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#1 *Centre for Economic Policy Research*

DISCUSSION PAPERS

Conference Papers And Proceedings

AUSTRALIAN INDUSTRY:
PRESSURES (OR OPPORTUNITIES?) FOR CHANGE

EDITOR'S SUMMARY

F.H. Gruen

Discussion Paper No. 1

May 1980

P.O. Box 4, Canberra 2600, Australia

Conference Papers And Proceedings

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CONFERENCE PROGRAMME

AUSTRALIAN INDUSTRY: PRESSURES (OR OPPORTUNITIES?) FOR CHANGE

Australian National University

11-13 April 1980

SESSION I

RELATIVE PRICE CHANGES AND THEIR EFFECT ON THE VOLUME
AND STRUCTURE OF AUSTRALIAN INDUSTRY

Friday, 11 April: 8.00p.m. - 9.30p.m.

- (a) *The effects of rising energy prices on the volume and composition of Australian industrial output*

Author: Dr. M. Folie

1st Discussion Opener: Dr. R.G. Hawkins

2nd Discussion Opener: Prof. S.F. Harris

Saturday, 12 April: 9.30a.m. - 10.45a.m.

- (b) (i) *The effect of internal cost and exchange rate changes on the competitiveness of Australian industry*

Authors: Dr. J. Marsden and Mr. G. Hollander

1st Discussion Opener: Mr. M. Connell

2nd Discussion Opener: Dr. V. Fitzgerald

Saturday, 12 April: 11.00a.m. - 12.30p.m.

- (b) (ii) *The increasing competitiveness of developing economies and their impact of Australian industry*

Authors: Prof. B. Johns and Mr. J. Metcalfe

1st Discussion Opener: Dr. P. McCawley

2nd Discussion Opener: Mr. J. Brennan

Conference Programme

SESSION II

THE CHANGING REGULATORY AND FINANCIAL ENVIRONMENT

Saturday, 12 April: 2.p.m. - 3.15p.m.

- (a) *The regulation of import competition and its effects on the environment of Australian industry*

Authors: Dr. K. Anderson and Prof. R. Snape

1st Discussion Opener: Mr. J. Mendel

2nd Discussion Opener: Dr. R.G. Gregory

Saturday, 12 April: 3.45p.m. - 5.00p.m.

- (b) *Mergers, trade practices policy and internal competition*

Author: Dr. N. Norman

1st Discussion Opener: Dr. J. Hatch

2nd Discussion Opener: Mr. R.M. Bannerman

Sunday, 13 April: 9.30a.m. - 10.45a.m.

- (c) *Financing of industry - recent trends and possible policy issues*

Authors: Mr. B. de Boos, Mr. P. Williamson, Dr. T. Valentine

1st Discussion Opener: Prof. J. Rose

2nd Discussion Opener: Dr. R. Allan

SESSION III

CLOSER ECONOMIC TIES WITH NEW ZEALAND

Sunday, 13 April: 11.15a.m. - 12.30p.m.

Closer economic ties with New Zealand - implications for industry on both sides of the Tasman and for the two economies generally

Author: Prof. C.G.F. Simkin

1st Discussion Opener: Mr. D. Moore

2nd Discussion Opener: Mr. P.J. Flood

Conference Programme

SESSION IV

SOME POLICY ISSUES - HOW BEST TO MOVE TOWARDS FREER TRADE

Sunday, 13 April: 2p.m. - 3.15p.m.

How best to move towards freer trade - some international perspectives

Author: Prof. A. Krueger

1st Discussion Opener: Prof. W.M. Corden

2nd Discussion Opener: Dr. P. Jonson

Concluding Session: 3.45p.m. - 4.30p.m.

