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IS THERE A FUTURE FOR LABOUR INTENSIVE INDUSTRIES IN THE AUSTRALIAN ECONOMY?

by

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CRES General Paper
R/GP6 (1976)

CENTRE FOR RESOURCE AND ENVIRONMENTAL STUDIES

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IS THERE A FUTURE FOR LABOUR INTENSIVE INDUSTRIES IN THE AUSTRALIAN ECONOMY?

There are a number of simple answers to this question. To an economist, however, a simple answer is usually incorrect; consequently, I shall attempt a more complex one. As a sovereign nation Australia is free, at least in principle, to determine its own pattern of industry or sector development. To that extent, it is within the power of society and the government to decide what kind of future labour intensive industries - or any other kind of industry - will have.

Looking at the question on this broad basis, as I shall, the issues of interest concern the influences or forces at work in the economy which affect the future of labour intensive industries; the kinds of actions feasible and necessary to influence these forces; and the overall consequences of such actions.

In looking at the basic economic influences relevant to the question it is useful to consider some very simple economic history. In the days of early man, in subsistence or non-exchange economies, man produced just about all that he consumed; he also produced his food virtually as he consumed it - he hunted, he gathered food and he moved on when supplies ran out. This was, of course, an extremely labour intensive operation, based on his own physical labour effort. Even here, though, two other factors were important.

His own skill either as a hunter, in finding food, or in fighting, influenced his total level of real

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material and non-material income and the labour intensity of particular aspects of his efforts. Obviously, therefore, even in looking back as far as this different qualities of labour were important. The second important factor is the resource base. When manna falls from heaven, the labour intensity of food gathering is low, compared with the situation of the man who cannot find it (i.e. the resource is lacking), or does not recognise it (i.e. he lacks the skill).

With increasing sophistication, man learned to use tools, to cultivate the soil, to store food and so on. In other words, he innovated, and he applied technology, which required the application of capital in one form or another: he created capital by, for instance, constructing tools and implements, or by producing sufficient food to make it possible to store some or to use some for cultivation. Associated with this, he learned to specialise as part of a group, so benefiting from the economies of scale.

What man was doing was applying more capital and technology to labour and the resource base - to land, to fisheries, to mineral deposits, or to forests. Substituting capital and technology occurred not just with respect to physical labour but to a degree to resources as well - as when fertiliser is applied to land. The main engine of growth, however, was and is the substitution of capital and technology for labour. It was this process right from the start which enabled the productivity of labour to rise and it is the productivity of labour which, with a given resource base, eventually determines, in a market system, the real incomes of labour in all its forms - both as physical input and as a manager or controller of productive operations. And by real income, I include not only material benefits, such as the amount and quality of food and clothing, but also non-material benefits such as good working conditions, shorter hours and economic and physical security.

If the resource base increases, it too will increase the productivity of labour applied to it, and hence labour incomes. Through the market for labour, this then spreads throughout the economy as an increase in real incomes and hence as wage costs.

There are two ways in which this substitution takes place. On the one side, economic growth normally involves an increase in average incomes in an economy and puts pressure on wage costs. This raises the price of labour relative to capital and the pressure to replace labour with capital. This is the most obvious and most widely observed pressure. In addition, however, technical progress makes capital goods cheaper relative to labour costs. This is important, since even if one could conceive of labour costs staying unchanged in real terms, the same development would still occur, though more slowly. The lower price of capital goods that occurred as technical progress increased, would then increase the price of labour relative to capital, this time by reducing capital costs; again, it would lead to capital replacing labour. This would put downward pressure on final product prices, or let them increase more slowly, and make labour intensive products relatively more expensive. In practice, both influences are experienced at the same time, as part of a continuous and interacting process.

With economic progress, then, goods and services can be produced with both less labour and less capital - consequently, the prices of goods and services fall in terms of the returns to labour, i.e. the returns to labour increase more rapidly than the costs of the goods and services produced.

The process of economic change or economic growth is complex. The change about which we normally think, and which was undoubtedly a major component of the early growth in industrial economies, was the replacement of human physical effort by other energy sources. Originally, animal, wind, and water power replaced human energy, and subsequently fuel and chemical energy has largely replaced them in the advanced economies.

