An Overview of Protection of Australian Manufacturing: Past, Present and Future

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Abstract

Australia, and before Federation, the colonies, have long histories of tariff protection. However, by the end of this century tariffs for imports of most commodities will have been lowered to negligible levels. This paper briefly examines the history of the tariff and the changing structure of assistance to manufacturing in the 1980s and 1990s. As the tariff has been dismantled, a variety of alternative measures have been implemented. Thus, while the 'old' protectionism of tariffs on imports has been discredited, a 'new' form of protectionism – much to do with providing assistance for exports – has arisen to at least partially take its place. The protective effects of many of these measures is far less apparent and possibly more deleterious than the tariffs they replace.

Part I of this paper provides a brief overview of manufacturing protection in Australia – from the first (revenue) duties imposed in the Colony of New South Wales, and the post-gold rush, protectionist tariffs of Victoria, to the assistance provided to manufacturing in the late 1980s and early 1990s. In

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examining recent assistance, the emphasis of Part II is on the distribution of employment and assistance by activity.

By the turn of the century, the Australian Tariff will have been largely dismantled. In recent years, the focus of assistance has shifted from tariff protection to alternative measures, and Part III looks briefly (and selectively) at some of these, including assistance for exports and research and development, and two of the most important industry 'plans' – textiles, clothing and footwear, and automotive. Finally, the changing form of future assistance – the 'fall' of the tariff and the rise of alternative measures is briefly examined.

1. The Past[1]

The role of tariffs in Australia has been debated in Australia since before Federation. Governor Phillip first proposed customs duties in 1791, though it was not until 1800, that 'assessments' – revenue duties – on imported spirits were imposed in the Colony of New South Wales. Protective duties can be traced back to the 1840s. Then, NSW, Van Dieman's Land and South Australia pursued 'beggar-my-neighbour' policies (imposing protective measure and counter-measure) designed to foster local industry at the expense of the other Colonies.

The first overtly protectionist tariff was introduced in Victoria in 1865 following the Gold Rushes which had resulted in a dramatic increase in Victoria's population. In eight years to 1860 it increased from 150,000 to 540,000, and a protective tariff was seen as a means of creating new employment opportunities for the erstwhile miners.

A significant barrier to Federation was the divergent views of protectionist Victoria (whose Governments were heavily dependent on tariff revenues) and free-trading New South Wales where pastoral interests dominated, and Crown land sales made the Government independent of tariff revenues. Essentially, the Victorians 'won' on the tariff issue in the Federation debate.

The common uniform external tariff which was introduced following Federation however recognised, according to the then minister for Trade and Customs (C.C. Kingston), 'at this time in our history neither free-trader nor protectionist can have his way entirely'. The prime objective of the tariff was raising revenue, 'but protection, to existing industries at least, must accompany it' (quoted in Brigden, 1929, p. 148). Thereafter, the protective element in the tariff tended to increase in importance.

