter by recommending that credits be made fully transferable. It retained the original proscription on the transferability of export credits between vehicle manufacturers without offering any further discussion (IAC, "Components", 1980: 21, 22, 31).

9.6 Phasing out Quantitative Restrictions

It is clear that in the longer term we want to reduce the Government involvement and get to a tariff-only solution for motor vehicles and components with lower and more uniform levels of assistance and with components treated more in relation to similar production activities and less in relation to end use. The $64 question is how to get there.


Given its ignorance, the Commission found it much easier to deliberate on its preferred ultimate assistance regime than to design a way of getting there. As one minute explained, the problem with phasing out the local content plan by gradually expanding
imported content under the plan was the target at which to aim. "The Commission does not even have the information required to determine a single company disadvantage curve at present. Thus, we can only guess at an end point for local content in the transition period, with little chance that this is anything more than an arbitrary target". Yet the problems with moving immediately to a tariff based regime were the obverse of these. "[N]ow we are unsure of the starting point in the transition period" (Note, 16th April 1980: 4, 8), and, one should add, at what point to end the 'transitional' regime. In other words, how far could one go in the decade to 1990 before encountering the political trip-wire which, in the terms of reference, went by the euphemism of "undue disruption".

Given the Commission's ignorance, the requirement to avoid 'undue disruption' would seem to argue for phasing out the local content scheme, even if other, contrary considerations might ultimately prevail. For gradual relaxation of quantitative restrictions would constrain disruption by constraining the expansion of imports during any short period. As an internal minute put it:

Which approach is preferred [phasing out the local content plan or moving immediately to tariff-only regime] depends as much on the judgments made about such matters as the importance of reducing Government involvement in the industry or whether the immediate move to a tariff-only regime might jeopardise the acceptance of the long term recommendations if it cannot be convincingly shown that [the Commission's recommendations] will not create undue disruption (Note, 16th April 1980: 14).

The Commission decided against phasing out the local content plan in favour of introducing a tariff regime the effects of which it was largely ignorant (see head quotes to § 9.3 above). It did so "mainly because" phasing out the local content scheme "would still mean considerable Government involvement in the industry and inappropriate signals (local content, etc)" (Minute, 21st May, 1980: 2). However, by the time it came to make this decision, the Commission's ignorance of the industry had come to count against phasing out the local content scheme . . . "because the Commission doesn't have enough information (on distribution of assistance and competitiveness of domestic production in the period to 1984) to design a transition package which would clearly give a preferred adjustment path" (Minute, 21st May, 1980: 2). As noted above, given the Commission's ignorance, Option B did offer a "preferred adjustment path" in its ability to contain "undue disruption". But in the way the Commission now posed the question, its own ignorance appears to prevent meaningful comparison between options. In such comparisons, Option B was just as incapable of demonstrating its superiority over
Option A as Option A was of demonstrating its superiority over Option B. By imposing a 'burden of proof' against options it was intuitively hostile towards, the Commission's ultimate choice of policy alternatives came down to little more than an assertion of its own 'in-principle' preferences.

9.7 Towards the 'Post 84' Report

The Commission was aware that it had given relatively short shrift to export facilitation in its interim reports. Drafts completed at the end of November 1979 came with a covering minute which called for "a lot more thought and analysis . . . especially on the [tariff] rates and how to deal with the export facilitation requirement" (Minute, 30 November, 1979: 1). Yet about a year later, with the draft report close to publication, a minute commented that "the present discussion of export facilitation in Chapter Six is relatively vague" (Minute, Approx November 1980 to January 1981: 3). After the first interim report, expanded export facilitation remained ostensibly under consideration as Option C (Note, 21st December, 1979: 1). Yet it rapidly fell out of view after late 1979 in drafts of the Commission's report. Like the option to phase out quantitative restrictions, it seems to have fallen by the wayside more by default than because of any clear case mounted against it. Few if any traces were left on the written records of the Commission as to why it was eliminated from serious consideration, but by April 1980, a paper discussing options for the draft final report did not mention Option C (Paper Attached to Note, 16th April 1980).

9.7.1 Trading Substance for Form

For us to say which kind of duty rate should be applicable we must know whether we can revert; we must know what kind of complementation we have. These are two very basic items. They're essential and if we can't do this then certainly the duty rate has to be higher.

GMH representative, IAC, PMVs, 1974, Transcript: 124.

It is said that everything has its price. Certainly when recommending tariff based assistance and probably when recommending against export facilitation, the Commission consistently erred on the side of providing a higher rate of assistance as the price for achieving its desired form. As a minute to Commissioners explained in November 1980, "a conservative approach" would be "taken on both undue disruption grounds and the fact that moving the industry away from close Government intervention to a tariff-only regime is a big step in the right direction" (Notes, 21st November 1980: 7). Other things being equal one can understand the Commission's preference for tariff-only
regimes over quantitative restrictions. But other things were not equal. The minute took the tradeoff between the form and rate of assistance for granted. It did not explain why achieving substantially lower rates of assistance within an assistance regime with a more 'interventionist' form might not be a bigger step in the right direction. In late 1979, it had been hoped that the tariff regime might commence at 45 per cent and phase down to 30 per cent (Notes accompanying Minute, 2nd November, 1979: 8). By the time of the draft report, the Commission proposed to introduce the tariff regime at 60 per cent and phase it down to 35 per cent.

The trade-off between form and substance emerged more sharply as the Commission changed its recommendations following responses to its draft report (IAC, PMVs, 1981: 143). Confronted by claims that automotive manufacturing would virtually cease under the draft report proposals (eg see GMH, IAC, PMVs, 1981, Draft Report Hearings Transcript: 11-12), the Commission increased the level of medium term assistance it would recommend. It was explicit about trading substance for form in its final report:

The Commission is faced with a dilemma. The recommended changes in assistance must be sufficient to induce the necessary changes in industry structure while at the same time avoid undue disruption. In terms of encouraging improved competitiveness ... the Commission reiterates the importance of changing the existing inappropriate forms of assistance. . . . Given the reference requirement to avoid undue disruption and the uncertainties about the likely effects, the Commission has chosen to slow down the recommended changes in the levels of tariff protection (IAC, PMVs, 1981: 143, also see 33).

Accordingly, in its final report the Commission changed its recommended medium term tariff from 35 per cent to 50 per cent. The Commission considered tariffs to be a superior form of assistance to quantitative restrictions because they placed a ceiling on the rate of assistance the industry received. Yet given the Commission's ignorance not only of the current competitiveness of the industry but also its likely competitiveness in the future (given changes in the industry and elsewhere in the economy), tariffs at too high a level might actually retard achievable structural change. The new recommendations risked providing significantly too much assistance in 1990 to secure the political acceptability of its recommendations in 1981. Other comments in the final report suggest the Commission was unsure of whether increased assistance would be necessary to avoid undue disruption (IAC, PMVs, 1981: 143 and see § 9.7.3 below). Recommending Option B - the steady relaxation of quantitative restrictions - at least for the first few years of a reform regime, would have allowed policy makers to target much
more closely the extent of industry rationalisation they considered politically acceptable with a view to moving towards a tariff only regime later in the reform path.88

In fact, notwithstanding the increase in the recommended long term tariff rate, the IAC recommendations were regarded as unimplementable by the government of the day. Yet as events transpired, the IAC recommendations would almost certainly have retarded what tariff reduction was achievable after 1986 when real exchange rate falls saw quota protection proving redundant, with 57.5 per cent tariffs restricting imports to just over 15 per cent of the market (Automotive Industry Authority, 1987: 52 and see § 10.1.3.2 below)! By 1990, under the 'Button Plan' (which resembled both Options B and C), tariffs were ten percentage points below the Commission's recommendation of 50 per cent (IC, PMVs, 1991: 191, 183).89

Perhaps more tellingly still, when the Commission chose to increase the recommended medium term rate of assistance to the industry, its earlier recommendations to restrict export assistance to the level mandated by government remained intact. The higher recommended tariff rate would have increased the assistance rate available to those exports which qualified under the (then) 7.5 per cent ceiling for export facilitation. But beyond this point, while assistance was being substantially expanded for import replacement, exports would not have benefited from the changes to the draft report. Yet expanding access to export credits was one way to facilitate the introduction of more ambitious (lower) assistance rates. Even before the draft report was finalised, the Commission's Assistance Evaluation staff had concluded that, even within the proposed 7.5 per cent limit, the export facilitation scheme would have "a major impact on the competitiveness of local production" (Notes, 21st November, 1980: 4-5). But the Commission does not appear to have considered extending export facilitation as one possible means of 'softening' its draft recommendations to avoid "undue disruption".

88 The hybrid 'tariff quota' arrangements actually adopted by both the Lynch Plan of 1981 and the more ambitious Button Plan of 1984 combined quota expansion with a steadily declining 'penalty tariff' applicable to imports in excess of quota entitlements. Depending on the settings of both quantitative restrictions and penalty tariffs, such arrangements can generate results which are either more or less ambitious than any given tariff based reform path. What they can do, however, is to provide a much more certain rate of import expansion and, to phase towards a tariff only solution. In addition, as penalty tariffs decline from high levels, policy makers acquire important information about the current competitiveness of the domestic industry and the effective assistance implicit in quantitative restrictions.

89 This slightly overstates the difference between the two programs, however, as the Button Plan allowed vehicle manufacturers access to 15 per cent imported content duty free. The IAC sought to restrict this to 10 per cent.
And it continued to propose, as it had in the draft report, that the export facilitation scheme the automotive reference had forced it to recommend, be discontinued after the Commission's recommended medium term regime had concluded in 1990 (IAC, PMVs, 1981, "Draft" and "Final": 9). It made no similar suggestion with regard to assistance to import replacement.

9.7.2 Assembly and Manufacture

The 1974 report had explained the locational complementarity of assembly and component manufacture, even if it had not provided a clear focus on the massive inefficiency usually inherent in Australian assembly of imported component packs. The latter issue was explicitly addressed in Martec's submission and participation in hearings in the later inquiry (see above quotation). By then the issue was no small matter. The volume which Ford and GMH were able to achieve on their high local content medium vehicles meant that they had sufficient 'excess content' to enable substantial assembly operations. GMH assembled 30,000 Gemini's per annum, largely from Japanese component packs (IAC, PMVs, 1981: 282). Ford was tooling up for a similar operation assembling the Mazda-based Laser (Newcastle Herald, 4th March 1981: 5).

The Commission noted that Ford's assembly of a small vehicle took place at cost disabilities of 200 per cent against the world industry, and that assembly of GMH's six cylinder sedan was markedly more competitive without exploring the locational complementarity between component manufacture and vehicle assembly or the costs of assembly within the plan (IAC, PMVs, 1981: 96, 304). And the Commission explicitly deliberated on the feature of the plan which was driving these inefficiencies - the requirement that vehicle manufacturers take up their duty free entitlements under the export facilitation and local content schemes in the form of components rather than built up vehicles. The Commission argued against any relaxation of this requirement within the export facilitation scheme in its first interim report on the grounds that it would be inconsistent with existing restrictions on the local content scheme and inequitable to other vehicle importers to allow vehicle manufacturers to import CBUs under their imported content entitlements (§ 9.5.3). Given that each of these considerations related to equity with other assistance arrangements, it was appropriate that the issue be revisited in major report on 'Post '84' arrangements. However this did not occur.
Indeed far from exploring the problem, the IAC proposed (one presumes inadvertently) to perpetuate it. To ameliorate the potentially disruptive effect of recommended tariffs at relatively high levels, the Commission proposed that vehicle manufacturers receive ten percentage points of their (then) current fifteen per cent entitlement to imports duty free - provided they imported components and not cars. The Commission was recommending that 60,000 odd cars be assembled in Australia at rates of effective protection approaching infinity!

9.7.3 Reformulation without Engagement: The Changed Econometrics of the Final Report

Lindblom's injunction concerning the importance of "skillful incompleteness" as opposed to the practical alternative of "accidental incompleteness" has been well illustrated so far by the Commission's use of quantitative general equilibrium modelling. It became more evident still when, notwithstanding the formal complexity and rigour of ORANI, the Commission gave the impression of casual improvisation as it changed parameters and assumptions following attacks on the modelling presented in its draft report. Thus in the final report the Commission conceded that while it did not accept "witnesses dire predictions" participants reactions had "changed [its] perception of the possibilities of disruption" (IAC, PMVs, 1981: 143; emphasis added).

In addition to the 'dire predictions' from the industry, the Bureau of Industry Economics (BIE) published a scathing attack on the methodology of the IAC's ORANI work. In addition to attacking the model's level of aggregation, it argued amongst other things that:

- the elasticity of import substitution within the industry - which governed the immediate effect of tariff reform on the industry - was the previously published estimate of the short term elasticity of substitution. Where the short term parameter had previously been estimated at five, the long term parameter estimated by the econometric project of which ORANI was a part was ten;
- the elasticities of supply and demand for the export industries - which was where the gains from reform largely came - were "extreme", "often outside the credible range" and they "invariably lean[ed] towards overstating the likely increase in exports"; and
- "Either the IAC [had] made a computational error, or it [had] used data at variance with the numbers put forward in its own report" (BIE, 1981: 3, 16ff, especially 21, 24).
The effect of these alleged inadequacies was generally to overstate the benefits and understate the costs of traditional tariff reform. In its 'base case' simulation in its draft report, the Commission had its recommendations producing an economy-wide fall in prices of 0.9 per cent leading to a 5.7 per cent increase in exports. This expansion in exports was sufficient to drive a significant improvement in the balance of trade and so, within the model, expansion in gross national output and employment (BIE, 1981: 22, IAC, PMVs, "Draft", 1981: 139). The Commission's other simulation assumed, without any serious justification, a 10 per cent productivity improvement in the vehicle industry to "illustrate" the effects of developments exogenous to the model such as economies of scale (IAC, PMVs, "Draft", 1981: 143). This produced a price fall of 1.3 per cent which generated a favourable and remarkably large five percentage point change in the whole economy's balance of trade (IAC, PMVs, "Draft", 1981: 143)! In the Commission's defence it must be said that despite its optimistic message, it reported its ORANI results guardedly in its draft report claiming that they supported the proposition that tariff reform in the automotive industry would "create sufficient job opportunities to offset those lost within the motor vehicles and components industry" (IAC, PMVs, "Draft", 1981: 154; also see IAC, PMVs, 1981: 155).