CENTRE FOR ECONOMIC POLICY RESEARCH
Australian National University

CENTRE FOR APPLIED ECONOMIC RESEARCH
University of New South Wales

JOINT CONFERENCE

11-13 April 1980

LIST OF PARTICIPANTS

Dr. C.J. Aislabie	Univ. of NSW
Dr. R.H. Allan	Univ. of Melbourne
Dr. K. Anderson	A.N.U.
Mr. R. Bannerman	Trade Practices Commission
Mr. J. Barber	John Lysaght (Aust.) Ltd.
Mr. B. de Boos	Australian Financial System Inquiry
Mr. J. Brennan	General Motors Corp.
Mr. J. Brunner	BHP
Mr. M. Connell	Victorian Chamber of Manufacturers
Mr. C.W. Conron	Prices Justification Tribunal
Prof. W.M. Corden	A.N.U.
Mr. M. Cronin	Industries Assistance Commission
Prof. J.W. Freebairn	La Trobe University
Mr. P.J. Flood	Dept. of the Special Trade Representative
Dr. M. Folie	Shell Australia
Dr. K. Gannicott	University of NSW
Dr. R.G. Gregory	A.N.U.
Prof. F.H. Gruen	A.N.U.
Dr. J. Hatch	University of Adelaide
Mr. K.A. Harris	Trade Practices Commission
Prof. S. Harris	A.N.U.
Dr. R.G. Hawkins	Dept. of Prime Minister and Cabinet
Mr. G. Hollander	Industries Assistance Commission
Mr. J.A. Hopwood	ANZ Businessmen's Council
Dr. P. Jonson	Reserve Bank of Australia
Prof. B. Johns	Bureau of Industry Economics
Prof. W. Kasper	University of NSW
Mr. A.G. Kerr	Dept. of Business and Consumer Affairs
Prof. A. Krueger	University of Minnesota
Dr. J. Marsden	Industries Assistance Commission
Dr. P. McCawley	A.N.U.
Dr. G. McColl	University of NSW

<i>Mr. P. McLaughlin</i>	<i>Treasury</i>
<i>Mr. J. McLeod</i>	<i>Conzinc Riotinto</i>
<i>Mr. J. Mendel</i>	<i>MTIA</i>
<i>Mr. J. Metcalfe</i>	<i>Bureau of Industry Economics</i>
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<i>Mr. A. Moran</i>	<i>Dept. of Trade and Resources</i>
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<i>Dr. T. Parry</i>	<i>University of NSW</i>
<i>Prof. J. Rose</i>	<i>University of Melbourne</i>
<i>Prof. C. Simkin</i>	<i>University of Sydney</i>
<i>Prof. R. Snape</i>	<i>Monash University</i>
<i>Dr. D. Thomas</i>	<i>Caulfield Institute of Technology</i>
<i>Mr. J. Todd</i>	<i>Bank of NSW</i>
<i>Mr. T. Todhunter</i>	<i>Fibremakers Ltd.</i>
<i>Mr. I. Tuffs</i>	<i>National Mutual Life Association</i>
<i>Dr. T. Valentine</i>	<i>Australian Financial System Inquiry</i>
<i>Dr. P. Warr</i>	<i>A.N.U.</i>
<i>Mr. P. Williamson</i>	<i>Australian Financial System Inquiry</i>

EDITOR'S SUMMARY

The Centre for Economic Policy Research, Australian National University, and the Centre for Applied Economic Research of the University of New South Wales, held a joint conference on "Australian Industry: Pressures (or Opportunities?) For Change". The conference was held at ANU from 11-13 April 1980. The fifty or so participants included students of economic affairs from the academic community, from the Public Service and from private institutions. The eight papers and the opening discussion of these papers are published in the succeeding eight Discussion Papers in this series.

Six of the eight papers presented fell into two broad categories. The first of these concerned the relative price changes which had taken place in recent years and their effect on Australian industry. Of three papers in this category the first was given by Dr. Michael Folie of the Shell Company and concerned the effect of the rise in energy prices on Australian industry.