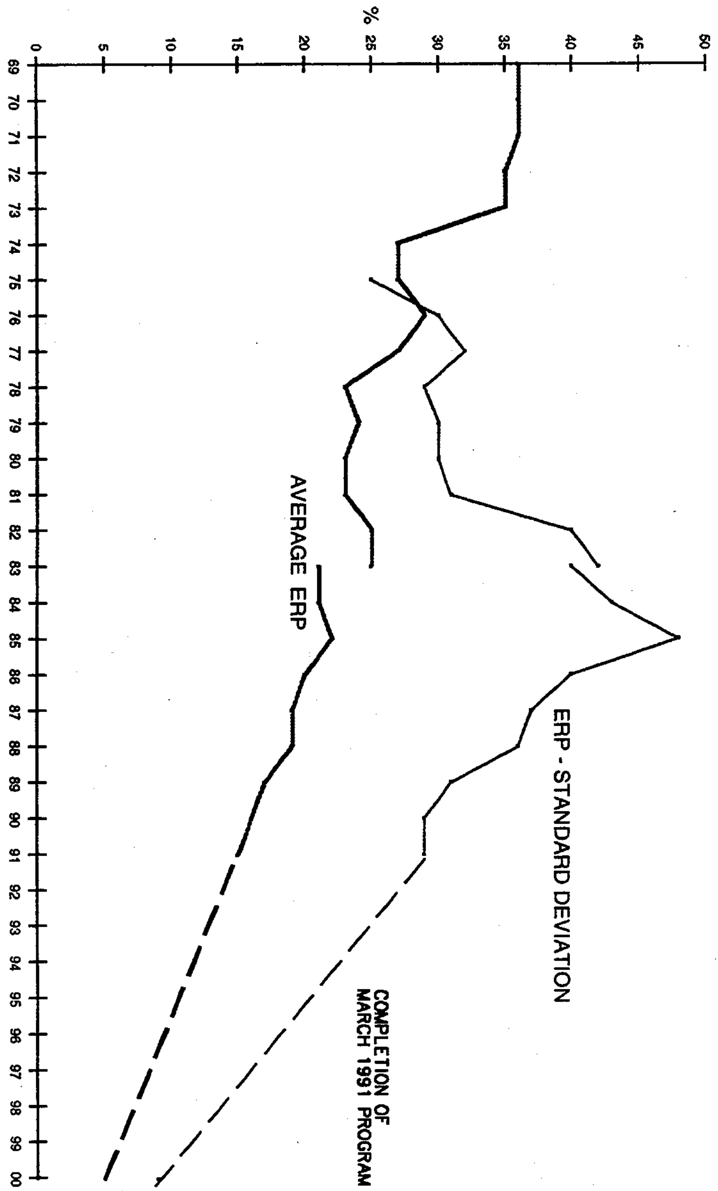
Indeed, the Tariff Board which was created in 1921 to inquire and report on matters of protection to the government, in 1928 expressed concern about 'the danger of the tariff being used to bolster up the ever-increasing cost of production', and instances of 'abuse' of protection where 'a highly protected industry returns to its shareholders, dividends considerably in excess of commercial rates ...' (Tariff Board, 1927, p. 18). The result was the formation of the Brigden Committee which inquired into protection policy. It was broadly supportive of the policy as it had operated to that time. However it suggested that '... the tariff may be likened to a powerful drug with excellent tonic properties, but with reactions on the body politic which make it dangerous in the hands of the unskilled and the uninformed.' It concluded that the tariff had reached its 'economic limits', and that 'no further increases in, or extensions of the tariff should be made without the closest scrutiny of the costs involved.' (Brigden, 1929, pp. 6-7). Despite this, by World War 2 tariffs were about one-half again as high as they were in 1929 as a result of measures introduced during the Depression (Jackson, 1975, p. 27).

For much of the 15 or 20 years after the War, the tariff was essentially redundant as a protective device. For many activities, import licensing (owing to foreign exchange shortages) became the operative means of protection, though the Government of the day stated explicitly that industry was not to take advantage of import controls as a protective barrier behind which it could expand. Not surprisingly, it was ignored.

Controls were eliminated in the early 1960s, and manufacturing then had to rely virtually solely on the tariff, the structure of which was substantially unchanged since the 1930s. The Tariff Board began calling on the Government for an overall review of the tariff in the late 1950s, but gaining acceptance was a long process. The review finally began under the McMahon Government in 1971, and was to take 7 years. The Whitlam Government which took office in 1972 continued the review, and in 1974 formed the Industries Assistance Commission (now Industry Commission), replacing the Tariff Board. The formation of the new Commission broadened the scope of the activities of the old Tariff Board from manufacturing, to include industries in the rural, mining, and services sectors. During this period, the 25 per cent tariff cut of July, 1973 – made by the Government, without reference to the Tariff Board – remains as the most significant single change in the tariff since World War 2.

Over the last 20 years, the review of protection has continued, but until recently there has only been a gradual nibbling away at average levels of assistance. Figure 1 shows this, with the average effective rate of protection (ERP)[2] of manufacturing falling from about 35 per cent in 1973 to about 27

Figure 1: Manufacturing: Effective Rates of Protection



Sources: IAC/IC, (1976,1983,1987,1990,1992).

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per cent in 1974, after the tariff cut. By 1983 it had fallen only another 2 or 3 percentage points.[3] Between 1983 and 1991, the average fell by roughly another 6 points. The very high standard deviations apparent in the mid-1980s were primarily the result of the continued very high levels of assistance for textiles, clothing and footwear (TCF), and passenger motor vehicles (PMV)[4] at a time of falling protection for most other manufacturing activities.