The replacement of labour effort with animal or mechanical effort would not, by itself, have provided the growth in the world economy that has occurred in this century. Contributions of economies of scale and the general increase in technology - including improvements in the way energy is transformed through heat and power generation, and through various forms of machinery, and improvements in the mechanism, human, mechanical or electronic, by which the energy generating or transforming processes are controlled - were both very important.

This somewhat lengthy discourse on the nature of economic progress can be summed up by saying that the replacement of human effort, and the replacement of human control mechanisms by capital intensive systems is what has characterised human progress and led to increased human wealth and well being.

So what does all this mean to us today?

Firstly, I have been talking generally about all economies and not particularly about Australia.

Differences observed in economic growth rates among various countries are not difficult to characterise, although often difficult to explain. They may reflect different resource endowments, but more often, they reflect differences in the degree to which technology has been embodied in capital and applied in association with labour to the available resources. Why these differences exist is an immense subject which I shall not pursue here.

By dint of its resource base (including an educated population), Australia has been able to absorb, develop and import technology and to apply increasing amounts of capital to production and, consequently, to grow wealthy. When a country has a high real income, normally the people in that country also have high real incomes, and as total real incomes grow so the average level of real incomes increases.

As a consequence of the fundamental economic pressures I have described, the problem for labour intensive industries is that it is the very success of the capital intensive and resource-based industries that generates the demand and cost pressures which cause the difficulties of the labour intensive industries. Their implications, however, will be heavily influenced by the market - by the nature of the demand for the product.

That the prices of the products of capital intensive industries fall relative to those of labour intensive industries, means that the products of the capital intensive industries will be substituted for labour intensive products: directly, as with plastic packaging for jute bags, or synthetic fibres for wool; or indirectly, such as a motor car for clothing.

Of course, for some products the market is not very responsive to price; this is frequently the case with service industries, such as television repairing.

Moreover, as incomes increase, many of the things which are labour intensive in this sense are also things which wealthy economies demand more of - such as, again, the service industries: restaurants, tourist and recreation facilities, the public sector, medical and health services and education.

The combination of the rapid increase in the relative costs of some labour intensive services, where the price does not affect demand very much, and expansion in the areas of demand that grow as incomes grow, can be seen in the growth of the service sector in all modern developed economies. Manufacturing industry, like agriculture, tends to be a declining sector of the economy in terms of the share of the total work-force that it employs or the proportion of the national output that it represents. The term decline does not itself have any particular significance; in some respects it indicates an increased importance in an economic growth sense - obviously, if we used twice the current volume of resources to produce the same volume of output, their share of the total workforce would be greater, but we would be less well off.

Let me try to draw some lessons from the discussion so far. I have stressed the inevitability, in the process of economic growth and development, of the costs of labour rising faster than other costs.

The importance of this is that it puts into perspective concerns about the high costs of labour that are referred to by all industries, but expressed with greater emphasis by the labour intensive and low productivity industries that are in weak market positions, such as apple and pear growers, footwear producers and butchers, than by capital intensive producers such as wheat growers and iron ore producers and labour intensive industries with a stronger overall market, such as hairdressers.

The cost of labour is high because it is generally associated with other highly productive factors of production - land, and the resources of the land such as minerals, or capital. In Australia in recent years, it has reflected overwhelmingly the productive association of labour with mineral resources. This is not to say that in the short run, labour cannot price itself too highly - and, in effect, price itself out of the market so that it is unemployed. But, given a reasonable period of time, an industry will find real wage rates have risen because elsewhere labour has been combined with other resources or factors of production in such a way that its productivity has increased and hence its returns or income.

Now let us ask whether there is any reason why the future should differ from the past? The answer is that, in terms of the broad influences I have been discussing, there certainly is no obvious reason why it should. In the years ahead, it seems highly probable that developments in the economy will take much the form of the past, with the trading area being heavily based on resources - agricultural and mineral; and with manufacturing developments being more and more in the technology-based sectors and moving into export markets.

~~Professor Hogan is to talk on this general question later today.~~ In the meantime I shall assume that real incomes will continue to grow - an assumption most people would accept, and on which most of the present public and private planning is predicated. If past trends continue, for example, average real personal incomes (which have increased by about 2-1/2% per year for the last 25 years) will just about double their present levels by the year 2000. Consequently, labour costs will also double by that time.