Michael Folie gave us a market place account of the likely impact of the steep rise in energy prices. He attributed these increases to two independent events of which the impact of OPEC was the more obvious, but also of importance was the collapse of the ability of the nuclear power industry to convince major industrialised societies that nuclear power represents a socially acceptable form of electricity generation. Both events have had a dramatic impact - not only placing upward pressure on all (non-nuclear) energy prices but also lowering short-term economic growth. Crude oil will be scarce over the next decade or two and only available at increasing real prices - whilst synthetic crude oil will not be available in any quantity over the next decade.

The extent to which world growth is constrained by reduced oil availability will depend on the rate at which other factors of production can be substituted for oil. In any case, real incomes in non-oil exporting nations as a whole will be lower than otherwise. Some countries will be relatively less disadvantaged. Besides such oil exporters as Mexico and Norway; Australia, Canada and South Africa are potential gainers since they can increase output of non-oil energy (coal, gas, uranium) at lower costs than other countries. The high price of oil has opened new investment growth opportunities for these countries and their adjustment problems should be less than for energy poor countries such as France, Italy, Japan and Korea.

The availability of export surpluses of coal and natural gas means that rising world energy prices have a net beneficial effect on the Australian economy. By international standards, coal will be available in Australia at low prices - because of the high transport costs of moving coal to the Northern Hemisphere. These transport costs provide one major source for Australia's comparative advantage. Another associated advantage is that it may be easier for some of the environmentally objectionable industries to re-locate to remote parts of Australia.

Where are these substantial Australian investment opportunities likely to be? First, there will be a significant expansion in both local and international demand for black steaming coal (though Folie is sceptical that total black coal exports will reach the levels projected by the Joint Coal Board - primarily because of transport infra-structure constraints. However, if a commercially viable process of manufacturing synthetic fuel from coal is perfected, then the coal sector could be subjected to even more substantial expansion).

International transport movements can be expected to become relatively more expensive. Thus, any weight or bulk reducing processing industries will become relatively more economic for Australia - if the bulky commodity is already produced here. But commodity processing will only be economic where the raw material is located in or very near to Australia. On the other hand, aluminium should be regarded as a special case in view of its extreme dependence on energy - with very few other industries being in the same category. Also, electricity costs from newly developing hydro schemes in Central Africa and South America may be substantially lower than anything available in Australia. Iron and steel is not regarded as parallel to aluminium because of the historic Australian view that substantial trade barriers around the world make an export-based steel industry not viable.

In the past Australian agriculture has gradually become more energy intensive, though there is some evidence that Australian agriculture may be no more energy intensive than agriculture in other countries. Ethanol production from sugar cane does not appear to represent a major new import substitute industry which could exist without protection. On the demand side the major impact on agriculture will be from lower world economic growth.

Folie seemed anxious to dampen what he regarded as excessive expectations about the likely employment and aggregate demand effects of the coming resources boom. There was some debate about this issue - which should probably be regarded as one of the major areas of uncertainty left after the conference. The uncertainties are basically threefold:

- (a) What are the likely aggregate demand and employment effects of the resource boom with any given fiscal and monetary policy?

- (b) If the stimulating effects are substantial in terms of overall demand and employment, are they likely to be offset by large scale skill shortages and/or by a renewed wage push?
- (c) Will the declining rate of productivity growth implicit in a lot of new fuel saving investment limit the overall economic growth rate of which the Australian economy will be capable?

On this last question two factors were stressed by different conference participants. Some stressed that the decline in the rate of growth of productivity reduces real income gains possible for the economy as a whole whilst others pointed out that, for any given level of expansion of real demand resulting from new energy-based investment opportunities, employment growth will be greater the smaller the increase in (labour) productivity.

The second paper dealing with relative price changes confronting Australian industry was by John Marsden and Gerd Hollander of the Industries Assistance Commission. It presented some very useful information about the changes in the competitiveness of Australian industry over the last decade. Marsden and Hollander concerned themselves with the price (and cost) competitiveness of Australian industry - defined as the changes in Australian prices and costs relative to those taking place in the economies of our trading partners. The broad movements during the last decade are well known - a decline in competitiveness between 1972 and 1974; a sharp improvement resulting from the devaluation in September 1974; followed by further improvements following the 1976 devaluation and - according to three of the four indices cited - in 1977 and 1978. But, as FitzGerald pointed out during the discussion, it was disconcerting to find that the four different measures of competitiveness in Figure 1 of the paper gave very different answers if one wants to compare

competitiveness, say, in 1979 with ten years earlier.