In 1974, attack had been the best means of defence against those who could not technically match the Commission. In 1981 the Commission again failed to engage, but in this case faced with critics who could match it technically, it did so by backing away from controversy. The Commission's final report made no mention the BIE critique, but commented that further econometric work had estimated the elasticity of substitution between domestic and imported motor vehicles as between five and ten. The final report accordingly raised the five per cent draft report figure to 7.5 (IAC, PMVs, 1981: 326, 335). "As no information was available on the import substitution elasticity for components", the Commission explained, "this too has been set at 7.5" (IAC, PMVs, 1981: 326-7). The Commission revised some of the export demand elasticities - in each case in the direction suggested by the BIE critique - downwards. And the method of closure of the model was changed. Where the balance of payments and aggregate employment results had each been controversial in the draft report simulation, the new method of closure assumed both to be fixed. The report justified this change without

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90 Note these are general equilibrium results and on that account all the more dramatic. In other words they allow for first round (partial equilibrium) effects to be offset by second round (general equilibrium) effects. In this case expansion of exports and increased employment in the relevant industry would give rise to wage rises and so rises in the cost of inputs which offset the expansionary first round effects on the balance of trade.
further explanation as "more appropriately reflect[ing] the longer term consequences of assistance changes for macroeconomic aggregates" (IAC, PMVs, 1981: 157). One of the fundamental aims of the ORANI model - to demonstrate that jobs lost in one sector of the economy would nevertheless be created elsewhere in the economy - was now an assumption.

The final report also contained extensive testing of the sensitivity of the various parameters. ORANI was run many times with alternative parameterisations. Yet given the extent of what was not known, and the assumptions which remained implicit in these experiments - such as the uniformity of intra-industry elasticity of import substitution - the question must surely arise as to the extent to which the ORANI could improve on educated guesswork. In addition each of the experiments was discrete and unrelated to others. The Commission explained that "[a]part from being in accordance with standard sensitivity procedure, this enables the computing costs of the exercise to be kept within reasonable limits" (IAC, PMVs, 1981: 335). The BIE critique had recalculated the Commission's ORANI simulations of the effects of the draft report recommendations to arrive at a contraction in component manufacturing output of 79 per cent (BIE, 1981: 8). The draft report had initially estimated the figure to be 28 per cent (IAC, PMVs, "Draft", 1981: 139). The appendix presenting the sensitivity tests in the Commission's final report indicated that with the new assumptions, the draft report proposals would have generated a fall in component output of 67 per cent (IAC, PMVs, 1981: 334).

9.8 Postscript

Like the 1974 report, the 1981 report came at a very difficult time for both the industry and the economy more generally. And as with the 1974 report, the 1981 report provided little guidance for a government unprepared to follow its recommendations and introduce a near tariff-only regime. And like the 1974 report - and for similar reasons - the 1981 report was ultimately rejected by the Government of the day which preferred the safety of a relatively protectionist version of Options B and C combined. The "Lynch Plan" continued market sharing allowing an increase in imported market share of the order of one percent per annum.91 To address concerns under the GATT, the quota system was

91 The formula allowed for four per cent volume growth in imports per annum or five per cent if the total market grew by over two per cent. Given 20 per cent market share initially going to imports and just under 2 per cent per annum market growth, the market share of imports would grow by approximately .4 per cent per annum with most volume growth still reserved for domestic suppliers. At three per cent market growth the formula produces approximately the same growth of market share for imports.
to be converted to a tariff-quota system with imports allowed over quota entitlements -
but at a prohibitive penalty tariff of 150 per cent phasing down to 125 per cent by 1992.
Export facilitation was to expand to 15 percentage points of local content (Moore and
Lynch, 1981). Approximately 60,000 vehicles per annum would be assembled within
the plan at infinite or near rates of assistance.

1983 saw the election of a government with a commitment to reform which as history
would show was genuine though not quixotic. The new Government found an industry
in disarray. On the subject of automotive industry policy there was little consensus
either within industry or outside it about what to do. Component manufacturers were
fighting vehicle manufacturers and both were fighting vehicle importers. Whilst some of
this conflict was the inevitable consequence of the various parties' differing interests,
there was virtually no common search for the most felicitous ways of accommodating the
interests of all these parties at the same time as satisfying the national interest in reduced
automotive industry protection. At such a time those advising the incoming Government
turned to the IAC's reports, and its officers for counsel on how and where to make the
most felicitous compromises, given that compromises were inevitable. They learned to
their dismay that the IAC could offer little constructive advice. But it makes sense to end
the story here. For beyond this time, it cannot be told by this author without the
discomfort of occasional lapses into autobiography.
10 Some Concluding Speculations

Modern science's methodological procedure is exclusive and intolerant, and rightly so. It fixes attention on a definite group of abstractions, neglects everything else, and elicits every scrap of information and theory which is relevant to what it has retained. The method is triumphant provided the abstractions are judicious. But however triumphant, the triumph is within limits. The neglect of these limits leads to disastrous oversights. . . . The methodology of reasoning requires the limitations involved in the abstract. Accordingly, the true rationalism must always transcend itself by recurrence to the concrete in search of inspiration. A self-satisfied rationalism is in effect a form of anti-rationalism. It means an arbitrary halt at a particular set of abstractions.

Alfred North Whitehead, 1925: 200

This dissertation has sought to illustrate the mishandling of certain issues relating to intra-industry trade and trade liberalisation by the economics profession in general and the IAC in particular. This chapter's title - 'concluding speculations' - is offered advisedly. In particular, where earlier chapters sought to persuade even a potentially hostile reader, this conclusion assumes a degree of agreement with the basic themes of the dissertation in an attempt to take things further. The chapter speculates on some of the deeper dynamics of the discipline and on some of the possibilities - both historical and intellectual - which were, and continue to be foregone because of the difficulty the discipline has in dealing with 'second best' issues and meliorative themes. Whilst numerous examples are offered to illustrate the points made in this chapter, its speculations are sufficiently ambitious that to offer more comprehensive persuasion would require several works of the length of this dissertation.

Section 10.1 argues that 'first best' and 'second best' principles considered together posed a particularly acute form of dissonance for those who felt compelled to choose between them. First best principles offered clarity, but the theory of the second best suggested that in many circumstances first best principles were an insufficient theoretical foundation for policy formulation. Sub section 10.1.1 argues that this insufficiency of theory has led to a radical break between theory and practice - a phenomenon which I call 'discursive collapse'. To avoid repetition, further elaboration is kept to the sub-section itself. Sub-section 10.1.2 argues that the Commission's reasoning about second best issues also suffered from discursive collapse, and explores some parallels with inquiries other than those into the automotive industry. Section 10.2 gazes into the imaginary
CHaPTEr TENh  SOME CONCLUDInG SPECULATIONS

territory which 'might have been' had economists engaged more productively in dialogue and mutual adjustment with other participants in the debate.

10.1 Dangerous Supplements for the IAC

The Commission's revealed strategy on the conundrums which faced it may be described by reference to modern psychological literature on human cognition and decision making. The study of 'cognitive dissonance' has attested to people's tendency to avoid feelings of discomfort arising from the confrontation of seemingly contradictory ideas (also see Akerlof and Dickens, 1982). Far from being new to modern psychology this insight is a commonplace wisdom explored in literature and expressed in such sayings as 'There's none so blind as those who will not see'. The phenomenon is captured by Nietzsche with aphoristic humour. "'I have done that' says my memory. 'I cannot have done that' - says my pride, and remains adamant. At last memory yields" (1886, § 68: 72). As Nietzsche suggests, the phenomenon is often most powerfully at work in situations where one or both of the competing ideas are infused with some moral or normative significance.

'Second best' issues disclosed cognitive dissonances of the kind just described. They led what might otherwise have been a compellingly coherent and simple political and intellectual program into a minefield of complications. The 'second best' issue did not just raise a 'special case' to be dealt with on its merits. It could be (and, in the community of economists, was) seen as providing a fundamental choice between two distinctly different approaches to reform each of which could claim legitimacy from economic theory (cf §§ 3.4.2, 3.4.3 above). The apparent choice between 'compensating' and 'eliminating' provided a case of 'normative dissonance'. One approach sought gradually to lower assistance where possible and to resist pressures for more assistance wherever they arose. Over time the aggregation of such actions might take the economy as close as politically possible to free trade. The alternative approach involved accepting the implications of piecemeal, gradual reform and accordingly seeking to balance the demands of each case on its merits with the overarching desire to move as rapidly as possible towards freer trade (A. Lloyd, 1975: 10).

Even though in practice they could co-exist in transition, as we have seen, in principle tariff compensation was a dangerous supplement to tariff elimination. In the event the IAC forswore the possibility of engagement with these difficult issues by clinging to an 'in-principle' rejection of tariff compensation in particular and 'second best' considerations more generally. Some Commissioners, like Alan Lloyd, forced it to compromise on occasions by recommending the maintenance of existing levels of
assistance for some low cost industries (eg Industries Assistance Commission, 1975, personal communication from Alan Lloyd). But with a few small exceptions, any measure, or indeed instrument which partook in some sense of the dangerous supplement - in tariff compensation rather than tariff elimination (or as will be seen below, even of facilitation of exports in the presence of tariffs) - was at risk. It was disparaged both for the 'uncertainty' of its affects on resource allocation and because it might help entrench a 'mendicant mentality' amongst business. Frequently this was despite strong evidence that, either on its own, or alongside other measures, the particular measure under reference would improve resource allocation, enhance productivity growth and strengthen the position of low cost exporters at the expense of higher cost import replacers. It is hard to avoid the conclusion that the Commission's apprehension of both economic and political threats and possibilities had more to do with a certain 'aesthetic' in political economy than with careful assessment of likely risks, costs and benefits.

10.1.1 Coping with the Insufficiency of Theory: The Phenomenon of 'Discursive Collapse'

The 'dangerousness' of tariff compensation underscored the allure of dealing with it as a matter of principle - by way of peremptory rule - rather than on the merits of individual cases. In this context the IAC adopted, consciously or not, a policy of exclusion rather than serious engagement with important material which came before it. As the demands for engagement became more insistent, the steadfastness of its refusal to engage degenerated into what is described in this sub-section as 'discursive collapse'.

10.1.1.1 Discursive Collapse in Economics: The Case of the Pareto Criterion

If the incomparability of utility to different individuals is strictly pressed, not only are the prescriptions of the welfare school ruled out, but all prescriptions whatever.

Harrod, quoted in Linder, 1961: 23

Chapter One (§ 1.3.2.4) drew attention to Phillip Mirowski's comment that modern economic discourse has been intolerant of discussion which offers little promise of definitive conclusion (1986: 192). Take, for example, the discipline's search for normative foundations upon which to base claims about economic welfare and efficiency. Here, economists' search for an analytical foundation or "apex value" (Lindblom, 1990: 42) to free economics from contention and value judgment, and so
prepare the way for definitive closure, drove them to the Pareto criterion of welfare comparison. According to that criterion, the economic welfare of a group of people can be said to improve if the economic welfare (generally income or wealth) of some of them improves whilst the situation of none of them deteriorates. In many, but not all circumstances, the criterion is both harmless and useful as a sufficient condition for demonstrating a welfare improvement - although it does not avoid value judgment. But, lured by the putative uncontentiousness of the Pareto criterion, the discipline has gravitated towards using it more strongly, as something which is both necessary and sufficient for welfare improvement.

It is evident that such a fastidious criterion provides a debilitating limitation on welfare claims about the empirical world. Virtually any significant economic development or policy involves losses for some. Given this difficulty, makeshifts have been constructed around the idea of 'winners' compensating 'losers' to transform a situation which does not meet the criterion into one that does. The fastidiousness of the Pareto criterion is thus met. Alas this is 'in theory', but not in practice where administrative limitations, adverse selection, moral hazard, imperfect information, and political exigencies combine to ensure the virtual impossibility of compensation systems capable of delivering actual Pareto improvements.

Since the original purpose of this procedure is to forestall contention around competing values, there can be no reason for relaxing it at any stage in one's reasoning from theory to practice in a particular policy situation. To do so later in the process is to raise the question of why one proceeded with such fastidiousness earlier. And raising the possibility of less fastidious foundations of welfare comparison is to raise the prospect that the analytic method of welfare economics - its construction from a (nearly) uncontentious foundation - may be of very limited use: that to be useful the skills of the welfare economist might need to be more modestly focused around what Self has called "the genuine rationalist role of clarifying issues and narrowing areas of disagreement" (1975: 24).

This is not, however, what has occurred. Instead the fundamentals of welfare economics have moved from the fruitful difficulties and turmoil associated with establishing and developing the Pareto criterion in the first half of this century to an unwholesome equilibrium. Debate about the theoretical underpinnings of concepts such

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92 There are plenty of people who would object to a situation in which the poor get relatively poorer even if they do not get absolutely poorer. A very different example would be provided by the example of the community's access to pornography. It is not clear that more is better.
as welfare and efficiency has gradually subsided while practice has oriented itself around one particular set of theoretical foundations which increasingly go unexamined and even unacknowledged. As Mishan complains:

The innocent layman might reasonably suppose that on so fundamental a concept as the criterion of economic efficiency there would be either basic agreement within the profession or else raging controversy, for unless such criterion can claim legitimacy the conclusions reached by economists in this vital area . . . cannot be taken seriously. In fact there is neither - only some desultory sniping from time to time. Among the many writers who have recourse to a criterion for ranking alternative organizations, few give much thought to the question of [the criterion's] legitimacy (1986: 88; also see Mirowski, 1986: 183).

This is the phenomenon which is here called 'discursive collapse'. The discipline seeks, by way of various makeshifts, to deal with the radical insufficiency of its own theoretical foundations and techniques for generating compelling conclusions about the empirical world. In so doing, certain shortcuts are taken and the consequence is frequently some travesty of the original intentions. Thus in a recent discussion, one economist comments on policies which "could lead to a true Pareto improvement - one in which at least some sections of the community could be made better off but in which no (or few) sections were made worse off" (Dee, 1994: 38). In this example the Pareto criterion now applies to sections of the community, and it applies give or take a few sections. The great bulk of welfare economics is now done by modelling the welfare of a community as a single consumer or by reference to an efficiency criterion based on 'potential Pareto improvement', each of which is analogous to defining welfare as gross wealth aggregated across individuals. Such work has valuable uses, but producing conclusions which do not depend on interpersonal comparisons is not one of them. Aggregating wealth across individuals is precisely the concept which the Pareto criterion offered to move beyond in its assessment of welfare!