The implications for the industries in question, and their significance depend, for reasons already given, on the scope for substituting capital for labour, for innovating and for introducing new technology; and, as we have seen, it is importantly dependent upon the nature of the market. There is only very limited scope - with known technology - for the substitution of capital for labour in, for example, repairing television sets. T.V. repairs will continue to increase in price at a more rapid rate than, say, motor vehicles or television sets themselves. Nevertheless, people have little alternative when their T.V. set breaks down to employ a repair man -

except to scrap the set.

Many service industries - not all of which are labour intensive in Australia, though very many are - would therefore normally continue to rise in relative importance, as is happening overseas.

In the United States, total employment in the mining, manufacturing and agricultural sectors, fell from 47% in 1947 to about 30% in 1971, and projections suggest a further decline to about 28% by 1980. In other words, services, other than construction, will account for two out of every three U.S. employees in 1980 compared with one out of every two in 1947.

In Canada, the service sector already has well over 60% of employees and is expected to have about 70% of the employment in 1980.

In Australia, taking non-rural employment only, from about 55% represented by the service sector in 1950 and a little over 60% in 1970, the service industries are expected to make up some 65% or more of non-rural employment in the 1980s.

I have not talked specifically so far about the role of trade. Before doing so we need to look at some definitions. Labour intensity is normally defined in terms of the ratio of labour to capital, or of labour to output. Whether a product is labour intensive, however, depends often on the particular price relationships in the country concerned. Rice in Asia is normally highly labour intensive; rice produced in the MIA is highly capital intensive; coal or iron ore mining in some mines, particularly older underground mines, is labour intensive but capital intensive in mechanised or open-cut mines.

Moreover, labour intensity normally refers largely to the physical energy input of labour. It need not be limited to that - an automated control system may replace a highly skilled works manager. Where labour intensity arises, however, from the inability to replace fairly simple repetitive manual processes, the lack of competitiveness is greater and the gap will almost certainly grow relatively faster in the future.

Similarly, what is a traded good may also vary. In Europe, particularly in countries such as Belgium and Luxemburg, very few things need be non-traded - electric power, water supply, fresh milk, bread etc., could be, and often are, traded goods; in Australia there is normally a relatively high natural protection. Even here, things like card punching for computer processing, or printing of periodical magazines, both normally regarded as non-traded services, are now being imported from Asia.

In the absence of action to offset or counter it, the working of the market economy in the process of economic development, would make labour intensive traded goods in the Australian context more and more uncompetitive. This is a point painfully well known, I imagine, to this audience.

Change is frequently painful for those affected by it, and throughout the world in almost any country at any time there are industries or regions, in which the nature of change is causing difficult problems of adjustment. In other developed countries, the present structural problems are not unlike those in Australia, and for much the same reasons. The industries or regions affected range from shipbuilding, electronics, older coal and other mining areas, as well as the textile, clothing and footwear industries; and, of course, in most European and North American countries and in Japan the agricultural sector has faced painful adjustment problems - as indeed it has in Australia.

Of course, problems of a growing lack of competitiveness of labour intensive production is not the only source of industry problems, though they are the major problems of a structural nature common to all developed countries and some developing ones with higher incomes.

Not all capital intensive industries in a small market context are necessarily internationally competitive, and problems can arise when greater economies of scale are available overseas - this is part of the motor vehicle problem. Other problems also superimposed on the structural ones are a consequence of the current world economic recession, misjudgements of market growth, or the normal consequences of competition, which is what the market economy is all about.

I said at the beginning of my talk that any country can decide to do what it likes about any industry. Let us look then at what could be done, or at least attempted, to offset or counter this situation. In the first place, a policy could be attempted to maintain protection against imports - through tariffs, tariff quotas or quantitative restrictions. There are a number of implications of such a policy.

Subject to some qualifications, this policy involves substantial costs to the Australian economy. The consumer pays more for the product, and the community could use the resources elsewhere to produce more if combined with capital in other fields.

The circumstances in which such assistance can be worthwhile are well known. They include where a defence or security interest is important, where a particular kind of economy of scale exists which is external to the firms concerned, where regional location problems exist, or where women who are unable to move to other employment are employed, and so on. But labour intensive industries are less and less those for which a defence or security interest could be claimed which would be generally accepted as warranting assistance; and economies of scale external to the companies involved that would not exist in any case are difficult to find.