An interesting, not widely appreciated phenomenon is that movements in competitiveness across industries over the decade were quite divergent - and that the net effect of the differential movements in the exchange rates of Australia's trading partners has tended to favour export industries more than import-competing industries (cf. Figure 4 of the Marsden-Hollander paper).

The second part of the Marsden-Hollander paper analysed the various factors affecting price competitiveness. It is possible to decompose the changes in competitiveness into those resulting from changes in protection, in exchange rates, changes in internal and external prices. Such a decomposition can only tell us about the first round effects of these factors on competitiveness; all sorts of indirect, general equilibrium effects are ignored. Bearing in mind these qualifications, it is still of interest to note that exchange rate changes have been the single most important factor contributing to changes in competitiveness over the decade.

The third and final section of the paper looked beyond these first round effects and examined the divergence of views among economists as to whether exchange rate movements can have a longer term effect on competitiveness. After a discussion of rival views and of the Australian evidence, Marsden and Hollander argue that "exchange rate movements can lead to changes in price competitiveness which are both substantial and sustained". This conclusion was contested by Kasper at the meeting and, by implication in the Snape-Anderson paper where there is a reference to the "essentially short run nature" of the phenomenon of exchange rate protection (a different name for essentially the phenomenon discussed by Marsden and Hollander).

In the course of discussion Corden suggested there were basically three possibilities which could explain Australia's success in engineering a real rather than just a nominal devaluation in November 1976:

- (a) The nominal devaluation brought about a real devaluation because of some rigidity or sluggishness of nominal wages (or perhaps because of some special features of the Australian economy such as the supposedly limited nature of the links between export industries and the rest of the economy, FHG);
- (b) The tight monetary and fiscal policy then prevailing brought about wage restraint and pricing restraint by firms in dominant positions. This then enabled the nominal devaluation to be transformed into a real devaluation.
- (c) There are possible industrial relations explanations - in terms of the indexation policy operating.

The paper by Johns and Metcalfe of the Bureau of Industry Economics was the third to deal with relative price changes - focussing on the increasing competitiveness of industry in some of the developing economies and its impact on Australian industry. The authors provided some details of the growth in manufactured exports to OECD countries by non-oil exporting developing countries. The bulk of the paper centred on trade between Australia and the developing countries. The recent rapid growth in imports of manufactured goods from developing Asia has been documented elsewhere. The four newly industrialising Asian countries (i.e. N.I.C.'s, namely Singapore, Hong Kong, Taiwan and South Korea) increased their share of Australian imports over all major import groups, whilst the other Asian developing countries tended to increase their share in labour-intensive or natural-resource based industries such as clothing, footwear, wood and wood products, food, beverages and tobacco.

Using a partial equilibrium decomposition technique adapted from Krueger and Marsden and Anderssen, the authors apportion changes in employment in two-digit Australian industry groups to imports and to Asian imports in particular. In most industries the magnitude of this decline in

employment was small. It was greatest in clothing and footwear (at almost 1.7% per annum) and second largest in textiles at 0.7% per annum. Averaged over all manufacturing industry the first round employment loss amounted to 0.24% per annum as a result of Asian imports and 0.62% per annum as a result of the growth of all imports (cf. Table 6; the period involved is 1968/69 to 1975/76).

The main conclusion of the paper was that the overall impact on employment in Australian industry from the increased competitiveness of the newly-industrialising Asian countries has been slight. These effects have been felt most severely in clothing, textiles and footwear, but there have been some less labour intensive Australian industries whose employment prospects have been improved by trade with developing Asia.