Largely as a result of the fastidiousness of the Pareto criterion, when economists come to the inevitable questions concerning the respective interests of 'winners' and 'losers', they find themselves untutored by their discipline. Thus, ironically, it is the practitioners of a discipline which is underpinned by a fastidious commitment to avoiding interpersonal welfare comparisons who are so often in the vanguard of those urging sacrifices on some, in the interests of the 'greater good'.

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10.1.1.2 Discursive Collapse and the Aesthetic of First Best

Why is the world so full of trimmers who prefer a compromised second best to a well defined first best?
Congdon, 1993: 32

Discursive collapse threatens 'second best' reasoning in economics in very similar ways. Lipsey's and Lancaster's 'general theory of the second best' illustrated the radical insufficiency of existing normative economic theory by demonstrating that, where just one of the conditions for an optimum was violated, the other conditions of the optimum could no longer be assumed to be desirable (1956-57: 11). Given that in any actual economy there are endless violations of Pareto optimality conditions, Mishan's concern that the new theory might represent a new "impossibility theorem" - in the tradition of Arrow - was understandable. The new theory initiated a vigorous debate about when one might still warrantably use 'first best' principles in admittedly 'second best' situations, notwithstanding the corrosive implications of the theory of the second best (Mishan, 1962: 205 and passim). If, from this point, the discipline was to move forward with theoretical integrity, it would have to have been by way of the development of this literature which was true to the theoretical foundations of neoclassical economics.

Today however the careful considerations explored in that literature are rarely confronted in contemporary discussions of policy problems to which the theory of the second best is relevant. In their place has arisen a more summary 'aesthetic' of the first best. Here, amidst disdain for the "messy world of the second best" (Harberler, 1988: 49), the impression is frequently given that policy makers may choose between 'first' and 'second best' policies - when the burden of the theory is to suggest that in second best situations, what looks like first best policy will generally be third best. In this way the theory of the second best emerges not as a caveat about the appropriateness of 'first best' principles, but rather as a problem to be somehow avoided. And so, as was the case with the Pareto criterion, courtesy of some logical shortcuts which depart momentarily from otherwise fastidious standards of rigour, a means of avoiding the problems emerges. Thus, again and again, economists excuse themselves from the difficulties of second best considerations by way of the assertion that sufficiently thoroughgoing liberalisation is capable of "the immediate removal of all distortions" (Vousden, 1990: 203) - a spectacular logical leap given the myriad 'distortions' endemic to any economic system which remain after any liberalisation (also see Krueger, in Krause and Kilwan,
Certainly there are few persuasive empirical or theoretical reasons for supposing that economic theory indicates that instant and total liberalisation is beneficial.94

By such means the significance of the impossibility theorem is transformed into something which elides the very difficulties of complexity, engagement and transition which it sought to confront. And, as was the case with the Pareto criterion, this shortcut threatens a travesty of the implications of the original theoretical work. Just as there was 'discursive collapse' in welfare economics around the fastidiousness of the Pareto criterion, here there is a discursive collapse around the one possibility which remains beyond the corrosive reach of the theory of the second best - instant and total liberalisation. A theorem which initially cast doubt on 'first best' principles is thus transformed into a spur for more radical and thoroughgoing commitment to the same 'first best' principles.

10.1.1.3 Discursive Collapse in Political Economy: The Mutually Reinforcing Aesthetics of 'First Best' Policies and Politically Unconstrained Policy Making

Frequently the leaps in economic logic outlined above are reinforced by a parallel political aesthetic in which the processes of politics appear as an unwelcome and essentially alien influence on economic policy making. This view of politics is itself frequently an exercise in precisely the kind of non-engagement with the complications of the empirical world, which can produce discursive collapse. The proposition may be

93 Note that Krueger does not assert that instant and total liberalisation is best, but she does make it a fundamental assumption of her analysis. Another example is provided by Bottini - an economist writing for the daily press:

[A]n efficient allocation of resources cannot be achieved unless all markets are liberalised: a distortion in the flow of any one of the factors of production inevitably creates a distortion in the flow of the others and deregulation thus fails to deliver (1993: 28).

94 There is scant empirical support for the proposition since instant and total liberalisation has not been attempted by any country and there are very few examples of actual reform which are tolerably close to it. The objection to taking neoclassical theory to support such a course is twofold. Firstly the standard neoclassical theory, which is taken to support instant and total liberalisation, makes a range of unrealistic assumptions. This point is logically equivalent to the point made above - that 'distortions' remain in a thoroughly liberalised economy the assumptions of neoclassical theory notwithstanding. Secondly the 'comparative static' method of neoclassical theory abstracts from the very problem at issue - transition.
Some Concluding Speculations

illustrated initially by the case of economists' support for uniform tariffs. Many economists have argued for uniformity in tariff setting over the last few decades on both economic and political grounds. Uniformity of tariffs is an attractive way of seeking greater uniformity of effective protection rates, but flies in the face of the principles of Ramsay taxation which dictate that taxes should fall most heavily where they influence behaviour least. Thus, where consumption effects are considered, uniform tariffs can generally be improved upon by selective changes to tariffs (Panagariya and Rodrik, 1993: 686).

Panagariya and Rodrik (1993: 686) comment that, as a result of the shakiness of the economic case for uniform tariffs, "policy advisers have lately begun to rely more heavily on administrative simplicity and the political context as arguments for tariff uniformity". Panagariya's and Rodrik's language seems to suggest that rather than being the driving force of assessments of the worth of alternative policies, policy rationales are sometimes called upon after the event - to justify policies which have already been arrived at according to some deeper intuition. Note also the scant kind of political analysis upon which economists are said to have relied. As Panagariya and Rodrik put it "[w]ith the exception of brief, verbal discussions... political economy arguments for a uniform tariff have simply not been spelled out. This is all the more surprising since in recent years the literature on the political economy of trade policy has grown rapidly" (1993: 687). In the terminology developed here, notwithstanding theoretical work which undermined the case for uniform tariffs, there appears to have been 'discursive collapse' around uniform tariffs, with the motive being a particular political strategy which was no less influential for being largely unexplored.

One view of the economists' relationship to politics is captured in much of the modern 'political economy' or 'public choice' literature. In it, political forces determine or constrain policy making and so, not surprisingly, operate to obstruct economically optimal policy making. In this context, political alternatives are often modelled as alternative constitutional rules which constrain politics. In such a framework, constitutional constraints on politics can remove political constraints on policy. Note that this comparison of the relative economic attractiveness of alternative constitutional rules does not model at all closely the political problem as it typically arises for political actors. For they are typically not in a position to influence their constitutional environment.

The way in which the difficulties confronting actual politicians and policy makers are elided in this tradition is closely analogous to the way in which second best issues have been elided in much modern economics. In economic discourse, an in-principle
injunction to policy makers to prefer 'first best' over 'second best' policies obscures the importance of the policy making context. For if the policy making situation is a second best one economic theory tells us the choices are not between first and second best but between second best and something worse. Likewise in the 'constitutional politics' genre, in place of the difficult choices confronting actual policy makers, there is substituted a subtly expurgated, and conveniently simplified problem of working out the rules by which it would be desirable to constrain policy making - or if you like, the situation the policy maker would most prefer to find themselves in!

This is not to deride such approaches. Constitutions are established or revised from time to time. And there are occasions when political behaviour today can acquire some constitutional significance by influencing institutional evolution or political precedent. For instance, advice to developing countries to tarifficate or auction quotas which are currently allocated administratively may, if it can be done, be very useful in reducing the scope for subsequent rent seeking. But where this kind of institutional engineering is very difficult or impossible, a hankering to constrain politics can be useless or worse. The constraint envisaged may involve compromises with what is economically best in a given situation, as can be the case with uniform tariffs for instance or the Commission's trading of the substance of lower protection for the form of a (near) tariff-only regime. And acting, or forbearing from acting as if there were a constraint, may help establish a constraint. But it may not. It may simply be quixotic. Such an approach can lead the practitioner away from an appreciation of the inevitability of engaging with the 'messy' world of politics and the consequent need to handle it with what skill one has. And skill in the political medium is skill in compromise and skill in making the best of what is given and/or what is possible - in short, skill in negotiating the world of the second best. Where it lacks those skills, economics risks becoming a discipline which, instead of seeking some felicitous conjunction with politics, becomes bemused by, hostile to and squeamish about the political medium through which economic policy is ultimately determined.

10.1.2 The Commission, the Second Best and Discursive Collapse

The story told in earlier chapters about the Commission's approach to export facilitation was one of discursive collapse. For as has been shown - despite being directed to the very issue by both its terms of reference and the circumstances in which the Government had placed it - the Commission never took up Alan Lloyd's injunction to refute the case for second best assistance on its merits in individual circumstances. It never really
engaged with the economic case for export facilitation and so its case against it remained unpersuasive. And, as was the case with uniform tariffs, certain intuitions about the politics of the issue were a major consideration and yet there was almost no consideration or discussion of those intuitions. With the exception of a few brief and scattered passages, the Commission failed to engage explicitly with the politics of second best assistance, either for tariff compensation or export facilitation in the automotive industry. The politics of export facilitation was hardly mentioned in its 1979-81 reports. One might speculate that the Commission felt it could not be too explicit about political pressures on government in its report. Yet references to the politics of export facilitation were very rare even in its working papers. Consistent with the framework outlined above, it seems that the economics and the politics of the second best took on the presence of a kind of 'shadow'. An intuitive hostility to the political and economic risks entailed by export facilitation was implicit in much of the Commission's reasoning but rarely if ever confronted directly, thought through, or carefully argued for.

Although, like all other reform options, it entailed risks, the politics of 'concessional trade liberalisation' offered significant promise - particularly given the practical impossibility of rapid tariff reform (see § 5.8.1 above). The Commission's fear of governments becoming 'locked in' to export facilitation was legitimate enough (see § 9.5.2 above). But one could not seriously engage with the issue without considering some of the political benefits of export facilitation - the scope for others to seek the extension and liberalisation of the scheme with potentially trade liberalising effects, and the extent to which assistance through duty remission might attract greater scrutiny and discipline from Governments through its impact on the budget. This is not to mention the political costs of not implementing export facilitation - which the Commission seems to have understood to be higher rates of assistance for import replacement than might otherwise prove necessary (§ 9.7.1 above). Would the Government be any less 'locked in' to higher levels of investment for import replacement than for export? It is hard to see why, particularly since assistance provided to relatively low cost exporters seems more likely to have encouraged activity which might one day be competitive at low or zero assistance than activity which shelters under higher rates of assistance to import replacement.

The Commission's reports on the automotive industry were part of a larger pattern in which the Commission became progressively more fastidious about reform which smacked of the 'dangerous supplement' of the second best.
Chapter Ten

Some Concluding Speculations

10.1.2.1 Shipbuilding

The (then) Tariff Board's recommendation to extend the shipbuilding bounty to exports in 1971 on 'optimal intervention' grounds will be recalled (see § 3.3.1 above). In a shipbuilding report five years later the IAC stepped back from its earlier position but was nevertheless relatively open minded on the issue. It noted that smaller shipyards had been both successful and "relatively efficient by world standards" and proposed further investigation into their circumstances for the purposes of making recommendations. It suggested that if, in the meantime, the viability of these small yards were threatened, the Government "give consideration to providing temporary assistance" by way of an export subsidy in addition to existing bounty assistance for import replacement (Industries Assistance Commission, 1976: 86).

After 1976 the Commission became more antagonistic to this approach, using the rhetorical form which would feature in its 1979-81 automotive reports - that it could see no reason for extending more assistance to exported ships than other exports received. In 1979 the Commission suggested that, in the light of more general export assistance provisions, the industry's bounty be confined to production for domestic markets. Although the Tariff Board's 1971 recommendation to extend the bounty to exports was not implemented at the time, this policy was introduced in 1984. In its 1988 Shipbuilding report the Commission noted the significant expansion of exports under the bounty and recommended phasing it out over three years at the same time as retaining the bounty for import replacement. It commented:

Continuation of the export bounty would provide assistance additional to that available for exporters of boats, and to most other exporting activities. Although providing bounty for domestic sales but not for exports would discriminate between end-use, such discrimination is inherent in the tariff-assisted environment for manufacturing in Australia (Industries Assistance Commission, 1988: 46).

Assuming, not unreasonably, that the aim of assistance to shipbuilding was to increase domestic output of ships, the Commission proposed that the Government move from a means of achieving its objectives which was 'first best' - or most direct by the principles of 'optimal intervention' - to one which was discriminatory in the way it achieved those objectives and so was 'second best' (Corden, 1974: 29). Its choice was justified by reference to its continuity with Australia's protectionist past.

10.1.2.2 Assisting and/or Facilitating Exports

A similar story can be told of the Commission's approach to export incentives more generally. Although it used the level of general export assistance as the 'benchmark'
from which to argue for the elimination of special export assistance schemes to particular industries, the benchmark by which it assessed the appropriate level of general export assistance went from a pragmatic one oriented around the theme of industrial transition, to an 'in-principle' appeal to the benchmark of zero assistance. That change itself might well have been an appropriate response to economic transition if only it had not taken place before that transition had actually taken place. For the benchmark by which the Commission continued to assess the appropriate level of assistance to import replacement remained altogether more compromising.

In 1980 Peter Sheehan was able to write that there was a broad consensus amongst Australian policy commentators not just in favour of tariff reduction but also for some export assistance - at least for a period of transition - although there were differences in emphasis with the IAC stressing the centrality of tariff reduction (1980: 213-4). The Commission's 1977 report considered existing industry wide export assistance schemes - mainly focused on export marketing - and was "satisfied that these schemes provide assistance primarily to low cost activities in all sectors of the economy with beneficial effects on resource allocation". The Commission also believed that "a case can be made for providing additional assistance to exporters for a period but not on a long term continuing basis". In commenting that this "may be an important means of giving effect to the implementation of the Government's long term policy of gradually lowering high levels of assistance" the Commission appears to endorse the idea that export assistance might play a useful role in facilitating tariff reform. Given the lack of progress on tariff reform in 1977, the Commission forbore from recommending export assistance. Nevertheless in an appendix it outlined the design of export assistance schemes "which the Government may wish to consider as part of an overall approach to meeting its long term objectives" (Industries Assistance Commission, 1977: 5-7).