Labour intensive industries, in part because past incentives have tended to be biased in this way, have tended to dominate in the field of decentralised industries. The form of assistance needs to be carefully designed, however, according to its intended purpose. As the Jackson Committee said, "the tariff is not an efficient instrument for promoting decentralisation because it provides equal encouragement to urban as to non-urban factories."

Some labour intensive industries, such as textiles and clothing, have traditionally had a high female component. Equal pay for women has obviously had a major impact in these industries - but if women are genuinely unable to get employment elsewhere, then there can be an economic gain from assisting that industry. It would be important to examine why such movement is not possible - and consider policies which deal specifically with those constraints.

Obviously, the calculation of these costs is difficult to make in any precise way and it is part of the debate on tariffs and other assistance. I do not want to enter into this debate. That there are costs involved, at least in the longer run, is not in question, I believe, since it would be necessary to show that the whole process of economic development which everywhere else has been based on greater applications of capital to labour does not apply to Australia.

This does not mean that society may not be prepared to pay that cost; it may well do so. The question then is what would the community, as a whole, gain from doing so; and to the extent that there are gains, whether they are sufficient to offset the costs. There are institutional mechanisms, such as the IAC process, designed to assess these issues in particular circumstances. The cost of providing this assistance, however, to maintain an industry in the circumstances described, can be expected to rise quite substantially over time. If the community is not prepared to pay these increases on a continuing basis, then the community is, in effect, deciding on the period over which the assistance is to be withdrawn.

From the point of view of the industries subject to the economic pressures I have described, the question of importance is whether measures of this kind will work effectively.

I have in mind, particularly, the longer term implications. First, uncertainty about any protective or other government assistance measure seems inevitable in all countries, Australia included. Given the high probability that for those industries with a high degree of labour intensity, the level of effective protection would (as I have suggested) have to continue rising simply to maintain the status quo, there is an added uncertainty since one could speculate that the likelihood of maintaining effective assistance levels in this way seems small. That would not simply be my assessment, but it would seem to be supported by the conclusions of the Jackson Committee.

Second, even industries with a high degree of competition from imports have usually benefited to a degree from the relatively fast rate of growth in the domestic market. The significant factor in the future is the quite marked slow-down in population growth rates and hence in the rate of domestic market growth pointed to in the Borrie Report. This will affect all industries, but it will affect more those having most difficulty competing at international price levels. It also has implications for the labour supply and I shall return to that. The chances of obtaining a satisfactory return on capital under these circumstances are likely to appear far from rosy - so the attraction to the businessman must be limited.

To the employee, other than those in special circumstances, the attractions must appear limited too. They must also appear limited to his union representative. The employee will be disadvantaged if he cannot get at least the average wage level; there will always be a particular hesitancy about pushing for wage increases when this may be to reduce further the competitiveness of the labour intensive industry. Where improved working conditions also require capital expenditure, the difficulty of providing that capital will be greater.

The employee will in fact normally see himself as much better off in many of the capital intensive industries or an industry which is labour intensive but which is capable of becoming capital intensive, or in the service sector: and to the extent that conclusions are possible from average wage data, he would be right. In such circumstances, he can normally press for higher wages and get them from increased productivity, particularly where capital substitution is possible. From an employee's point of view, therefore, a labour intensive industry competitive with imports does not have many attractions as a longer term proposition.

For country towns, general assistance measures are of very limited value; specific assistance measures to decentralised industries would be much more beneficial, but these are likely, at best, merely to offset the disadvantages of decentralisation - from an industry-wide viewpoint, they normally apply to only a small percentage of an industry.

A complete ban on competitive imports might maintain the industry in some relation to market growth. Apart from the slower market growth due to slower population increases (to which I have already referred), however, the steady increase in prices this would imply, relative to other prices, would reduce the market further over time.

The difficulty of maintaining this protection in the face of domestic consumer pressure would be enormous - the lessons of the butter/margarine experience are pertinent - and overseas pressures would also be very strong.

Moreover, in many of these situations, a rational process of adaptation is for Australian producers to enter into arrangements with the overseas competitors to produce the most labour intensive parts of their output. Such arrangements will be inhibited, if not prevented, by the existence or even the possibility of such restrictions.