2. Levels of Assistance in the 1980s and 1990s

(i) The Structure of Assistance

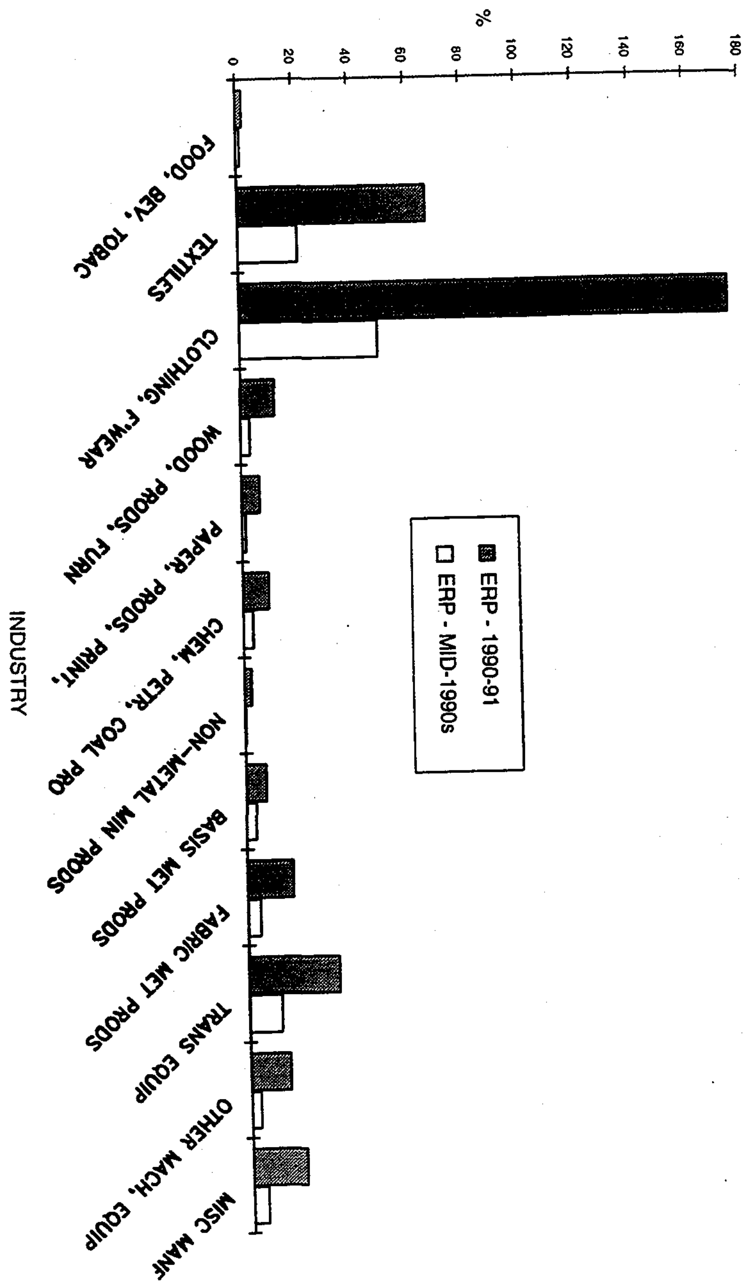
Figure 2 shows ERPs for Australian manufacturing industries[5] in 1990-91, and the rates scheduled for the mid-1990s under the program of tariff cuts announced in the Commonwealth Government's March, 1991 Economic Statement (see below). The very high rates of assistance provided to TCF and PMV just mentioned are clearly highlighted. While the ERPs for these activities will come down significantly over the next few years, even after the 1991 program is completed, these two industry groups will shelter behind protective barriers very greatly in excess of any others.