In the years after this report, unemployment remained high and the political climate for trade liberalisation remained poor. The Government made strong commitments to trade liberalisation in principle in its 1977 White Paper on Manufacturing Industry, but made little practical progress. Average effective rates of assistance actually rose slightly (Industry Commission, Annual Report, 1990-91: 2). By the time the next review of export incentives reported in early 1982, however, the Commission was also reporting on options for achieving general reductions in protection. In addition to the existing Export Markets Development Grants Scheme the Government had also introduced Export Expansion Grants (which owed something to the proposals developed in the Commission's 1977 report).
The 1982 export incentives report conceded the 'second best' case for export assistance to reduce the home market bias otherwise produced by tariffs and, despite some problems of administration concluded, nevertheless, that the two existing export assistance schemes had probably produced net benefits. It reiterated its opposition to maintaining the schemes in the long term, but, in view of their current contribution to allocative efficiency, indicated it was "reluctant to propose" their removal "unless there is evidence that this would lead to some longer term gain". At this point the Commission pointed to its current inquiry into general reductions in protection and argued that if general tariff reform were pursued, the termination of the export marketing and expansion grants schemes "would be consistent with the longer term interests of the community". Although it had previously referred to export assistance as an "important means" of achieving tariff reform (see above) this new perspective implicitly cast export assistance and tariff reform as alternatives. The Commission proposed phasing out both export schemes within three years. This was despite finding that removing the schemes would worsen resource allocation and "hence" lead to "some decrease in economic welfare" (Industries Assistance Commission, 1982: 1-2, 59). Two days later the Commission reported on general reductions in protection. Yet the most ambitious of the options proposed involved reducing average tariffs to a ceiling of twenty per cent over ten years (see below). This meant that, apart from possibly facilitating tariff reform, export assistance would be likely to produce allocative efficiency gains throughout such a period.

In 1987 the Commission's hostility was extended even to duty drawback for inputs to export. The Commission made no mention of the role such schemes had played in successful Asian development. It recommended that the existing duty drawback schemes be abolished although it did make a 'fallback' proposal to improve scheme administration if its principal advice was rejected. The Commission repeated a range of objections to partial trade reform. It observed that duty drawback tended to be enjoyed mostly by manufacturers some of whom were highly assisted and that the schemes involved high compliance costs. It went on to deploy against duty drawback an impossibly heavy burden of proof:

> Even if it were possible to constrain export concessions to lightly assisted activities, there could be no guarantee that the longer term outcome would be an improved industry structure. The encouragement given to some lowly assisted exporting activities might be at the expense of other efficient activities - not all lightly assisted activities export and not all exporting activities use imported inputs to the same extent. Hence attempts to confine them to lightly assisted activities which export could lead to some decline in
other equally or more efficient activities (IAC, "Concessions", 1987: 43, emphases added).

In these circumstances the Commission argued that the concessions were a very partial and unsystematic way of alleviating the problems created by protectionism. But its deprecation of concessional treatment to inputs for exports from highly assisted activities obscured the fact that exports from highly assisted industries often suffered from the greatest degree of negative assistance - even with concessional treatment. This point had emerged with some force in the 1977 Export Incentives report (1977: 86). What modelling the Commission did do in 1987 indicated that export concessions improved allocative efficiency.95

Consistent with the framework outlined above, the Commission deployed its traditional juxtaposition of the politics and economics of first and second best reform strategies as alternatives. The Commission took the unusual step of highlighting the contribution of one of its inquiry participants over those of others. It placed a quotation from the National Bank's submission to the inquiry in italics at the head of its concluding chapter. The quotation offered a familiar tilt at the commonsensical fallacy of protection all round arguing that "[a] nation has a choice" between "promoting exports and protecting domestic producers from import competition":

Measures serving one end, directly and indirectly oppose the other. A system that appears to both promote exports and protect domestic producers against competition, in reality does neither (IAC, "Concessions", 1987: 61).

The point is of course legitimate. But it fails - as the Commission also did in its report - to tackle the more pressing problems of amelioration, priority and transition. Indeed the passage damns the Commission's revealed preference for tariffs over alternative mechanisms during the transition to free trade as much as any other gradual trade liberalisation strategy. The Commission concluded by asserting the choice between first and second best approaches to reform: "[I]f the government wishes to reduce the costs

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95 The Commission called these 'short run' projections, but the short run to which the Commission referred lasted about two years and incorporated a range of general equilibrium effects including inflation and labour market responses to increased demand for inputs to expanding exports of manufacturers and consequent contractions of export industries like meat, petroleum and coal which imported few of their inputs [IAC, 1987, Appendix E: E - 10, 22]. I cannot explain why the Commission did not provide longer run estimates with greater capital mobility between sectors. However as a rule, the longer run the analysis, the greater the gains from reform because of the scope for capital investment to respond to relative changes in profitability [see § 9.5.4 above].
imposed by tariffs and other charges on exporters and efficient industries generally, it should do so directly" (IAC, "Concessions", 1987: 62). And the Commission's complementary political aesthetic of first best reform was summarily deployed against the concessions. "The relief the concessions provide can reduce pressure for the development of a more neutral and consistent approach to industry assistance" (IAC, "Concessions", 1987: 61, emphasis added). The Commission provided no evidence that this had occurred, nor did it explore any of the alternative perspectives. One might argue, for instance, that refusing to facilitate export growth with duty drawback would constrain the expansion of exporters who would thus be similarly constrained in their capacity to exert pressure for further liberalisation.

10.1.3 Multiple Objectives and the Escape from Marginalism

[I]f the standard for efficiency is taken to be operation on the hypothetical [production possibility] frontier, all production choices made in the real world must be judged inefficient. This is so because, in actuality, decision makers face a variety of binding constraints in addition to those considered by . . . theory. Thus, the effective opportunity set always lies inside the hypothetical frontier, and the most any producer can do is to reach the boundary of the effective set. On this view, efficiency results when all of the operative constraints are recognized and the conditions for constrained maximisation are met.

Eirik Furubotn, 1990: 229, emphasis added.

The theorem of the second best demonstrated the radical insufficiency of neoclassical theory for generating useful normative conclusions about policy in a richly constrained world. One might argue that the theorem pointed directly to the need for decision makers to recognise the constraints they faced, with a view to making the most felicitous tradeoffs possible. Such an approach underlay the importance which Braybrooke and Lindblom gave to 'margin dependent comparison' between alternative policies and their emphasis on the need for plurality in policy analysis. As they put it, "[t]he [policy] problem' is in fact a cluster of interlocked problems with interdependent solutions" (1963: 54). Braybrooke and Lindblom were preoccupied with social policy but the material from this study shows the relevance of their approach to economic policy making under constraints. For although economics is paradigmatically oriented around the concept of change at the margin, the marginalism of economics operates as an engine of closure not exploration. Marginalism in economics operates within the framework of optimisation and optimisation is only possible within well defined frameworks. This
sub-section explores the many ways in which economists failed to make the 'margin dependent comparisons' necessary to shed new light on the problems they encountered.

The arguments for a pilot school dental service discussed in Chapter One (§ 1.3.2.2.3) were founded on the "cluster of interlocked problems" relevant in that instance, and particularly on the complementarities between existing institutions and emerging needs and opportunities. In economic terms existing institutions represent sunk costs, and so adapting them to multiple objectives (the school conducting a dental survey for instance) may frequently present a lower cost response to emerging needs and opportunities than the establishment of new institutions. But this kind of ameliorative adaptation comes from taking something as 'given' and making the most of it. It is 'second best' - like Baranson was when he asked how to improve automotive protection, accepting that the policy objectives underpinning Latin American protectionism would, rightly or wrongly, continue (see § 6.4 above). However this is the dangerous supplement to 'first best' thinking in which there is an efficient instrument for each objective sought and a range of practical problems are assumed away, particularly the fact that virtually all policy instruments, and many market transactions, are not costless and meet their objectives imperfectly.

The problem which intra-industry trade posed for the Commission was embedded within a cluster of problems relating to the economics and politics of trade liberalisation. From the perspective set out in this dissertation, even the objective of trade liberalisation itself comprised multiple objectives. For it comprehended both inter-industry and intra-industry trade liberalisation, and tradeoffs between the two were implicitly made whenever policy makers made choices between different strategies and different instruments of trade liberalisation. Further, inter-industry trade liberalisation via tariff reduction and intra-industry trade liberalisation via import/export links interacted with each other at both economic and political levels. From an economic perspective, traditional tariff reform directly reduced inter-industry disparities of assistance but it also indirectly reduced intra-industry disparities of assistance. Import/export links directly reduced intra-industry disparities of assistance but in so doing they could also reduce - or increase - inter-industry disparities of assistance (§§ 5.2, 5.4). From a political perspective, as GMH argued in both the 1973-74 and 1979-81 inquiries, and as the Commission seemed to accept in the latter one (§ 9.7.1), assistance to low cost exports could probably be traded off for reduced assistance to the highest cost import replacements. But economists generally - and the Commission in particular - showed little interest in the scope for tradeoffs at the margin between different forms of assistance. For the comparison could only be made once the adaptive, 'second best'
question had been put: "While assistance is being reduced, can one improve what assistance remains?"

Although its quantitative modelling could have yielded worthwhile insights and disciplined the difficult process of weighing alternatives, the IAC did not subject export facilitation to any margin dependent comparison with alternatives - including the alternative it ultimately endorsed of higher tariff assistance. Within the economics profession more generally, greater adaptiveness was shown in forging the new development consensus from economic theory and emerging evidence (§ 3.3.1). Within economic theory however, economists expended enormous effort in exploring the implications of scale economies for trade policies in the unrewarding intricacies of strategic trade theory (§ 1.3.3). But they made surprisingly little progress in thinking through some of the relatively straightforward implications of scale economies and intra-industry trade for trade policy reform (§ 4.6.3). That is, they made little progress in considering the 'second best' problem of how one might ameliorate trade policies which, it could be widely agreed, were not optimal.

10.1.3.1 Tradeoffs between Simplicity and Comprehensiveness: Ceteris Paribus and 'First Best' Thinking

Some economists concede that monetary policy can influence both prices and output, but worry that one objective will be pursued at the expense of the other. The mechanical formulation of this argument is that one instrument cannot achieve two objectives. But multiple objectives are routinely pursued - and satisfactorily met - in all walks of life. The issue, therefore, should not be settled by any mechanistic dismissal of the possibility.

Bernie Fraser, Governor of the Reserve Bank, 1994: 18

That more rigorously 'margin dependent comparisons' were not made between tariffs and export assistance is striking, given that the two matters were closely related. What of the opportunities for margin dependent comparison and mutual adjustment between more disparate economic phenomena? Economists evinced a strong desire to keep different matters in their (separate) intellectual places.

Chapter Three has already outlined the way in which Alan Lloyd and the 1974 Green Paper argued that the case for tariff compensation might be stronger where it met equity as well as efficiency objectives. It is easy to understand Peter Lloyd's hostility to
assessing the worth of tariff compensation according to multiple criteria. He regarded any systematic policy of tariff compensation as unworkably complex even when evaluated against the single criterion of economic efficiency. He was also appealing to the virtue of keeping things in their intellectual place. Economists are inured to this kind of pigeonholing in both positive and normative economics. In positive economics it occurs routinely by way of the *ceteris paribus* assumption. This enables economists to investigate the logic of a single phenomenon within the economy by imagining (logically) extraneous factors to remain unchanged. In normative economics the assignment of particular instruments as the appropriate or 'first best' means of achieving certain objectives and the implicit deprecation of using other ('worse') instruments to achieve those objectives fulfills a similar function. Both techniques are indispensable analytical tools, but they are invitations to fallacy where their partiality is insufficiently appreciated.

Peter Lloyd would have felt justified in insisting that things be kept in their place because ignoring equity considerations in setting industry assistance does not mean ignoring equity. Other policies - like welfare and tax policy - can typically deal with equity objectives more efficiently than industry assistance policy. But even the most efficient instruments for enhancing equity are neither perfectly effective nor costless. Thus any tariff compensation which met both efficiency and equity objectives would lower the cost of achieving any given level of equity with other instruments and these benefits have their logical place in any evaluation of the worth of tariff compensation. Peter Lloyd's injunction to ignore the equity implications of tariff compensation may have been well judged advice. But that is because it appealed to the administrative and political virtue of simplicity and the need for 'rules of thumb' to guide decision making, not because there is any intrinsic logical merit in turning a blind eye to some effects of policies because their principal purpose lies elsewhere.
There were other crucial matters to be considered in designing assistance reform. The macroeconomic context in which reform was pursued - particularly the rate of economic growth, the exchange rate and the balance of payments - each had considerable influence on both the economically desirable and the politically achievable rate at which assistance reform could be pursued. So too did the extent to which reform conformed to the orthodox top down and across the board rules. Before criticising the Commission's treatment of these issues, it must be conceded that it was in a particularly difficult institutional position to deal with them. Actually relating assistance reform to the economy's capacity to adjust was a tall order in any event. But this was particularly so for the Commission because - except in its annual reports - it did not provide a steady stream of advice to government as government departments could do. Instead its advice on specific industries was provided in response to terms of reference which were dictated by governments from time to time. Having succeeded in attracting the 1973 reference on the automotive industry, the Commission was unable to conduct a comprehensive review and offer new recommendations until it received the 1979 reference.

Whatever institutional difficulties the Commission faced, its removal from the day to day advising role of departments did provide it with the opportunity to consider the issues carefully and to deliberate on their significance both for its own advice and for governments more generally. In its annual reports the Commission gave substantial attention to the issue of relating reform to the economy's capacity to adjust. Unfortunately however its thinking failed to develop satisfactorily, for it never engaged in any searching 'mutual adjustment' between the available alternatives.

My principal purpose here is not to advocate one particular approach to matching reform with the economy's capacity to adjust, although some of my sympathies are evident.
Rather I argue, firstly, that this was an important area of deliberation which could not be solved except by 'margin dependent comparison' and 'mutual adjustment' between competing values and objectives. Secondly, I argue that, while the Commission agonised about several of these issues, its unpreparedness to engage in 'mutual adjustment' once again led to important choices being made largely by default rather than design. In each case the Commission proffered plausible reasons for its views, which drew on 'first best' principles. But its reasons were rendered plausible by its failure to engage with uncomfortable (second best) issues. In the upshot, the chance for assistance reform to be more felicitously tailored to the economic and political scope for reform was lost.