There are also broader considerations of major importance. While the recent trade embargo by the Phillipines is probably an undue reaction to a particular trading situation, the two-way relationship of trade is likely to be affected very substantially by our actions on imports. Nevertheless, I agree with the Jackson Committee that Australia is likely to become more rather than less dependent on trade. In any case, Australia stands to incur significant costs in terms of its own long-term national self-interest if it is not able to provide reasonable opportunities for trade from countries which already are, or could be, major markets for our exports - the Japanese and Asian markets being particularly important - or which can influence the terms on which trade is carried out. In particular, the goods that the developing countries have to export are likely to be labour intensive. Measures to protect labour intensive industries in Australia from imports are likely to affect, and be regarded as discriminating against, the developing countries.

To quote the Jackson Committee again, "Australia must move with these world (trade) developments if it is to avoid being an isolated, high cost producer and to forego the benefits of specialisation and trade."

The assumption I made earlier was that income growth in the economy would continue and that labour costs in the economy would grow relative to all other costs. This is not a matter of the undue pressure of the unions, but simply something that would probably happen with or without the unions. Union pressures can increase or slow the rate of growth and can, at any time, affect to a degree the distribution of the benefits of growth - but my expectation of labour cost increases stems basically from the expectation that real income will continue to grow.

Obviously, allowance must always be made for the totally unpredictable, but nothing at present appears likely to affect this growth in a way which would favour, in the Australian context, labour intensive industries. The energy crisis may increase the price of energy and could perhaps slow the substitution of machine energy for physical energy, but it is unlikely to stop the continued growth of relative labour income or to reverse the direction of economic growth.

The other crucial qualification concerns the argument about the need to provide employment opportunities. At certain periods in the historical past, there has been a case for creating employment opportunities by supporting labour intensive industries. In general terms, however, the situation in the postwar period has been one in which labour has been a relatively scarce commodity - hence the greater increase in its price, that is, in wage rates. In the future, the various developments in the resource fields and in meeting the growing needs of the community in terms of service activities, will place heavy demands on labour resources. This will be accentuated by the slowdown in the rate of growth of the workforce. We could well be like the European countries who have found it difficult to meet their demands for unskilled labour. Inthose countries, various forms of more or less temporary immigration have been considered necessary. Our own immigration program in the past has, to a degree, filled a similar gap in Australia. The Jackson Committee referred to expected difficulties in getting people to do dirty, unpleasant and monotonous, work. The probable result will be that higher wages will be necessary to attract people into doing this kind of work.

There are many things that economists have not found adequate answers to, but, despite what we accept as a very serious level of unemployment at present, they do know generally how to maintain the overall economic activity and employment and to limit unemployment to a much smaller - and in percentage terms small - level compared with the interwar period even in periods of recession.

Economists are correct in saying that problems of overall employment levels can be maintained by adjustments to various internal aggregates - money supply, government expenditure and the like - and by adjusting exchange rates. One could include the various forms of tariffs, quotas and the like as additional means of adjustment. Economists argue that these are normally less effective or have effects involving greater costs elsewhere as the trade-offs. Nevertheless, if used as employment protecting mechanisms in this way - as they often are - they cannot be other than very variable to be effective and so are not much help, except in short-term situations, to import competing industries.

In general, then, the problem will continue to be mostly one of pressure of demand on labour supply rather than one of concern about finding jobs.

This is not denied by the fact that unemployment may, from time to time, reach levels greater than customary in the recent past. The increased inflexibility downwards of prices and costs seems likely to make it increasingly costly, in terms of inflation rates, to sustain at all times past levels of employment. Industries which exist merely to absorb the episodic and limited unemployment that may occur in a business cycle, however, have limited prospects of profitability.