In discussion McCawley suggested that, apart from net employment losses, one needed to consider gross employment changes - and these were likely to be considerably greater. The discussion generally revealed the familiar division between those concerned with short run employment prospects, with possible changes in wage shares resulting from a reduction in protection and the more dominant mood of the conference which stressed the costs of resisting change and how much real income was foregone by inadequate adjustment to changing world economic conditions. One of the dissenting protectionist positions is reprinted at the back of this summary.

* * * * *

Our aim in commissioning the second set of three papers was to examine the changed regulatory and financial environment in which Australian industry has found itself in the last few years.

The first paper in this group examined changes in the regulation of import competition and their effects on the environment in which industry operates. I think Kym Anderson and Richard Snape summarized the broad picture on the protective scene well. There have been three major changes:

1. There has been some progress in reducing the level of effective protection for some 80 per cent of Australian manufacturing industry. Even if this only amounts to an elimination of "water in the tariff", it serves a useful function if it reduces incentives to invest in areas of high effective protection.

2. The "problem" industries of Textiles, Clothing, Footwear and Motor Vehicles have succeeded in receiving large increases in protection - despite the fact that these industries were already among the most protected industries in the early half of the decade. Most of the increases in protection since 1973/74 have been through the imposition of quantitative import restrictions rather than via increased tariffs. In spite of these increases in protection, imports seem to have enjoyed a generally increasing share of the market in these problem industries (though the figures do not extend past 1976-77, cf. Table 5 of the Anderson-Snape paper).

3. There has also been a growth of financial assistance to export manufacturing industries (cf. Table 7) - industries which generally, but not invariably, receive low levels of protection.

One question which Anderson and Snape did not address themselves to - but which economists might find interesting - is what has been the NET effect of these changes in essentially three directions. In other words, is the structure of relative prices ruling within Australia now any nearer to the structure of relative prices of tradable goods ruling outside Australia than, say, ten years ago. Because that is surely the acid test of what we are trying to achieve - namely to structure internal incentives

so as to match the structure of external incentives confronting the Australian economy.

After sketching the changes in Australia's protective system, Anderson and Snape attempted to provide an explanation for the pattern of differential protection and for the changes in this pattern. The explanation attempts to use the concept of a political market for government favours - with some interest groups having either lower collective lobbying costs and/or higher potential gains from lobbying. It is argued that industries which are declining, which face above average increases in wage costs and in import competition and which are low-wage, labour intensive and low-value added fall into these two categories. They also tend to be the industries which have received relatively more protection in recent years. Gregory, in the discussion, was somewhat sceptical of the insights provided by this view of protection as an outcome of the economic theory of democracy - for the cogent reasons listed in his opening of the discussion.

Another section of the Anderson-Snape paper covers some ground also traversed in the Johns-Metcalf paper; namely the effect of the high and increasing levels of protection of the Textiles/Footwear/Clothing/Motor vehicle industries on the profitability of these industries. Both groups point to the high level of profitability of these industries (i.e. above the average for manufacturing) - and its substantial increase since 1974/75.

Neville Norman's paper on "Mergers, Trade Practices and Internal Competition" concentrated particularly on legislation designed to investigate or control mergers and take-overs. Within this limited framework it provided a useful - though not universally accepted - discussion both of merger legislation and of whether this

legislation should be strengthened or changed in other directions. The major discussants of the paper felt that the focus on merger legislation narrowed the subject down too much. Fortunately the Conference was given an illuminating broad-brush account of the changing business environment resulting from the more open Trade Practices legislation introduced by the Labor government. This has had a salutary effect in encouraging competition in many sheltered industries - in particular in such non-traded goods areas as distribution and transport. The disappearance of highly sophisticated collective price agreements which were usual (and respectable) in many areas of industry and commerce (e.g. white goods, corrugated boxes, resale price maintenance in most areas of retailing) must have had a beneficial effect on competitive behaviour generally. But as Ronald Bannerman reminded us, there is always pressure from interest groups to get back to cosy licensing arrangements. At present this pressure exists in the transport industry - but if granted there, it would no doubt spread elsewhere. In addition, there are, of course, still many areas where restrictive anti-competitive practices are the norm (e.g. the taxi industry in each Australian capital city, newsagencies, professional fees etc.). Agricultural marketing is generally exempt from Trade Practices legislation while one member of the Conference referred to trade union strike and boycott activity as the biggest group of restrictive trade practices of all. This prompted a suggestion that - in order to get effective Trade Practices legislation - we needed to elect a government dominated neither by trade union leaders nor by spokesmen for farming interests!