The options of ad hoc, 'opportunistic' reform and reform according to pre-determined schedules are set out in the head quotation above. As Max Corden had explained in 1966, trade liberalisation might be particularly apposite where the balance of payments was in surplus and inflationary pressures were strong (cited in Vines, 1994). Here tariff reduction could meet its traditional microeconomic objectives whilst simultaneously contributing to the macroeconomic objectives of reducing a trade surplus and inflationary pressure. Moreover where inflation was driven by excess demand, adjustment costs would be minimal as there would be excess demand for factors of production - including labour. Here the benefits of tariff reform would be magnified and its costs minimised.

If the economy had ever been predictable enough to allow the rate of tariff reform to be tailored to economic circumstances by way of fixed schedules set many years in advance, that time had passed by the Commission's inception. By then the Bretton Woods exchange rate arrangements had broken down, Australia had just engineered a dramatic 'opportunistic' 25 per cent tariff cut in just the kind of circumstances Corden had foreshadowed, and the economy had begun its long, painful and unpredictable adjustment to the first oil shock. As Rattigan recorded in his memoirs, his Chairmanship of the Committee which recommended the twenty five per cent tariff cut "posed an interesting problem" (1986: 164). For the 'opportunistic' reform being contemplated stood in sharp contrast to the emphasis on careful deliberation, and transparent process and advice which Rattigan had so trenchantly and successfully established as a bulwark against protectionist opportunism (cf Glezer, 1982: 120).

In its second annual report in the wake of an economic downturn, the Commission drew particular attention to the need to relate assistance reform to macroeconomic circumstances, but it proposed to do so based on well researched "judgements about such matters as they arise in the course of inquiries" (emphasis added): that is before it
could be known what economic circumstances might emerge some years later. As if to acknowledge the problem which this posed the Commission emphasised:

An aspect of fundamental importance in the Commission's approach is that no pre-determined time profile for change has been implied or specified by the Commission (1974-75: 10).

It is hard to know what to make of such a comment given the Commission's proposal of a fixed reform timetable for the automotive industry (reported two pages earlier in the same Annual Report) and its hostility to changing this timetable as economic circumstances deteriorated after its report's publication. Shortly after its 1974 automotive report was rejected by the Whitlam Government, the Commission sought, as Glezer puts it, to "bend with the wind". Rattigan proposed to Whitlam that since "the present . . . is not a suitable time for implementing structural changes" Commission inquiries could include short term recommendations which "would not add to existing short-term employment difficulties in the industry concerned" (Glezer, 1982: 130).96 This did not really solve the problem, for it did not address the situation in which economic conditions and accordingly the political scope for reform unexpectedly deteriorated during the course of a reform program. Whitlam, a progressively lonelier champion of tariff reform within an increasingly nervous party (see Bert Kelly, Diary, 20/9/74), responded curtly:

I understood from the approach to high cost industries outlined in the Commission's Annual Report for 1973-74 that the Commission would relate its recommendations to the economy's capacity to sustain the changes involved, but I welcome your reassurance that this is to be the case (Glezer, 1982: 130).

After a period of largely unproductive soul-searching in its first few annual reports, the Commission's thinking on the issue collapsed into an uneasy reliance on fixed timetables for assistance reform either within industries or - when it got the opportunity in 1982 - more generally. Temporary assistance and temporary slackening of the pace of pre-set reform programs offered means of achieving 'mutual adjustment' between assistance reform and macroeconomic conditions (see eg IAC, Annual Report, 1973-74: 21), with each option involving both benefits and costs. Some of the Commission's statements occasionally contemplated the possibility of such measures. However the Commission consistently deprecated them, both in principle (Annual Report, 1977-78: 40-41) and

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96 In its 1975-76 Annual Report, the Commission also contemplated the possibility that lower assistance for high cost industries might be "deferred or phased in because of temporary or short term conditions" (1975-76: 7), although in this passage the Commission is not advocating such action.
when provided with the circumstances in which such measures might be contemplated (see eg Annual Report, 1975-76: 13 and Glezer, 1982: 155ff).

In the Commission's exposition, macroeconomic objectives were neatly paired with appropriate instruments and assistance policy was an inappropriate instrument with which to address macroeconomic difficulties (Annual Report, 1975-76: 14). This rehearsal of the principles of 'first best' policy making was unexceptionable:

Considerations of equity and resource use efficiency seem to require that general economic problems should be dealt with by general measures (such as fiscal, monetary and exchange rate adjustments) that do not discriminate between industries (Annual Report, 1975-76: 14).

But however reasonable, these words did not extricate policy makers from the fact that some instruments and some macroeconomic circumstances intensify the economic and political constraints on assistance reform while others relax them. The Commission's approach might have been useful in establishing the case for maintaining reform throughout periods of 'general economic problems'. The Commission feared that flexibility in the rate of tariff reduction would stall reform during difficult times and that the momentum of reform might never be recovered. "[T]here will always be seemingly persuasive arguments as to why the present time is inappropriate for reducing assistance" (Annual Report, 1977-78: 41). In fact reform did stall in the late 1970s despite the Commission's protestations and it recovered along with economic activity in the 1980s despite the Commission's fears that it would not. And of course pre-commitment was a doubled edged sword. However much the Commission disliked the escalating political hostility to reform during economic downturns, the fluctuating political constraints on reform could not be wished away. And the consequence of sticking to reform schedules which turned out to be overambitious was often - as it was here - the wholesale rejection of the Commission's recommendations. In the meantime, the corollary of the Commission's adherence to pre-commitment where substantial tariff reduction was involved was that when unforeseen economic developments after the Commission's inquiries were not exposing the Commission's recommendations as too ambitious, they often exposed them as too timid!

The Commission's recommendations for the automotive industry in both 1974 and 1981 were fairly ambitious even when they were formulated. But in each case, economic conditions deteriorated within a few months of publication, rendering both reports politically impossible to implement and the IAC's analysis and proposals marginal to the political outcome. In its third Annual Report the Commission had commented on the
contradictions which would arise if it were to tailor its ambitions in individual inquiries to the changing macroeconomic circumstances:

Those industries which happened to be reviewed during a period of short term economic problems should not have their long term assistance assessed on the basis of different factors from those reviewed in boom conditions (1975-76: 7).

Yet the Commission did change the ambitiousness of its medium to long term reform aspirations as circumstances changed. The disappointments associated with the slowdown of the late 1970s and early 1980s led to a timidity which, though it may have seemed justified at the time, was then frozen into the Commission's recommendations by virtue of its penchant for pre-commitment. Again, the Commission's automotive reports exemplify the problems. Between its 1974 and 1981 automotive reports, the Commission's proposed 'medium term' tariff for the industry doubled from 25 to 50 per cent. Likewise the Commission's 1982 recommendations for a ten year program of general tariff reductions were modest compared with what they would probably have been had they been offered in early 1974 and certainly compared with what turned out to be economically and politically possible six years later (see below).

Real exchange rate movements also interacted with both the political feasibility and economic desirability of tariff reform. For when Australia's real exchange rate fell - as it did precipitately in the mid 1980s - the international competitiveness of Australia's traded goods and services sector improved and this lowered the economic and political costs of tariff reform. At the same time, the inflation unleashed by devaluation made the anti-inflationary effect which tariff reform offered more urgent. The effect was so strong in the mid 1980s that import penetration fell sharply despite pre-set tariff reform programs which had been considered relatively ambitious when originally formulated. The 1984 'Button Plan' sought to liberalise automotive trade by reducing 'penalty tariffs' on vehicle imports in excess of quota allocations from 150 to 57.5 per cent over eight years. The end point in this plan offered only a little more protection and was similar in form to the Commission's 1981 proposals. However, the collapse of the Australian dollar in 1986 swamped the effect of falling tariffs. Vehicle imports were halved between 1985 and 1986 (AIA, 1987: 20)! (Something similar would have happened under the Commission's proposals.) In these circumstances 'mutual adjustment' between trade liberalisation and other objectives argued for a dramatic acceleration of the tariff reform programme.97

97 These problems were not addressed until two years later - by which time the exchange rate had begun to rise! Note also that admitting the possibility of some sensitivity to context in the tariff reform
In its early Annual Reports the Commission pointed out that the recent move towards more flexible exchange rates provided increased scope to address balance of payments issues by means other than protection (1973-74: 11, 1974-75: 26). But beyond suggesting that this increased the scope for trade liberalisation, the idea that there might be some 'mutual adjustment' between trade liberalisation objectives and real exchange rate movement in the sense suggested above does not appear to have been canvassed by the Commission. The Commission insisted instead that "an assistance program program can be 'mutually adjusted' with other objectives. In circumstances in which there was general support for fixed tariff reduction schedules and the need to force some minimum rate of reform whatever the circumstances, the following proposal was put to the Industry Commission in its automotive inquiry of 1990:

When the currency falls, so too should tariffs. When it rises tariffs should rise again, though if the policy is to be pursued in a trade liberalising context for a relatively heavily protected sector, it may be appropriate to prevent tariffs rising above a pre-specified tariff reduction regime. It is not envisaged that the rate of tariff reduction be varied in an ad hoc way in the future, but rather that the logic set out here be embodied in a pre-set and politically incontestable formula which would not be altered for the duration of the reform program to be established in the current review process (Gruen, 1990: 38-9).

The proposal appeared in a major submission to the Commission which had the broad support of most of the firms in the industry, and the 'mutual adjustment' it embodied was designed to address all the major concerns of the Commission, providing flexibility to intensify the pace of tariff reform if the circumstances warranted, without giving away pre-commitment to some minimum level of tariff reform. However, the Commission offered no comment on it (Industry Commission, 1990).
predicated on preceding changes in relative prices (including exchange rates) being maintained would be highly vulnerable" (IAC, Annual Report, 1986-7: 5). This was a plausible argument - but one which was presumably as telling against its own proposals for reform according to fixed tariff reform schedules as those proposals against which it was intended as a critique. The Commission made either explicit or implicit exchange rate assumptions whenever it sought to tailor its recommendations to the economy's capacity to adjust and whenever it modelled of discussed the effects of its recommendations (see eg IAC, "Reductions", 1982: 95, 125). In its hearings, and in its reports the Commission generally tended to take the then current exchange rate as 'given'. Participants protested that the level of assistance they 'needed' in the future could not be sensibly discussed without some knowledge of exchange rates at the time (eg see IAC, PMVs, 1974, Transcript: 81, 157, 1984).98

Although the Commission's agenda was very much in the ascendant by the late 1980s, it is worth noting that none of the major reductions in protection involved the implementation of IAC recommendations. Each was brought about by governments seizing certain opportunities for trade liberalisation as they presented themselves. The most important piece of tariff reform of the 1970s was the 25 per cent across the board tariff cut. Rattigan agreed to the proposal, but agonised about its consistency with the IAC line he was developing (Rattigan, 1986: 164ff). The major top down reductions of assistance to the automotive and apparel industries were each crafted by the Government after it substantially rejected IAC recommendations for the same industries (IAC, Annual Report, 1986-87, Appendix 5).

One might argue that the IAC reports came to be seen as a 'benchmark' of ambition or 'ambit claim' for structural reform from which Governments could retreat in negotiations with industry and still manage significant reform. However, in the case study presented here what looked like an ambitious benchmarks in 1974 and 1981 rapidly became politically untenable as events unfolded. Although the IAC reports may have had some political usefulness as a high water mark of ambition, they offered those needing to make

98 Elsewhere there were occasional references to exchange rates though again, discussion focused on what assumptions to make for the future rather than the scope for mutual adjustment between assistance reform and exchange rate movement:

Since the inquiry began there have been significant changes in exchange rates and the prices of some imports - and also in local costs - with the result that apparent price disadvantages on some products have varied considerably from time to time. Assessments of price disadvantages set out in the sectional reports reflect the latest price and cost data available to the Commission, and except where considered inappropriate, recent exchange rates (IAC, "Glass", 1974: 4).
the compromises between the IAC's preferences and the dictates of necessity, very little
guidance about how to do so (§§ 8.4, 9.8). And with hindsight, many of the reports of
the 1980s were too timid as high water marks. In the automotive industry and elsewhere
- for instance in the case of textiles, clothing and footwear (Industries Assistance
Commission, 1986) and general reductions in protection (Industries Assistance
Commission, 1982) - reports of the early and mid 1980s were exposed as too timid well
within the decade-long period their recommendations comprehended. Although the
Commission's report on textiles, clothing and footwear (TCF) was released in May
1986, after the dollar had fallen dramatically, its report contains almost no serious
discussion of these circumstances. The Commission's 1986 TCF report proposed the
removal of quotas and top down reform to a ceiling of 50 per cent by 1996. The 50 per
cent ceiling was also chosen by the Commission for the automotive industry - but this
was five years previously when the real exchange rate was nearly 30 per cent higher (see
Figure 10.1 above and Statistical Appendix Table A10.1 below). Less than six years
later, in 1991, the Government announced a program which, by 1993 would go below
the 50 per cent target set by the IAC for 1996. The Government's plan reduced the
highest TCF tariffs to 37 per cent by 1996 and to 25 per cent by the year 2000 (Textiles,

In 1982 the IAC released a report proposing various top down and across the board
options for general reductions in protection (IAC, "Reductions", 1982: 88). The
preferred top down option in 1982 contemplated reform 'down' to 20 per cent over ten
years. Six years later, in the wake of stronger economic growth and currency
depreciation, the Hawke Government announced a tariff reform program which reduced
tariffs to a ceiling of 15 per cent, excluding automotive and apparel industries over a
period of just four years (IAC, Annual Report, 1987-88: 33). Thus the most ambitious
targets set in the 1982 report were substantially exceeded within the ten year period
despite their being essentially ignored for the first six years! The 1988 announcement,
was made at a time which was propitious for reform. Growth was reasonably strong
and the exchange rate was well below the levels of the seventies and early eighties.
Circumstances were less propitious in 1991 when government announced a further tariff
reform program. Real exchange rates were somewhat higher (see Statistical Appendix
Table A10.1) - though they were still below their levels in the late 70s and early 1980s -
and Australia was experiencing what policy makers (wrongly) expected to be a relatively
short lived recession. Nevertheless the politics of assistance reform appeared to have
changed. The 1991 reform program reduced tariffs other than automotive and apparel
related items to five per cent by 1996.
In addition to the more propitious timing of at least the first of the two announcements, it seems plausible to suggest that the Government's preparedness to deviate from top down and across the board tariff reform was also instrumental in achieving the extent of reform that it did. The Commission had counselled against such deviations in its 1982 report on General Reductions in Protection. Significantly, it made the point in its 1982 report by commenting that a 20 per cent ceiling for tariffs without exceptions was better than a 20 per cent ceiling with exceptions (1982: 1). But this comparison illuminates little more than the idea that more reform is better than less. It is not a 'margin dependent comparison' in Braybrooke and Lindblom's sense because it does not illuminate whether the possible costs of deviating from orthodox reform might have yielded some other benefits. The appropriate 'margin dependent comparison' might have juxtaposed a reform target of a uniform 20 per cent tariff ceiling with a 10 per cent tariff ceiling with exceptions where they were politically necessary as they seemed to be for automotive and apparel industries.