It should be stressed that the industries shown in this, and the following figures are highly aggregated, and the average ERPs shown obscure some of the very high rates for some of the activities within the respective industry groups. Footwear, for example, had an ERP of more than 230 per cent in 1990-91 (scheduled to fall to 36 per cent in the mid-1990s), and Passenger Motor Vehicles and Parts had an ERP of 60 per cent (falling to a scheduled 25 per cent).[6]

(ii) Protection and Employment in Manufacturing

Tables 1 and 2, respectively show aspects of the assistance provided to the twelve manufacturing industries and their employment levels. Taken together, a feature of the two tables is the disproportionately high levels of assistance provided to TCF and these industries' relatively low levels of employment. For example, the net subsidy equivalent[7] of the ERP for clothing and footwear was $1.275 billion in 1990-91. The industry employed 55,600 people[8], and thus the **annual** net subsidy provided by the protective structure was $27,400 for each of its employees. In fact, the NSE per employee exceeded the average wage in the industry[9]. Clearly, employment in clothing and footwear has been bought at a very high price.

Figure 2: Effective Rates of Protection 1990-91 and Mid-1990s



Sources: IC, (1992).

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Table 1: Assistance to Manufacturing Industries

	ERP 1991 (%)	ERP Mid-90s (%)	NSE 1991 $m	NSE/ EMP $
Food, beverage, tobacco	3	2	264	1561
Textiles	68	22	567	19964
Clothing, footwear	176	50	1275	22931
Wood, wood products, furniture	13	4	340	4479
Paper, paper products, printing	7	2	279	2674
Chemicals, petroleum, coal products	10	4	467	8980
Non metallic mineral products	3	1	81	2035
Basic metal products	8	4	404	6047
Fabricated metal products	17	5	567	5803
Transport equipment	33	12	1097	12270
Other machinery, equipment	15	4	709	5816
Miscellaneous manufacturing	20	6	470	7730

Source: Industry Commission, *Annual Report, 1992* (Canberra: AGPS, 1993)

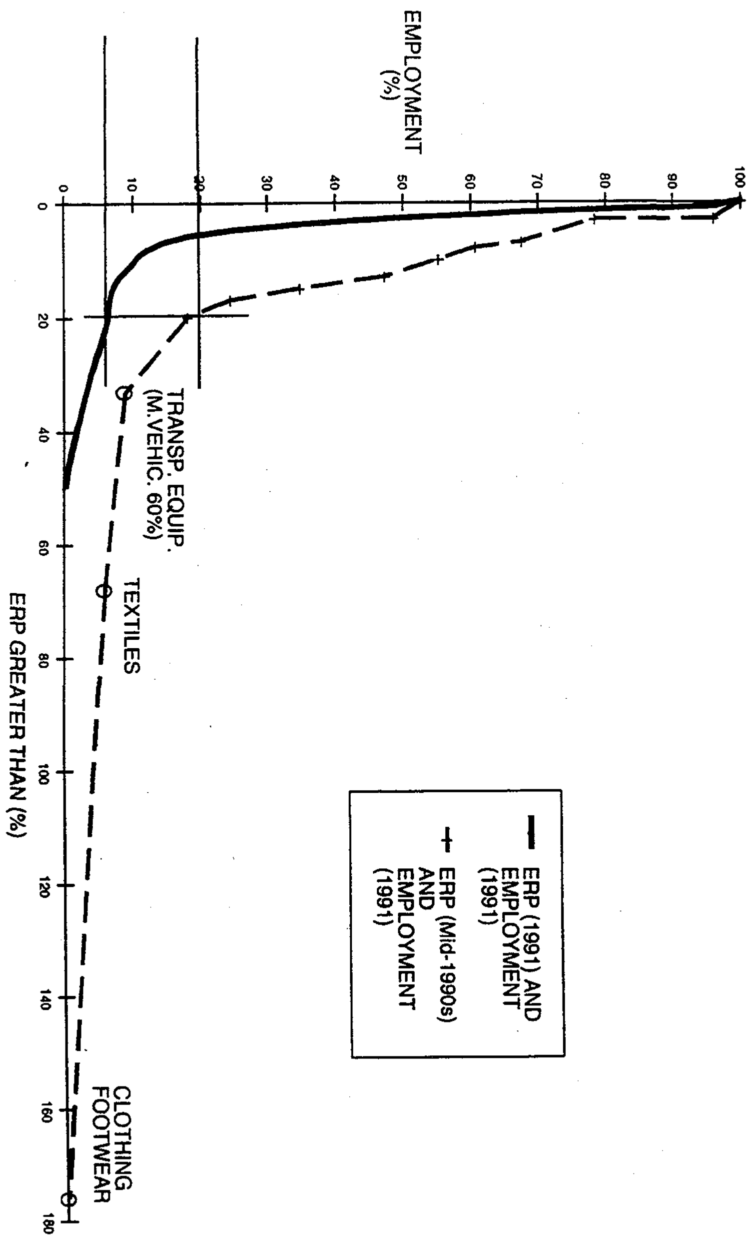
Table 2: Employment in Manufacturing Industries