The de Boos-Williamson-Valentine paper on "Trends and Possible Policy Issues in the Financing of Industry" did a good deal to document the effect of the changing financial environment on the business community - even though some Conference participants were quick to point out that their

sample referred really only to listed public companies. While these represented a sizeable and very important share of total private economic activity, even the smallest firms included in the sample were relatively large by Australian standards. However, in spite of this proviso, de Boos, Williamson and Valentine presented some interesting, useful and new information regarding the changing financial environment.

First, they documented the increasing indebtedness of publicly listed companies. Their regression equations suggested (a) when 'real' after tax profitability has been squeezed, companies have increased their debt/equity ratio; (b) increasing the level of capacity utilisation has a similar positive effect on the debt/equity ratio of such companies; (c) there is some evidence of a long term trend towards the use of more fixed debt use - evident since the mid-sixties. This could be due to the development of stronger corporate debt markets since the early sixties; (d) there was no evidence that the Reserve Bank quantitative restrictions on bank lending had any significant effects on historical changes in debt/equity ratios for the whole of this sample of 300 listed companies. But it was of interest to note that this was no longer true of the smallest 75 companies in the sample - who presumably have less access to alternative sources of debt finance than the larger listed companies. This suggests that these bank lending restrictions have an unequal impact on borrowers - with the smaller borrowers being more adversely affected. This finding is especially significant in the light of the earlier comment that even the 'small' firms in this sample are relatively large by the standards of all (i.e. listed and non-listed) Australian companies.

Another part of the paper examined movements in the vulnerability of firms as a result of increased fixed interest indebtedness. Two forms of vulnerability were identified: 'cover' - i.e. the ratio of earnings minus

interest and taxes to fixed charges - and 'potential cover' which makes allowance for the fact that some firms were carrying a substantial quantity of 'old' low interest debt, which may need to be refinanced at higher nominal interest rates which have been ruling more recently. While coverage has fallen considerably from the high levels of the early fifties, there has been a strong convergence of current and potential cover. There is also an interesting Table (No. 2) on the major (proximate) determinants of historical changes in potential cover.

As with the debt-equity ratio, de Boos, Williamson and Valentine use multiple regression analysis to explain changes in profitability among their sample of firms. Since their earnings measure is based on historical cost accounting, inflation has a significant positive effect on 'profitability' - even though it might have had significant negative effects on profitability after allowing for price changes - however these might best be measured. According to the authors, the most significant finding of their profitability equation is the significant long-term downward trend in 'profitability'; even when the influence of capacity utilisation and inflation is taken into account.

Conference participants wanted the authors to study not only past trends - but also to examine likely issues in the eighties. The key question, a number of participants felt, was whether local capital markets could cope adequately with the large demands likely to be placed on them by the coming resources boom.

* * * * *

The next two papers did not fit into the overall pattern to the same extent. The first - by Colin Simkin of Sydney University - discussed closer economic relations between Australia and New Zealand - a perennial

topic which periodically becomes the subject of closer consideration. As pointed out by Simkin, present interest is the result of concern on both sides of the Tasman about the recent contraction of manufacturing, the rapid growth of manufacturing exports from Asia, and the slow growth of "traditional" Australia and New Zealand agricultural exports. For New Zealand especially "hope seems to lie in the development of manufactured exports and more favourable access to their largest market". The historical growth of Australia - New Zealand trade probably owes less to bilateral reductions of trade barriers under NAFTA since the mid-sixties than to other factors. Since the aim of NAFTA is to avoid serious injury to existing industries in Australia and New Zealand, it is not surprising that the Free Trade Agreement has probably had less effect on the expansion of Australia - New Zealand trade than unilateral reductions in such barriers.