The ambitiousness of both its 1988 and 1991 statements suggest that the Government made precisely this kind of tradeoff. To take advantage of the improved scope for reform in 1988, the Government accelerated its sector specific reform strategies in the highly assisted automotive and apparel industries but it nevertheless proposed to remain within the political 'speed limits' to reform in those industries. This left it free to pursue more rapid tariff reform elsewhere. Without such an approach the whole tariff reform agenda would have been politically hostage to the political power of the most highly assisted sectors. Thus it seems plausible that, by offending against the letter of the two neoclassical reform rules, reform was accelerated. *Form was sacrificed for substance.*

10.2 The Extinguished Prospect of Dialogue and 'Mutual Adjustment' between Perspectives

My problem with this paper is that while most economists will read it as a confirmation of their views, it does not go very far on engaging the debate with those who hold different but reasonable views and are prepared to debate them in relation to evidence.

Vince FitzGerald commenting on a defence of 'economic rationalism', King and Lloyd, 1993: 127

As Ross Garnaut has colourfully put it, the unprecedented success of Asian development has provided economists and historians with "a rich new set of data" on the important questions: "To the economist whose discipline is a social science, the emergence of this new case ... is as great a gift as a new hemisphere to an astronomer" (1990: 4-5).
The early 1970s, the beginning of the period under study here, saw a good deal of collective disciplinary puzzlement about how the successful developing countries might have achieved what they did, and the extent to which their experience entailed lessons for others. Where the focus was on trade policy, Hong Kong and Singapore showed that success was certainly not inconsistent with free trade. However the relatively heavy state intervention in trade and in other ways in Japan, Korea and Taiwan and these countries' latter day followers - such as Thailand, Indonesia and Malaysia - raised the prospect that, at least in the context of existing protection, outward oriented assistance and what I have called intra-industry trade facilitation policy may have made important contributions to development and so to economic welfare.

Although it appears to have been relatively sympathetic to free trade, the new development consensus of the 1970s was not primarily preoccupied with advocating 'free trade' instead of 'protection'. It argued instead that where protection was offered, it could be improved by making it less discriminatory against exports. This accommodated the export assistance provided by successful developing countries at the same time as weaving the commonsensical theoretical principles of optimal intervention into the story. Section 3.2.4 quoted Jagdish Bhagwati musing more boldly that the 'key' to the development success of countries like Korea and Taiwan might not be their lack of intervention, but rather the energy with which their intervention moved from one developmental priority to a subsequent one - in this case from import replacement to export.

Having, as they did, an essentially dynamic conception of economic development, these observations were consistent not only with the themes of economists like Schumpeter in the 1930s and forties, but also with themes which were re-emerging within economics after the heavy over-emphasis on perfectly competitive perspectives of the 1950s and sixties. From the late 1950s through till the 1970s, a variety of relatively new perspectives came to suggest that the allocative efficiencies at the heart of traditional economic analysis were only a part - and possibly quite a small part - of the productive benefits of market competition and trade. These perspectives raised the prospect that the greatest gains from trade liberalisation might come from X-efficiencies, scale economies, lower rent seeking expenditure and dynamic economies associated with knowledge creation through learning by doing and research and development (Abramovitz, 1956; Solow, 1957; Linder, 1961; Arrow, 1962; Leibenstein, 1966; Vernon, 1966, Krueger, 1974).
Section 1.3.2.1 discussed the means by which multiple perspectives could be incorporated into the search for better policy. Where differing perspectives each highlight similar phenomena as having either positive or normative significance, this adds to the confidence the practitioner can have in their significance. As Findlay put it, the disciplinary strength of the new development consensus of the 1970s arose from precisely this kind of integrative approach. It built bridges - provided some mutual adjustment - between the evidence and a range of theoretical considerations. The perspectives to which the new approach appealed included not just the perfectly competitive frameworks of economic orthodoxy in which free trade was best and 'optimal intervention' was non-discriminatory, but also the "murky but relevant waters of such concepts as X-efficiency and 'learning-by-doing'" (Findlay, in Hong and Krause, 1981: 31).

One can understand that a suggestion such as Bhagwati's could be disquieting to a profession which was uneasy about both the political and economic implications of intervention - and particularly wary of interventions to compensate for other interventions. If Bhagwati's suggestion is right, the extent to which the successful Asian countries moved towards free trade might have been largely a sideshow, the central story being the extent to which their policies supported and/or accelerated the evolution of individual industries and firms from import replacement to export. Yet this does not exhaust the potential relevance of Bhagwati's suggestion. For Australian policy of the 1970s, some 'mutual adjustment' between Bhagwati's perspective and the more prosaic 'optimal intervention' story to which the new development consensus appealed raised the spectre of seeking the best of the two perspectives whilst avoiding their major dangers.

This dissertation has shown how frequently the IAC was presented with the opportunity to develop an approach to trade liberalisation which melded something of the Asian approach to trade, trade liberalisation and development, with the traditional normative economics of trade liberalisation and the principles of optimal intervention. The need for gradualism in trade liberalisation was not then challenged within the mainstream of economic policy thinking, and was certainly not challenged by the IAC. This raised the prospect of symmetrical top down and bottom up reform involving traditional tariff reductions together with some transitional assistance to export without losing sight of the ultimate goal of freer (or preferably free) trade. As has been suggested above, this is not far from the Australian 'policy consensus' of the mid to late 1970s in which the IAC had participated. But it was not long before the Commission was pitting itself against that
consensus and arguing against any extension of assistance to exports - and, towards the end of the 1980s, even the continuation of tariff concessions to exports (§ 10.1.2.2).

A latter day apostle of the reform consensus of the late 1970s was John Button. He was not the first industry minister of the post war era to proselytise the merits of tariff reform, and industrial rationalisation, but he was the first to both preach and practice the new creed. At the same time he spoke of the importance of what he called 'positive' assistance which would be available to directly assist the processes of industrial transition particularly by assisting those activities at the forefront of industrial development - particularly export, research and development. The IAC supported policies "which were positively directed towards improving the mobility and quality of resources" such as adjustment assistance and other measures which were "factor oriented and general in application rather than specific to particular industries" including assistance to research and development (IAC, 1973-74, Annual Report: 22, § 147).

Button also developed a range of 'plans' for specific industries. Those for the automotive, textile, apparel and steel industries were adaptations of existing high cost industry-specific assistance schemes. Each 'plan' sought to use what assistance was provided to help the industry restructure at the same time as gradually reducing the assistance available - bringing it closer to average levels of assistance for manufacturing. With hindsight these plans may be judged relatively successful in this aim. But in taking the existing high cost industry schemes as starting points and then seeking to improve them and make them more supportive of desirable restructuring, the formulation of the Button plans was an exercise in melioration and 'mutual adjustment' between what was given, what was possible, and what seemed desirable. Other plans implemented by Button offered what, by the standards of Australia's tariff assistance, were generally moderate to low levels of assistance for industries judged to be potential 'growth' industries of the future.99 One need not support all, or indeed any of the initiatives thus justified to still believe that the economists of the IAC could usefully have participated in the discussion within which this approach was developed.

Instead the Commission deployed its peremptory rules against 'second best' and 'industry-specific' policy making against all these schemes. "Alternative assistance

99 For instance the 'Factor F' scheme for pharmaceuticals subsidised approximately 20 per cent of the expansion of activity in the pharmaceutical industry which took place during its first five years (Bureau of Industry Economics, 1991: 76). Given that the scheme offered subsidies of between 8 and 25 per cent on increases in value added in various kinds of activities, the rate of assistance which it provided to value adding in the industry as a whole would have been well under these figures.
measures are not the answer" declaimed the headline of one section of a Commission Annual Report (1989-90: 15; also see IAC, Annual Report, 1988-89: 4). The more reputable of those promoting such measures - including the Commission in the 1970s - had only ever argued that they might be part of the answer and, to quote the Commission's 1977 report on export assistance, that they "may be an important means of giving effect to" another part of the answer - tariff reform (see § 10.1.2.2 above). But in place of engagement, whether it be by way of well considered theoretical support, development, scrutiny or critique, and whether offered at the 'in-principle' level or on a 'case by case' basis, the IAC fell back on the strained dichotomies which expressed its squeamishness about the compromises inherent in gradual policy transition:

Administrative and institutional settings need to recognise that the economy operates as one system; that the creation of separate environments for selected industries tends to impede the growth of others; and therefore that policy towards particular industries should be driven by the objective for the whole economy. In this light, removing impediments to a more competitive economy is 'positive'; action to selectively promote or sustain the competitive position of particular industries is 'negative' (IAC, Annual Report, 1986-87: iv, cf IAC, Annual Report, 1988-89: 4).

In such pronouncements the IAC implicitly turned a blind eye to the way in which its own recommendations violated the same injunctions. For in their gradualism, the Commission's own proposals for the automotive industry were inevitably industry-specific. The 1981 report proposed arrangements which deviated from tariff-only assistance to meet certain transitional difficulties which faced the Commission - though as it turned out in a disastrously inefficient way (§ 9.7.2). And both its 1974 and 1981 reports proposed assistance to the automotive industry at relatively high and so 'industry-specific' rates in each case into the next decade. Given the unacknowledged contradictions in its own approach, the IAC's position came to accord an implicitly privileged status to tariff assistance, on occasion even bidding the rate of assistance up, as it sought to determine the minimum level of tariff assistance consistent with the various requirements written into its terms of references to ensure the 'prosperity' of the industry and avoid 'undue disruption'.

Without necessarily arguing that more 'positive' assistance was warranted in all, or even any of the cases in which the IAC opposed it, one might argue that its rejection in principle was a travesty of economic science itself. For the greatest contribution the discipline of economics brings to the public policy debate is its 'equilibrium' perspective - its capacity to assess simultaneously multiple, interacting effects and so engage with the economy as a system. It is in defence of such an approach that economists can be heard
insisting that public policy should never assume that a single objective of policy has an absolute value - whether it is protecting the environment, reducing road deaths or increasing exports: that rather, policies should be assessed according to their likely benefits and costs. As Braybrooke and Lindblom put it, "an analyst says little of worth - even to clarify his own mind - if he declares that he values full employment. He must also specify how much ... of various other values he would be willing to forego" (Braybrooke and Lindblom, 1963: 30-1). Yet whenever any degree of plurality entered the analysis, the rigours of marginalism - which form the proud foundation of modern economics - were discarded. In the cases discussed in this dissertation, economists sought to reject policies containing any element of tariff compensation, on account of their perceived and/or potential costs, with scant, if any consideration of their potential benefits.

10.2.1 An Australian Adaptation of 'New Trade Liberalisation'

[T]he complexity of our environment is far beyond our capacity for logical analysis. It is this permanent threat of the unknown that creates the need for judgment. ... Competitive advantage ... cannot be preserved by exploiting proprietary technology or a superior concept of strategy, which are depreciating assets; it requires a continuing capability for making and implementing good judgments, on which both proprietary technology and superior strategy depend.

Brian Loasby, paraphrasing Mark Casson, in Loasby, 1991: 647

Cairncross once distinguished between theorists seeking to trap the inner secrets of the economy in their models, and the practitioners who live in a world of action where "time is precious, understanding is limited, nothing is certain, and non-economic considerations are always important and often decisive" (in Henderson, 1986: 105). In the spirit of Loasby's summary of Casson above one might suggest that economic policy can make its greatest contribution to growth, development and welfare where it responds to threats and opportunities emerging in the environment with policies and strategies which embody 'good judgment'. Good judgment will involve 'margin dependent comparisons' and tradeoffs between what is important, and what is desirable but, by comparison, of lower priority.

Peremptory rule making is typically context independent and so, in many ways the enemy of the development and exercise of good judgment. And as contemporary management theories stressing 'continuous improvement' have emphasised, peremptory rules profoundly obstruct the evolution of adaptations to emerging circumstances. They thus obstruct the discovery and realisation of complementarities between existing and
possible objectives and institutions; it has become fashionable to call these 'synergies'. The peremptory rules around which the IAC developed its trade liberalisation program even constrained its capacity to adapt towards instruments which had the sanction of economic orthodoxy at the time. Thus after 1971, it generally opposed removing the inward orientation of the shipbuilding bounty because this would be 'industry-specific' (§ 10.1.2.1). It likewise deprecated ameliorating the export suppressing effect of tariffs with duty drawback because of the 'second best' and/or unsystematic and so 'industry-specific' nature of its possible consequences (see § 10.1.2.2 above). It takes little imagination to see how peremptory rules against both 'second best' and 'industry-specific' policy making, might profoundly retard any capacity to explore ameliorative possibilities - if necessary by small scale experiments - and so find one's way in the real world described by Cairncross.