	EMPL 1988 ('000)	EMPL 1991 ('000)	EMPL LOSS (%)
Food, beverage, tobacco	177.4	169.1	4.7
Textiles	35.6	28.4	20.2
Clothing, footwear	76.6	55.6	27.4
Wood, wood products, furniture	88.5	75.9	14.2
Paper, paper products, printing	112.6	104.3	7.4
Chemicals, petroleum, coal products	54.7	52.0	4.9
Non metallic mineral products	42.1	39.8	5.5
Basic metal products	75.0	66.8	10.9
Fabricated metal products	109.9	97.7	11.1
Transport equipment	113.3	89.4	21.1
Other machinery, equipment	138.8	121.9	12.1
Miscellaneous manufacturing	69.0	60.8	11.9

Source: Australian Bureau of Statistics, *Manufacturing in Australia, 1990-91* (Cat. 8221.0)

Figure 3 is an illustration of the distribution manufacturing employment by ERP. For example, 1990-91, fewer than 20 per cent of employees in manufacturing were engaged in activities sheltering behind ERPs of more 20 per cent, and by the mid-1990s, the proportion will fall to about 5 per

Figure 3: Australian Manufacturing Protection and Employment



Sources: ABS, (1993); IC (1992).

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cent of employees. TCF and transport equipment (which includes passenger motor vehicles) in terms of current and scheduled protection, are, and will remain, clearly outliers compared with the remainder of manufacturing.

How well has assistance cushioned employment in manufacturing? Over the period 1988-91, nearly 132,000 jobs were lost in the manufacturing sector – 11 per cent of the its workforce. While losses were felt in all industries, they were concentrated in TCF (about one-quarter of the industries' workforces) and transport equipment (more than one-fifth of its workforce). (See Table 2.) As we have seen, these are by far the most highly protected groups of industries, and in time of recession, this illustrates the poor insulating properties of even very high rates of protection.[10]

Finally, Table 3 provides the distribution by State of employment in these problem industries, and shows their relative concentrations in the two states facing the greatest burdens of the recession. Victoria has the highest number of employees in all three industries, while textiles, and clothing and footwear provide higher proportions of total employment in Victorian manufacturing than the corresponding proportions in any of the other States. South Australia however, has the highest relative exposure in transport equipment (mainly motor vehicles and parts). The State has been a traditional centre for motor vehicle industry – Holden's Body Builders Ltd began there – and the table shows South Australia's continued reliance on the industry (mainly Holden's and Mitsubishi).

Table 3: Distribution of Employment by State, 1991

	Text No. ('000)	Clothing No. ('000)	Transp't No. ('000)	Text (%)	Clothing (%)	Transp't (%)
New South Wales	7.0	19.0	19.9	2.1	5.7	6.0
Victoria	14.3	26.8	42.5	4.5	8.5	13.4
Queensland	1.4	4.5	6.5	1.1	3.6	5.2
South Australia	2.5	3.7	15.9	2.6	3.9	16.8
Tasmania	1.4	0.3	1.3	5.7	1.2	5.3
Western Australia	1.8	1.1	3.0	2.8	1.7	4.7

Source: Australian Bureau of Statistics, *Manufacturing in Australia, 1990-91* (Cat. 8221.0).

3. The Changing Focus of Assistance

Both major political parties now accept the dismantling of tariff barriers. Really the only point at issue is how fast it will happen. That is not to say, however, that manufacturing will face the future without assistance. At least partially replacing tariffs, will be far less transparent means of assistance, including anti-dumping laws, assistance for exports, assistance for R & D, and industry-specific arrangements. The remainder of this paper will look briefly at these.