Examination of trade flows over the period 1969 to 1976 shows that both Australia's and New Zealand's total exports grew more slowly than world exports - New Zealand's at only 55% of the rate of Australia's total exports. This is largely attributed to the adverse commodity composition of both countries' exports and, particularly in New Zealand's case to lack of competitiveness (and other factors - cf. Table 1 of Simkin's paper).

In the case of bilateral trade, while Australia's share of NZ's imports hardly improved, NZ's share of Australia's imports increased strongly. Although this may suggest that NZ may have gained more from NAFTA than Australia, it was probably due more to other factors such as the 25 per cent tariff cut and depreciation of the \$NZ relative to the \$A. Nonetheless, trade gains do appear to have occurred as a result of NAFTA.

Examination of studies of possible future growth of world trade suggest slower growth of Australian and NZ exports than world exports, mainly because of unfavourable "competitive - discriminatory" effects. While such projections should not be taken too literally, they do suggest the possibility of major trading problems, the most serious of which relates to Australia and NZ's competitive positions in the world economy. Efforts to foster trans-Tasman trade are not likely to be helpful if they lead to impairment of competitive ability.

However, there are some things which could be done to improve trans-Tasman trade which would not impair competitiveness. Firstly, measures could be taken to reduce real transport costs - but nothing substantial can be done here until governments are prepared to tackle union monopolies and strikes. Secondly, import controls could be removed - but it would be unrealistic to believe that there could be more than a substantial easing, particularly as import licensing is supposed to be non-discriminatory. However, there may be scope to replace import licensing by tariffs and to exchange tariff preferences.

Trade gains from a limited free trade area would be small and, although there is the possibility of dynamic gains of various sorts, these are also likely to be small in the case of Australia and NZ. Professor Simkin concludes that

"It would certainly be mistaken to think that trans-Tasman trade by itself could provide a worthwhile offset to losses from slower growth of world trade or reduced international competitiveness. If, as some of us hope, Australia and New Zealand seek adjustments to these changing circumstances, not by tightening protectionism, but by improving competitive efficiency in more open economies, that could well have a favourable spin-off for trans-Tasman trade and so improve its minor but useful contribution to growth of our real incomes."*

* I have used here substantial parts of Mr. J.D. Moore's written summary of Simkin's paper.

Simkin and the two Discussion Openers seemed agreed that bilateral trade agreements had not played a very significant role so far - either in raising living standards in either country or even in increasing trade greatly. Des Moore reminded us of the dangers of any trade liberalisation which only succeeded in diverting trade, rather than creating it as well. There were also some comments about the dangers for Australia of being linked more closely - e.g. by a customs union - to an economy which is even more protectionist than Australia. The most striking observation during the discussion - for me - was a comment that Wellington talked of "the Australian economic miracle" - which only shows that "economic miracle" is definitely a relative term!

* * * * *

In the final paper of the Conference, Professor Anne Krueger of the University of Minnesota provided us with some international perspectives on how best to move towards freer trade. (In conjunction with Professor Jagdish Bhagwati, Anne Krueger has recently completed a nine country study of "Foreign Trade Regimes and Economic Development". This study was conducted under the auspices of the National Bureau of Economic Research.)

Anne Krueger discussed the experiences of countries moving towards freer trade under three headings: European integration, multilateral tariff negotiations and the experience of Brazil, Israel and South Korea with trade liberalisation. She then attempted to distil the following lessons from these experiences (and from various unsuccessful attempts at trade liberalisation). First, many attempts have foundered because of political opposition, which has arisen in response to a subsequent recession (even when this recession was more the result of efforts to

reduce inflation). If trade liberalisation is not expected to be permanent, moves towards freer trade have generally been abortive.