Elsewhere, it seemed that the policy makers of East Asia were making 'good judgments' about what was most important in trade reform. In their attempts to address the immediate imperatives of development - particularly the need to improve their external accounts - they built their export drive around a range of improvised policy innovations and adaptations (§ 4.7.3). As interpreted by the architects of the new development consensus, the export drive then became an engine of discovery, priority setting and adaptation by which participants in private enterprise and public policy searched to discover and remedy impediments to better performance. In this context to a significant extent, trade liberalisation and wider reform priorities appear to have emerged as an endogenous product of the export drive. Krueger describes the Koreans' "pragmatic" approach to export expansion thus:

[When export performance was deemed satisfactory, policies were left unaltered; when however it appeared that export growth was faltering, changes were instituted until satisfactory performance was again observed. . . . The means chosen [to encourage exports] varied pragmatically in accordance with the degree of success then being achieved. . . . As those urged to export protested at various disabilities or disadvantages, means were found for removing such disadvantages; when exports lagged, new incentives were introduced or the value of existing incentives increased in order to spur export performance (1979: 85, 92-4).

Had Australian policy grasped the opportunities for some synthesis between its own trade liberalisation objectives and the lessons from Asia, it might likewise have embarked much earlier upon the reform tasks which it ultimately embraced. Australia's taxation, labour relations, and transport systems emerged as central planks in Australia's 'microeconomic reform' agenda in the mid to late 1980s as falling tariffs and increasing export orientation drove the search for cost reduction. The IAC played an important role
in exposing these issues to public view towards the end of the 1980s. It had occasionally anticipated some elements of the 'microeconomic reform' agenda earlier (see eg Annual Report 1980-81, Chapter Two) but its focus remained overwhelmingly on traditional assistance issues until 1988 when it noted that the Government had "placed a new emphasis on microeconomic reform" (1987-88 Annual Report: iii). Australian businesses' and policy makers' eagerness to identify means of cost reduction and productivity growth might have taken hold much earlier had there been a more collaborative relationship between economists, business and consumers. The IAC's automotive inquiries provided it with suggestive evidence on a range of matters which later became central to the microeconomic reform agenda. As has been seen, in its 1974 report the Commission offered little comment on Japan's emerging labour productivity revolution despite direct reference to the labour issues in the terms of reference (§ 7.2). The same may be said of transport cost issues, despite the complaints of automotive exporters in the 1970s and indeed throughout the 1960s.100 It is not surprising that automotive exporters were the ones to mention these matters, as they were the ones at the vanguard of change and development in a hitherto cosseted and inwardly oriented industry. They bore the brunt of domestic protection in export markets which did not compensate them for their high costs. Likewise as early as 1973, it was Australia's largest automotive exporter, GMH who called for Australia to move away from payroll and sales taxes towards value added taxation so as to better integrate Australia's trade and taxation systems and remove particular burdens on Australia's traded sector (IAC, PMVs, 1974, Transcript: 105).

It is perhaps unwise to dwell too long on what might have been. Nevertheless participants in good dialogue can usually each expect to gain. In this case the economists' gain would have been the greater relevance of their discipline to emerging problems of economic transition. Australia's industry structure and its circumstances in the 1960s and seventies were 'rather like' those of Asian countries in certain important respects - particularly Australia's existing inward orientation and its potential for export orientation. In response to those circumstances, a range of people including industrialists, economists, politicians and participants in IAC inquiries were suggesting the same kind of policy instruments which had already been tried - with some apparent success - in Asia and documented in the early works of the 'new development consensus'. Had the culture of the economics profession been more focused on the

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100 For the 1960s see AFR, 26th January, 1961: 15; CPD, 20th October, 1966: 2011; for the 1973-4 inquiry see Ford, Folder 3, Box 3, Report 21; Leyland at IAC, PMVs, 1974, Transcript: 1785, GMH at p. 1398. For component manufacturers see eg Rubery Owen at p.1424.
concrete problems of adaptation, amelioration and transition, had it been more 'outward looking' in its attempts to absorb those issues to which business people drew attention, these ideas might have been taken more seriously within the economic corpus. Economists might have scrutinised both their weaknesses and strengths in an effort to develop a more coherent understanding of - and so consensus about - when heterodox trade liberalisation options might offer benefits.

Australians had previously made important contributions to economics by thinking through the economic circumstances of their own country in an original way. Groenewegen and McFarlane's comment on Australian economists' historical "willingness to test new ideas with critical scrutiny" (see head quotation of Chapter Seven above) is probably most notably exemplified by the Brigden Committee's anticipation of the Hecksher/Ohlin/Samuelson 'factor proportions' theory of trade. Tom FitzGerald spoke of the episode as an inspiration to Australian economists:

"What is inspiring ... is the example of Australian economists who arrived at independent conclusions contrary to the world orthodoxy, who invited criticism from the most eminent upholders of that orthodoxy, and, on being rejected, put their argument in an international forum, to gain ultimately a large measure of acceptance for their initial heresy. Today they are far better remembered and admired by an eminent American economist, the Nobel Prize winner Paul Samuelson, than by any Australian counterparts. ... Professor Samuelson has recently referred to them as 'my-down-under-heroes' (1990: 41; also see the debate between Manger (1981) and Samuelson (1981) on the extent of the Brigden Committee's innovation).

This dissertation has argued that there was scope for Australians to make a similar, though perhaps more modest contribution by developing the normative economics of symmetrical top down and bottom up tariff reform. Integrating instruments such as export credits into the neoclassical corpus could have produced large payoffs. Australian economists might have helped forge an adaptation of Asian 'concessional trade liberalisation' which was consistent also with Australia's circumstances and its Western liberal administrative traditions. This is because in Asia - and when they were first introduced in Australia - concessional trade liberalisation measures operated with extensive and highly discretionary bureaucratic supervision, which often frustrated or foreclosed their trade liberalising potential and ensured that they would continue to be both used and seen as instruments of mercantilism. Australian economists might have shown how liberalising existing concessional import schemes could play a useful role in initiating and deepening trade reform and the circumstances in which so doing might make an important contribution to trade liberalisation either in the presence of, or without more traditional trade reform.
The benefits of intellectual engagement with Asian success might have accrued not simply in the form of adapting the lessons of Asian development to Australia's circumstances. Australia's economists might have returned to the discussion by pointing out how Australia might usefully incorporate the possibilities inherent in 'new trade liberalisation' into its own trade negotiation agenda. In addition to arguing the case for foreign countries to reduce their tariff and quota protection directly, Australians could have pointed to the scope for its Asian trading partners to advance their own interests (as well as Australia's) by expanding and liberalising the instruments of concessional trade liberalisation which they had already introduced. In so doing Australian economists might have been able to point to their own country as a pacesetter in these matters in combining inter-industry and intra-industry trade reform. Had the temper of Australian economics been less preoccupied with the dichotomy between protection and free trade and more focused on adaptation and amelioration, an Australian economist might have published a paper such as the one Paul Wonnacott published recently entitled "The Automotive Industry in Southeast Asia: Can Protection be Made Less Costly" (1996). Indeed the earlier in our period the issue had received attention from Australian economists the better position they would have been in to help Australian trade negotiators influence the evolution of automotive protection in the region. As it was the Commission showed little interest in such a course.

And one thing leads to another. The traditional attitude to trade liberalisation as exemplified by the IAC's fear of the dangerous supplement of export assistance is broadly mirrored in the international disciplines on trade embodied in the General Agreement on Tariffs and Trade (GATT). In particular, the GATT provides privileged status to existing tariffs beneath any internationally negotiated 'bound' tariff ceiling, at the same time as absolutely proscribing industrial export subsidies. For any country using export assistance to help it make the transition to freer trade, such as Australia and many countries in Asia, the GATT disciplines threaten a return to the inward orientation of the past. This suggests the possibility of moulding the GATT disciplines to accommodate greater pluralism in the means of trade liberalisation. In fact from its inception, the GATT did accommodate the one form of 'non-traditional' trade liberalisation widely acknowledged within the economics canon at the time - regional trade liberalisation by way of customs unions or free trade areas. Although the condition that internal tariffs within regional trade agreements are eventually entirely eliminated is

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101 The paper advocates lower, more uniform assistance in the region and proposes that, where countries cannot be persuaded to remove local content plans, they allow exports to qualify as local content.
Chapter Ten

Some Concluding Speculations

no guarantee of welfare improvement (Cooper and Massell, 1965: 471-2), this concession to pluralism appears to have facilitated significant net trade creation.

By analogy, Australia shared an interest with many Asian countries in bringing policies such as import/export links within the GATT and developing specific GATT disciplines for them (as opposed to outright prohibition) so that they might be used in ways which reinforced rather than undermined trade liberalisation. Such issues barely raised a mention amongst Australian economists and policy commentators, who continued to focus on the need for inter-industry trade liberalisation as suggested by the HOS framework - the need for agricultural trade reform. Of course Australia could benefit from inter-industry trade liberalisation. But it - and its trading partners - could also benefit from intra-industry trade liberalisation providing it was consistent with trade liberalisation more generally.

On this matter as on so many others, Martec provided a promising lead, even if it did not provide the last word:

A further problem arising for the Australian motor industry is that important export destinations like South Africa, New Zealand and South East Asia, are increasingly succumbing to their own protection policies and local content programs. The way around this is to cultivate complementation programs for regional vehicle manufacture, with Australia participating fully (1972: 1.7; also see AMI representative, IAC, PMVs, 1974, Transcript: 362).

10.3 Martec and the Commission: A Summary and Postscript

As Chapters Six to Nine argued, the skills and perspectives of the IAC and other participants to the debate were highly complementary. This was nowhere more clearly exemplified than in the case of Martec. Although neoclassical economics was weak at handling the dynamic 'evolutionary' perspective which was Martec's forte, many of Martec's ideas could be adapted to a neoclassical understanding of the industry by way of existing concepts such as 'optimal intervention' and concepts which could be readily developed, such as intra-industry trade facilitation policy. Much of Martec's message boiled down to the joint assertions, backed with persuasive examples, that scale economies were important for the industry and that intra-industry trade (and so intra-industry trade facilitation) were essential to realising them. But it is remarkable how little impact Martec and other apparently heterodox voices had.

The technical orientation of the economics profession and the Commission's work certainly played its part. Both major IAC reports referred uncritically to minimum
efficient scale (MES) as (arbitrarily) defined in some economics textbooks. The Commission proceeded to focus on the highest production scales achieved in large developed countries, presumably as a consequence of its understanding of MES and of the fact that these were the examples which had been well worked over by economists in previous studies. How much more pertinent was Martec's observation, devoid as it was of the trappings of scholarship?

Certain vehicle producing companies in other parts of the world have in their home country, a similar, or lower domestic sales base than do GMH and Ford Australia EACH have in Australia. Yet these overseas companies are not only domestically successful, they are viable in international terms through a world wide perspective and a strong export orientation. . . . Volvo of Sweden, GM associated Isuzu of Japan, Chrysler associated Mitsubishi of Japan, Honda of Japan, and BMW of Germany, all fall into this category (AIM, October, 1974: 13).

Indeed as it turned out virtually the whole of the IAC's technical apparatus actively concealed the issues which were central to Martec's contribution. The Commission's demand studies focused on the domestic market only, its assistance evaluation assumed that there were no exports and that there would be none irrespective of policy change (§ 1.3.2.1). And like its assistance evaluation, its ORANI modelling assumed that there was no product differentiation in the industry and so was incapable of shedding light on scale economies or intra-automotive-industry trade.

However to explain the IAC's failure of vision as a failure of technique would be seriously incomplete. It would invite the conclusion which Krugman has proposed elsewhere, that the ongoing march of economists' technique will ultimately ameliorate these problems (see § 1.3.3). That is why I have argued that the IAC's failure of vision was ultimately a failure of the conversation which took place between itself and others. In this the IAC was not the simple victim of the technical resources of economics at the time of its inquiries.

It was motivated to deprecate many inquiry participants' contributions because they raised the spectre of the dangerous supplement. As the IAC came to see it, this compromised the politics of reform by admitting the possibility of 'compensation' rather than 'elimination'. Often there was a harder edge to the IAC's motivation in which its opponents were seen - usually correctly - as motivated by self interest rather than economic efficiency. Indeed the self-interestedness of industry and the disinterestedness of the IAC was one of the building blocks of the IAC's political economy (see §§ 6.1, 6.2 above). Before Rattigan's chairmanship of the Tariff Board, assistance policy had been far too receptive to business lobbying. The IAC accordingly prided itself on
"maintaining the distance from industry groups that is required for balanced decisions and advice" (Carmichael, 1986: 345; also see Rattigan, et al, 1989: 79). Bill Carmichael is undoubtedly right to identify this as one of the great achievements of the institutions he helped create. However the act of 'distancing' itself from industry carried with it the risk that the Commission would be a poor listener. This study has tried to show how that risk was aggravated by the professional culture of economics itself which conceived of debate too much as a competition between those with different views, and too little as a search for common ground.