(i) Anti-dumping

In 1988, following a review of the then existing arrangements (Gruen, 1986)[11], the Government established the Anti-dumping Authority (ADA) initially to operate for 5 years, and now extended until 2001. The ADA procedure is a review and appeal mechanism, independent of the Australian Customs Service.

In assisting particular producers at the expense of the wider community, dumping duties have effects similar to other forms of border protection. With the recession there has been a significant increase in dumping complaints[12]. Moreover, changes to the procedures have made it easier for local producers to use the dumping laws in conflict with the program of tariff reductions implemented in 1991, though the ADA has tended at least to improve the transparency of the system.

The likelihood is that as tariffs continue to fall, the number dumping complaints will increase as firms seek to preserve or increase present margins of assistance.

(ii) Assistance for Exports

Australia has taken the high moral ground in criticising other countries for subsidising their exports. Currently assistance to Australian exporters is running at about $1 billion per year, though not all of this is for manufacturing. In 1991-92, direct export subsidies for manufacturing totalled almost $50 million; export marketing, trade promotion and development grants were more than $270 million; and export finance assistance more than $380 million (IC, 1992, Table I1)[13]. In its 1992 One Nation statement the Government expanded some existing programs (eg, the Export Finance Corporation's insurance guarantee and lending operations), and introduced a number of new measures (eg, the Export Access Program was introduced to help small and medium-sized businesses develop the resources and expertise necessary develop and sustain export markets). In so doing it

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signalled that it was committed to continuing export assistance for Australian industry until at least the late 1990s.

(iii) Research and Development

Including funding for University research, Commonwealth support for research is currently about $2.6 billion per year. Of this, special purpose and directed grants attributable to manufacturing totalled nearly $50 million in 1991-92, while revenue foregone as a result of the 150 per cent tax concession for research and development expenditure amounted to $250 million. (IC, 1992, Table I2).

New programs announced in the One Nation statement include the formation of the following:

(a) ***Australian Technology Group*** – a company with a one-off capital of $30 million, formed for the purpose of identifying research with commercial potential, and protecting and marketing Australian research locally and overseas.

(b) ***Cooperative Research Centres Program*** – to provide grants to establish research centres undertaking research into resource, manufacturing, information, environmental and biomedical sectors. It is planned that by 1994-95, the program will fund up to 50 centres, and cost about $100 million each year.

(c) ***Advanced Manufacturing Technology Development Program*** – which supports the development and introduction of innovative manufacturing technology products. It has a budget of $20 million over 7 years.

In these and other measures, the Government has indicated a commitment to assisting research and development both directly and indirectly in the medium to long term.

(iv) Industry Specific Arrangements

There is a wide range of industry-specific assistance arrangements currently operating[14]. This paper will examine some recent revisions the major manufacturing industry plans directed at the highly assisted TCF and automotive industries.

(a) Textiles, Clothing and Footwear

The present plan was announced in 1986, and reductions in border assistance began in 1989. Tariff quotas were to be abolished, tariffs lowered and

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adjustment assistance (up to $120 million) provided for firms and employees. In the Government's March, 1991 Economic Statement, the plan was modified to bring forward the removal of tariff quotas to March, 1993, and a schedule was introduced to phase down tariffs from a maximum of 55 per cent to 25 per cent by 2000. The administration of the plan is vested in the Textiles, Clothing and Footwear Development Authority which was established in March, 1992.

While the Government has broadly held to its commitment under the plan, the TCF Statement of July 1992 (Button, 1992), however provided significant additional support to cushion the effects of the recession. Among the measures was more liberalised access to the Imports Credits Scheme, which was introduced in 1991. The scheme is similar to the export facilitation arrangements for the passenger motor vehicle industry (see below), and provides exporting manufacturers a credit on import tariffs equivalent to 30 per cent of the value-added in their exports. This rate will be maintained until 1996, phasing down to 15 per cent on 1 July 2000. Those who do not wish to use their credits to import TCF goods may sell them, and a market has developed in the trading of import credits among firms.

(b) Automotive

Following an Industry Commission inquiry in 1991, the Government announced its post-1992 assistance arrangements for the passenger motor vehicle (PMV) industry which will continue until 2000. The main features are:

Tariffs for passenger motor vehicles and parts

Nominal tariffs will fall by 2.5 per cent each year from the current 32.5 per cent to 15 per cent by 2000. Tariffs on components will remain at 15 per cent over the period, resulting in a reduction of the ERP from about 90 per cent now, to about 30 per cent in 2000.