Second, many failures have resulted from balance of payments pressures - perhaps associated with an overvalued exchange rate. There are no instances on record of a successful move towards freer trade with an unrealistic (and overvalued) exchange rate.

Third, a move towards freer trade is likely to be more successful if the realignment of incentives comes about not only by dampening the profitability of some activities (through reducing protection) but also by increasing the attractiveness of other activities. These positive incentives can come from devaluation, from tax rebates to all exporters (e.g. Brazil) or from the benefits received by a country from multilateral trade negotiations. This has relevance to the earlier discussion regarding so called "exchange rate protection". If it is true that it is possible to engineer a medium term improvement in a country's competitive position, could this not provide the positive incentives which Krueger believes is needed during a period of trade liberalisation and all-round reductions in protective measures?

Fourth, there have been no substantially successful moves towards free trade which have retained quantitative restrictions on a sizeable scale. (I take it agriculture is excluded from this "general lesson").

Fifth, Anne Krueger believes that the benefits of all successful moves towards freer trade have substantially exceeded prior estimates, whilst the costs have generally been less than the pessimists believed they would be.

On this basis the author argues in favour of reasonably rapid - rather than slow - movement towards freer trade, and provides three convincing arguments in favour of speed rather than caution.

* * * * *

Conference participants were invited to contribute their comments for inclusion with the published papers and Discussion Opener's comments. We thank those who took the opportunity to do so.

It seems appropriate to include here the following points made by Mr. Tim Todhunter, as they cover the Conference generally and are not confined to any particular paper.

1. A great deal of ignorance was displayed over the micro-economic facts in the industries concerning which most of the Conference was discussing policy. For example, I had to point out the substantial and continuing improvement in competitiveness of the textile, clothing and footwear industries under tariff quota conditions 1976-79 which followed a decline of competitiveness under ad valorem tariff conditions. This appeared to come as a surprise to most of the attendants.
2. There was no recognition at any stage in the Conference that there is a major difference between quota (i.e. licensing) and tariff quota (i.e. two-tier tariff with a cut-off point based on volume). The textiles and clothing industries have operated under the latter system since 1976. If academics and public servants spend two days discussing an issue in industrial economics and focusing their policy conclusions on one industry or two, they should understand the facts first.
3. There was practically no discussion on the key issue of growth in the challenges and opportunities for structural change. In a prestigious conference such as this, the papers seem to be far too heavily directed towards the narrow aspect of Australia's visible protection system.
4. There was an unwillingness on the part of many attending the conference to recognise the peculiar nature of the Australian exchange rate vis-a-vis other developed countries of the world, leading to a position of negative protection for the majority of our resources, and therefore to distortions in allocation. This was picked up by Anne Krueger and Richard Snape.*
5. The essential policy relationship between exchange rate and protection were not properly discussed in the Australian context. This is Anne Krueger's point No. 4, p.24, in her paper. Des Moore and Wolfgang Kasper refused to acknowledge the significance of treating the two policy tools together.
6. The textile, clothing and footwear industries are not "excessively" profitable. The Strategic Planning Institute of Cambridge Massachusetts has found that among the major strategic influences on

* See also Mr. Todhunter's comments on the Anderson-Snape paper, in C.E.P.R. Discussion Paper No. 5.

profitability and net cash flow, the first is investment intensity, where they say "Investment intensity generally produces a negative impact on percentage measures of profitability". Therefore, metals, mining, petrochemicals, and other capital-intensive industries generally should show a lower profitability than textiles, clothing and footwear.

This is not the place for a detailed reply to Mr. Todhunter's points. Briefly, points 1,2 and 4 do not seem to bear on the major arguments advanced by those who favour a more outward looking trade strategy for Australia. The profitability of the "problem" industries is high not only compared with industry generally but also when compared with their earlier profitability say 1968/69 to 1973/74 (cf. for instance Table 8 of the Johns-Metcalf paper). I grant a point made under 3. - namely that more attention should be devoted to the less visible forms of protection (both in Australia and overseas).