And sometimes there was a fine line between keeping one's distance and arrogance. Economists friendly to the Commission in the Priorities Review Staff prosecuted the IAC cause in the following terms: "The Martec report and plans are professionally unsound and should be regarded as irrelevant" (Quoted approvingly by Rattigan, 1986: 223). Certainly the Commission kept its distance from Martec. In 1976 Martec invited the IAC to comment on its most recent analysis of automotive industry policy which it intended to send its clients. It received the following reply:

```
21st October 1976

Dear Sir,

I am returning, without comment or endorsement, the copy of selected pages from a confidential draft of a study entitled "The Australian Motor Industry in the Years to 1984" which the Chairman received this morning.

Yours Faithfully,

(A. E. S. Davey)

Secretary

(Martec, 1976: A 2)
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The late Tom FitzGerald argued that "[i]n economics, qualities of personal character can be no less important than technical competence" (1990: 41). Certainly the story set out here suggests that in policy making, as in life, it is difficult to be rigorous or fruitful in conversation if one focuses on exploiting the weaknesses of others' arguments - instead of meeting their strengths.
11 Statistical Appendix

Items appear and are numbered according to the chapter and in the order they are first referred to in the text.

Table A2.1 General Motors-Holdens Export Performance

<table>
<thead>
<tr>
<th>Year</th>
<th>Domestic</th>
<th>Export CBU</th>
<th>Export CKD</th>
<th>Total Exports</th>
<th>Export Intensity - by volume (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1948</td>
<td>100</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>1949</td>
<td>7700</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>1950</td>
<td>20100</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>1951</td>
<td>25200</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>1952</td>
<td>31900</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>1953</td>
<td>44200</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>1954</td>
<td>54500</td>
<td>300</td>
<td>300</td>
<td>0.6</td>
<td></td>
</tr>
<tr>
<td>1955</td>
<td>62400</td>
<td>1300</td>
<td>1300</td>
<td>2</td>
<td></td>
</tr>
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<td>1956</td>
<td>66700</td>
<td>2200</td>
<td>2200</td>
<td>3.2</td>
<td></td>
</tr>
<tr>
<td>1957</td>
<td>90100</td>
<td>1300</td>
<td>3200</td>
<td>4.8</td>
<td></td>
</tr>
<tr>
<td>1958</td>
<td>108300</td>
<td>900</td>
<td>1500</td>
<td>2.2</td>
<td></td>
</tr>
<tr>
<td>1959</td>
<td>111900</td>
<td>1300</td>
<td>2100</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>1960</td>
<td>129700</td>
<td>2500</td>
<td>8200</td>
<td>7.6</td>
<td></td>
</tr>
<tr>
<td>1961</td>
<td>105700</td>
<td>2500</td>
<td>4400</td>
<td>6.1</td>
<td></td>
</tr>
<tr>
<td>1962</td>
<td>127000</td>
<td>2600</td>
<td>3700</td>
<td>4.7</td>
<td></td>
</tr>
<tr>
<td>1963</td>
<td>155300</td>
<td>3800</td>
<td>7000</td>
<td>6.5</td>
<td></td>
</tr>
<tr>
<td>1964</td>
<td>156500</td>
<td>4900</td>
<td>8800</td>
<td>8.0</td>
<td></td>
</tr>
<tr>
<td>1965</td>
<td>132100</td>
<td>19400</td>
<td>13700</td>
<td>12.8</td>
<td></td>
</tr>
<tr>
<td>1966</td>
<td>137700</td>
<td>15100</td>
<td>10800</td>
<td>9.9</td>
<td></td>
</tr>
<tr>
<td>1967</td>
<td>131800</td>
<td>11200</td>
<td>10800</td>
<td>7.8</td>
<td></td>
</tr>
<tr>
<td>1968</td>
<td>154000</td>
<td>14400</td>
<td>10800</td>
<td>8.6</td>
<td></td>
</tr>
<tr>
<td>1969</td>
<td>161000</td>
<td>13400</td>
<td>10800</td>
<td>7.7</td>
<td></td>
</tr>
<tr>
<td>1970</td>
<td>165600</td>
<td>24000</td>
<td>13400</td>
<td>12.7</td>
<td></td>
</tr>
<tr>
<td>1971</td>
<td>168000</td>
<td>24400</td>
<td>13400</td>
<td>12.7</td>
<td></td>
</tr>
<tr>
<td>1972</td>
<td>160900</td>
<td>33500</td>
<td>13400</td>
<td>17.2</td>
<td></td>
</tr>
<tr>
<td>1973</td>
<td>164300</td>
<td>41200</td>
<td>13400</td>
<td>20.1</td>
<td></td>
</tr>
<tr>
<td>1974</td>
<td>157900</td>
<td>32600</td>
<td>13400</td>
<td>17.1</td>
<td></td>
</tr>
</tbody>
</table>

*Source: Correspondence with GMH.*
### Table A7.1  
**Motor Vehicles at the Three Digit ASIC Level**

<table>
<thead>
<tr>
<th></th>
<th>Motor Vehicles and Parts (ASIC 321)</th>
<th>Clothing (ASIC 242)</th>
<th>Total Manufacturing</th>
<th>Motor Vehicles as % of Total Manufacturing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Intensity (Index)</td>
<td>88</td>
<td>13</td>
<td>100</td>
<td>88</td>
</tr>
<tr>
<td>Labour Productivity</td>
<td>$7,200</td>
<td>$3,102</td>
<td>$6,049</td>
<td>119</td>
</tr>
<tr>
<td>Average Wage</td>
<td>$3,191</td>
<td>$1,996</td>
<td>$3,023</td>
<td>106</td>
</tr>
<tr>
<td>Exp't Intensity (%)</td>
<td>4.0</td>
<td>0.8</td>
<td>6.5</td>
<td>62</td>
</tr>
</tbody>
</table>


### Table A7.2  
**Motor Vehicles at the Four Digit ASIC Level**

<table>
<thead>
<tr>
<th></th>
<th>Proportion of Total Mfg (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Motor vehicles (ASIC 3211)</strong></td>
<td></td>
</tr>
<tr>
<td>Capital Intensity</td>
<td>110</td>
</tr>
<tr>
<td>Output per worker</td>
<td>$8,446</td>
</tr>
<tr>
<td>Average Wage</td>
<td>$3,382</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Truck and Bus Bodies (ASIC 3212)</strong></td>
<td></td>
</tr>
<tr>
<td>Capital Intensity</td>
<td>33</td>
</tr>
<tr>
<td>Output per worker</td>
<td>$4,695</td>
</tr>
<tr>
<td>Average Wage</td>
<td>$2,900</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Vehicle Instruments (ASIC 3213)</strong></td>
<td></td>
</tr>
<tr>
<td>Capital Intensity</td>
<td>49</td>
</tr>
<tr>
<td>Output per worker</td>
<td>$4,901</td>
</tr>
<tr>
<td>Average Wage</td>
<td>$2,837</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Motor Vehicle Parts n.e.c (ASIC 3214)</strong></td>
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<tr>
<td>Capital Intensity</td>
<td>61</td>
</tr>
<tr>
<td>Output per worker</td>
<td>$5,408</td>
</tr>
<tr>
<td>Average Wage</td>
<td>$2,937</td>
</tr>
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</table>


### Table A7.3  
**Export and Import Intensities of the Automotive Industry**

<table>
<thead>
<tr>
<th></th>
<th>Export Intensity</th>
<th>Import Intensity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Motor Vehicles and Parts</td>
<td>4.0</td>
<td>22.3</td>
</tr>
<tr>
<td>Total Manufacturing</td>
<td>6.5</td>
<td>16.8</td>
</tr>
</tbody>
</table>

### Table A7.4 Comparative Statistics of the Motor Industry and Other Manufacturing *

<table>
<thead>
<tr>
<th>Year</th>
<th>T/O</th>
<th>Sales</th>
<th>Value Added</th>
<th>Impts</th>
<th>Expts</th>
<th>Exp Intens</th>
<th>Net Exp Intens</th>
<th>Imp Intens</th>
<th>T’over/ VA</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$m</td>
<td>$m</td>
<td>$m</td>
<td>$m</td>
<td>$m</td>
<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>ASIC 323 - MOTOR VEHICLES AND PARTS</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>68/69</td>
<td>1,519</td>
<td>1,396</td>
<td>561</td>
<td>325</td>
<td>50</td>
<td>3.3</td>
<td>-18.1</td>
<td>23.3</td>
<td>271</td>
</tr>
<tr>
<td>69/70</td>
<td>1,713</td>
<td>1,562</td>
<td>625</td>
<td>375</td>
<td>72</td>
<td>4.2</td>
<td>-17.7</td>
<td>24.0</td>
<td>274</td>
</tr>
<tr>
<td>70/71</td>
<td>nc</td>
<td>nc</td>
<td>nc</td>
<td>391</td>
<td>92</td>
<td>na</td>
<td>na</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>71/72</td>
<td>1,948</td>
<td>1,763</td>
<td>719</td>
<td>364</td>
<td>102</td>
<td>5.3</td>
<td>-13.4</td>
<td>20.6</td>
<td>271</td>
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<tr>
<td>72/73</td>
<td>2,088</td>
<td>1,890</td>
<td>707</td>
<td>356</td>
<td>151</td>
<td>7.3</td>
<td>-9.8</td>
<td>18.8</td>
<td>295</td>
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<tr>
<td>73/74</td>
<td>2,350</td>
<td>2,124</td>
<td>888</td>
<td>499</td>
<td>158</td>
<td>6.7</td>
<td>-14.5</td>
<td>23.5</td>
<td>265</td>
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<tr>
<td>ALL MANUFACTURING</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>68/69</td>
<td>18,671</td>
<td>17,298</td>
<td>7,501</td>
<td>2,947</td>
<td>1,605</td>
<td>8.6</td>
<td>-7.2</td>
<td>17.0</td>
<td>249</td>
</tr>
<tr>
<td>69/70</td>
<td>20,727</td>
<td>18,403</td>
<td>8,273</td>
<td>3,354</td>
<td>2,090</td>
<td>10.1</td>
<td>-6.1</td>
<td>18.2</td>
<td>251</td>
</tr>
<tr>
<td>70/71</td>
<td>nc</td>
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<td>nc</td>
<td>3,679</td>
<td>2,151</td>
<td>nc</td>
<td>nc</td>
<td>nc</td>
<td>nc</td>
</tr>
<tr>
<td>71/72</td>
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<td>20,936</td>
<td>9,688</td>
<td>3,550</td>
<td>2,557</td>
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<td>23,410</td>
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<td>12,710</td>
<td>7,318</td>
<td>3,818</td>
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</table>

* The table generates three indicators of the competitive performance of the industry - export, net export and import intensity. Export and import intensity measure exports against turnover and imports against domestic sales respectively. Net export intensity measures net exports (exports - imports) over turnover.

** Selection of three digit ASIC industries to represent ETMs follows the selection offered in Industry Commission, Annual Report, 1991-92: 70.

Source: IC, 1995. (NB the Commission has revised the data since its use in the IAC’s 1973-74 Annual Report.)
### Table A7.5 Comparative IIT Intensity

<table>
<thead>
<tr>
<th>Year</th>
<th>IIT Intensity (%)</th>
<th>ASIC 323</th>
<th>ETMs</th>
<th>323/ETMs</th>
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<td>27</td>
<td>32</td>
<td>82.5</td>
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<td>32</td>
<td>36</td>
<td>91.0</td>
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<tr>
<td>70/71</td>
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<td>41</td>
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<tr>
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### Table A8.1 Comparative Export Intensity

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<th>Year</th>
<th>Turnover</th>
<th>Imports (M)</th>
<th>Exports (X)</th>
<th>Net Exp't Intensity</th>
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<td></td>
<td>$m</td>
<td>$m</td>
<td>$m</td>
<td>(X-M)/Turnover %</td>
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<td>ASIC 323 - MOTOR VEHICLES AND PARTS</td>
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<td>74/75</td>
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### Table A10.1 The Real Exchange Rate 1970-92

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<th>Sept Qtr</th>
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<td>82.1</td>
<td>80.6</td>
</tr>
</tbody>
</table>

Source: Reserve Bank of Australia
12 References

References are presented in three sub-sections. § 12.1 cites archived documents. § 12.2 cites Commission reports and papers which are referred to frequently and which have accordingly been abbreviated. § 12.3 is the main bibliography. It cites material not cited in §§ 12.1 or 12.2.

To enable the reader to determine whether the full reference for a particular citation is located in § 12.2 or § 12.3, abbreviated citations cite the "IAC" as the author, and the date of those citations appears after a word or acronym indicating the nature of the reference. By contrast, unabbreviated citations carry the unabbreviated title of their author "Industries Assistance Commission" with the date appearing immediately afterwards. The full references to all such citations appear in § 12.3.

Thus, "(IAC, PMVs, 1974)" refers to the following publication cited in § 12.1:

"(Industries Assistance Commission, 1982)" refers to the following publication cited in § 12.3:

In the body of the dissertation, the draft of a report is indicated by the word "Draft" in the citation immediately preceding the date. Where this does not appear, the report cited is a final report. Likewise, the word "Transcript" appearing in the citation of a Commission report refers to the official transcript of the inquiry.

12.1 References to Archived Documents

Archived Documents

Unless otherwise stated, minutes are minutes to Commissioners. Dates given for drafts or reports are the dates on accompanying minutes. The numbers appearing at the end of each entry (and in two entries in subsequent sections) specify the Folder, Box and Report Numbers respectively as classified by Australian Archives. The number 12/17/265 indicates a document to be found in Folder 12 of Box 17 of the documents relating to IAC Report No. 265.
Papers Relating to the 1974 Report

All Working Papers identified with a "A" are filed under 1/17/21.

Working Paper A2, "Price and Cost Comparisons"

Working Papers identified with a "B" are filed under 2/17/21.

Working Paper B7, "Vehicle Pricing"
Working Paper B11, "Natural Protection"
Working Paper B13, "Export Incentives"
Working Paper B14, "Regional Complementation & Co-operation"
Working Paper B16, "International Agreements".

Minutes
Undated Minute to Commissioners, "Effects of Recommendations on Australian Manufacture of Light Vehicles", 6/18/21.

Letters
Rattigan to Steel, Letter from A. Rattigan to G. N. Steele, 21st October 1974, 6/18/21.

Miscellaneous

Documents Relating to the 1979-81 Reports

Dated Commission Documents in Chronological Order
Minutes dated 26th, 27th, 28th June and 4th and 5th of July 1979, 3/17/267.
Minute, 2nd November, 1979, 12/17/267.
Notes accompanying Minute of 2nd November 1979, 12/17/267.
Minute, 30 November 1979, 4/20/267.
12.2 Commonly cited Commission Reports, Papers and Submissions

Reports and papers abbreviated below were published in Canberra by the IAC or Industries Commission (IC) as indicated (in the case of papers) or by the Australian Government Printing Service (in the case of reports). References in the text which do not appear with the abbreviations appearing below, appear in the bibliography.

|----------------------------------------|--------------------------------------------------------------------------------------------------|

* The relevant minute appears at the bottom of a folder of files which are compiled in (roughly) chronological order. This and the tone of the minute in the context of other similar minutes - particularly that of the 9th October 1979 (see below) - suggest a date of around October 1979.
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IAC, PMVs, 1975

IAC, PMVs, 1981

IAC, PMVs-EF, 1979

IAC, "Reductions", 1982

IAC, "Trends", 1981
12.3 Bibliography

Apart from commonly cited Commission reports and archived documents, all primary and secondary sources are listed below. Where details have not been provided, of dates or place of publication for instance, I was unable to discover them from the publications in question.


Aristotle, 1953. (1976); The Ethics, Penguin, Middlesex.


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Harris, R. G., 1985. Trade, Industrial Policy and International Competition, Minister of Supply and Services, Canada.


Harris, S., et al, 1974. Rural Policy in Australia, Canberra, AGPS.


Kasper, W. and Parry, T., 1978. *Growth, Trade and Structural Change in an Open Australian Economy*, Research School of Social Sciences, the Australian National University, Canberra, and Centre for Applied Economic Research, University of New South Wales, Kensington.


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