Automatic duty-free entitlement

PMV producers are able to import free of duty vehicles (the plan producers are major importers of complete vehicles) or components to a value of 15 per cent of the total value of their production, provided they satisfy certain minimum requirements regarding production volumes.[15] This is to discourage low volume production, and replaces the directive measures specifying industry structures which operated under the earlier 'Button Plan' for the industry. In 1991, the entitlements totalled about $700 million (IC, 1992, p. 219).

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Export facilitation
Unlimited additional duty-free imports are allowable against export credits earned by plan producers, component producers and importers, for undertaking or arranging exports. These credits (in 1991 they totalled nearly $610 million) provide an implicit subsidy, in that it will pay a firm to subsidise exports, as long as the subsidy paid is less than the duty it saves. The available subsidy will however decline as tariffs fall.

(v) The Focus of Future Assistance

Australia's long history of assisting manufacturing appears set to continue, though overt protectionism is declining, and the form of assistance is changing. In substance, the Commonwealth tariff which has existed since Federation in 1901, appears unlikely to last much beyond its centenary. As tariffs decline over the remainder of the 1990s, at least partially replacing them will be far less transparent means of assistance, a few of which have been described.

Some of the 'new' measures of Government assistance may be supported on the grounds of market failure. Government support for high-technology industries is one such case. For example, free markets will tend to allocate too few resources to R & D. Individual firms are often unable to fully appropriate the rewards from their research, and thus they will tend sit back waiting for others to do it for them. This is an example of the free-rider problem, and intervention may be justified to correct this market failure. Nevertheless, there is still the appropriability problem at the country (as opposed to the firm) level – the benefits of knowledge created (and subsidised) in one country may accrue to those in other countries. The smaller the subsidising country, the more severe this problem is likely to be. Quite aside from this, however, there is a fundamental difficulty in determining the magnitude any external benefit, and thus the appropriate level of any government support.

A second, more recent argument for assistance based on market failure, centres on the absence perfect competition. Thus, in industries characterised by only a few firms, profits may be earned by firms in excess of profits for equally risky investments elsewhere. These excess profits will be the subject of international competition, and their capture is the objective of 'strategic trade policy' (Brander and Spencer, 1985). Here, a subsidy to domestic firms (for example) may be used to shift the excess profits to them from foreign firms. The subsidy will deter investment and production by foreign firms, and may raise the profits of domestic firms by more than the subsidy paid. The capture of profits that would otherwise go to foreign firms, raises national income at the expense of other countries (and invites their retaliation). There are fundamental problems with the argument. The information required to successfully put the policy into operation is unlikely to be available[16] – even when the industry is considered in isolation. In fact, industries compete with others for resources so that detailed knowledge is needed of the inter-industry effects of implementing the policy. It must be recognised that creating a strategic trade advantage for (and thus drawing resources to) one industry, may create a strategic trade disadvantage for others.

The long-standing focus on protection against imports, now discredited, is shifting to assistance for exports – essentially an equivalent measure. However, to the extent that Australia's trade affects world supply and demand, an export subsidy will lead to a deterioration in the terms of trade (unlike a tariff)[17]. Export subsidies lead to a potential twofold loss to the exporting country: from the distorting effects of the policy on production and consumption; and from the deterioration in the terms of trade.

Nevertheless, the 'new' export assistance, is being applied to even the very highly protected import-competing activities, textiles, clothing and footwear and motor vehicle manufacture. In one form or another, these industries will remain relatively highly protected at least until the turn of the century, and likely beyond it.

One aspect of export assistance is easier to defend. There is an important role for such organisations as AUSTRADE in providing easily accessible information to firms regarding potential export markets (though AUSTRADE's efficiency in so doing is the subject of debate). For firms each to go over the same ground obtaining the same information is clearly expensive and inefficient. It will tend to deter potentially successful exporters from looking abroad.