Where labour intensive industries can substitute capital for labour, the situation may be resolved satisfactorily. The pressures on agriculture in the postwar period have been very great as a consequence of exactly the same economic forces as I have discussed - the small farm problem was essentially one of inadequate levels of capital in relation to the available labour. In consequence of the pressures, and with the help of adjustment measures, there has been a great deal of substitution of capital for labour - the agricultural workforce has fallen very substantially and capital per farm has increased; Australian agriculture today in total is more capital intensive than joined the urban workforce from the rural sector in the last 25 years. Immigration from overseas has been larger. Moreover, the annual mobility of labour has been particularly high - something like 5% of the manufacturing workforce changes its job each month. Whatever allowance needs to be made for double counting of people who change jobs frequently, or move within an industry - the general proposition holds that the process of moving from job to job in all industries is a continuing one with large numbers of people involved. The Statistician's survey indicates that (in 1972) one quarter of all employees had been in their job for less than 12 months.

It seems neither necessary nor feasible to hold that no changes should be allowed without new jobs being available. What investor in new plant, for example, is going to wait until some planner allows employees from another plant, which is running down its activities, to work in the new plant; what employee will accept direction as to when and where they should change jobs in this way? The difficulties of matching the timing in specific cases, as this kind of argument implies, are enormous even if this were possible.

Adjustment is a difficult process, although perhaps the most effective aid to adjustment is a booming internal economy; but this also accentuates the pressure for economic change because the labour force in labour intensive industries will be attracted to better paying jobs elsewhere unless their own wages rise comparably - this is likely to add further to the difficulties of the labour intensive industry unless it can substitute capital for labour.

The processes of change which I have described have a wide range of implications for the economy as a whole and for individual sectors. As I have suggested, they are ones that lead us to expect sizeable increases in real income in the future.

It is generally accepted, however, that the market mechanism does not cope adequately or effectively with the processes of change. As in Australia, most wealthy countries overseas have introduced various forms of structural adjustment programs designed to assist the process. These normally consist of two elements: action to ease the pace of change where this is affecting particular sectors - and the clothing and textile industries are one wide, if not universal, example; and action to speed and smooth the adjustment process.

The important premise of these adjustment programs remains that the market system is the most efficient method of running our economy - but that it does need some help to work more effectively and perhaps less harshly in the short run.

Given the committed capital and committed skills, the need for time to adapt is clearly demonstrated - what the Jackson Committee refers to as "gradualism". There will obviously be quite major differences about how gradual such change should be - and judgements about this should not be made at the depth of a recession or at the peak of a boom. Nevertheless, the fact of gradualism itself would be universally accepted.

Having said that, I find it difficult in principle to see why such assistance should be given only to adjustment problems caused directly by government action. Technological change itself may occur in a situation in which the market is not efficient in smoothing the process of adjustment without specific government action. In any case, in practice, disentangling the two is very difficult.

Moreover, we all gain from the process of economic change; only a few are adversely affected by change, though the intensity of that hurt may be large. Those who gain should be prepared to assist those hurt; this would, in any case, reduce resistance to change.

If I can attempt to draw this together in terms of the subject matter of this paper, I can say very simply that:

- the economic pressures that arise from the very nature of economic growth will continue to increase the costs of labour relative to capital and physical resources;
- that this affects those industries which are labour intensive more than those which are capital intensive
- for many of these industries, the market situation is such that demand will be maintained or will grow for these products despite the continuing increase in relative prices that will be necessary;
- for others, the cost pressures will lead to specialisation, to product differentiation, to the development of specialised skills, to further substitution of capital for labour and the application of new techniques, innovatory processes, and the like;
- where a labour intensive industry cannot increase its

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competitiveness in this way and is subject to competition from either capital intensive products produced domestically or from lower cost imported goods - whether capital or labour intensive - it will be in increasing difficulty in providing a reasonable return to the capital invested and to the labour and skills employed in it.

- the scope for government action to offset this is limited, it would almost certainly need to grow at a significant rate, and would not offer much that is attractive for either investors, managers or employees;
- specific problems of regions, of immobile female or migrant labour, and those arising from an undue pace of structural change, irrespective of its cause, warrant community assistance but by specific measures aimed at the specific problems.

I have quite deliberately not directed my remarks to any particular industry, including the clothing industry. The problems are apparent in broad terms; I do not know enough, however, to know how far the steps already underway or planned to adjust to the continuing pressures of economic change, to specialise in products requiring highly skilled inputs of style and quality, or greater capital and technology, or in creating differentiated products that meet the increased demand that growing community real incomes is prepared to pay increasingly for, will offset the pressure which I have discussed.

This will need to be looked at in the context of specific industries.