Where then does this now leave us? The 'old' import protectionism with the tariff as its centre-piece has been a long time dying. The 'new' protectionism appears set to become at least a partial replacement. While some of these measures are direct charges on the Federal budget and as such, likely to be the subject of regular scrutiny (though once given, money is difficult to take away), others are far less transparent than the measures they replace. It remains to be seen if the new protection is as long-lived as the old.

Notes

1. The discussion of this section draws on Conlon (1986, pp. 10-16). Important references regarding the early history of protectionism in Australia include Allin (1907) and Reitsma (1960).

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2. It should be stressed that the tariff is only one of many methods of industry assistance/barriers to trade. They include:
   i) (tariff) quotas
   ii) standards (eg, Australian Design Rules for motor vehicles)
   iii) quarantine regulations
   iv) direct subsidies paid to firms (eg, paid to Kodak)
   v) targeted industry assistance (eg, industry 'plans' such as the Textile Clothing and Footwear Plan).

   The estimates of effective rates of protection discussed in this paper are those of the Industry Commission. They include the effects of at least some of these nontariff barriers. For those not familiar with the term, the ERP seeks to measure the net effect of the protective structure on the value-added of an activity. It nets out against the stimulatory effect of protection for the final product, the adverse effect (usually called the tax effect) of tariffs and other forms of protection on inputs. An effective rate of 100 per cent, for example, means that the net effect of the protective structure is to increase the value-added of an activity by 100 per cent over what it would have been in the absence of protection.
3. The discontinuity in the data is a result of a revision by the IAC of the weights used in computing the average.
4. For some activities in these industries, protection increased, mainly as a result of the introduction of quantitative restrictions (eg, for passenger motor vehicles).
5. These are (2–digit) industries defined by the Australian Standard Industry Classification (ASIC).
6. It should not be thought that manufacturing is alone in having particular activities characterised by high ERPs. For example, in agriculture, Milk (73 per cent ERP) and Dried Fruit (70 per cent) had about the same level of assistance as Textiles in 1990.
7. The subsidy that would have to be paid to provide the same net level of assistance to the industry as the current assistance arrangements (eg, tariffs).
8. The employment data by ASIC industry is latest available at the time of writing.
9. In 1990-91 the average wage was $21,000 per person (ABS, 1993, Table 5).
10. Over the 3 years, the ERP for TCF changed little (for many activities there was a slight increase), while for Transport Equipment it fell from 46 to 35 per cent.(The ERP for Motor Vehicles and Parts fell from 88 to 65 per cent. (IC (1990, Table A11).
11. Gruen, F.H., *Review of the Customs Tariff Anti-Dumping Act, 1975*, Department of Industry, Technology and Commerce.
12. In 1987-88 there were 29 formal complaints, in 1991-92, 88 complaints, mostly by firms in the Chemicals and Petroleum Products industry (IC, 1992, Table J1).
13. The last two figures exclude assistance which is obviously not directed at manufacturing.
14. They include those assisting dairy and wool, waterfront and shipping, road transport, pharmaceuticals, and in the past, steel.
15. The full 15 per cent for models produced at volumes exceeding 30,000 units p.a., down to zero for volumes at, or below 20,000 p.a.
16. Strategic trade policy may analysed in terms of game theory in which the outcomes (the payoffs) of alternative policies are known.
17. Tariffs and subsidies both drive wedges between the prices at which goods are traded within a country and the prices at which they are traded internationally.

The prices that producers and consumers base their decisions in the country imposing the tariff therefore differ from prices observed in the world market.
The 'terms of trade' refers to international prices and is the ratio at which a country may exchange a unit of its exports for units of its imports. It is then the **relative price** of exports to imports. To illustrate, consider two commodities produced in Australia: an importable (say, cloth) and an exportable (food). A tariff imposed on Australian cloth imports will increase the (relative) **internal** price of cloth (if the price of imported cloth increases as a result of the tariff, local producers of cloth will tend to increase their prices too), and correspondingly lower the (relative) internal price of food. Consequently, Australian producers will tend to produce more cloth (the importable) and less food (the exportable). Australian consumers will, at the same time, tend to change their consumption in the opposite direction. They will shift consumption from (now relatively more expensive) cloth to cheaper food.
In terms of the total world supply and demand for the two commodities, the effects of the Australian tariff on cloth imports therefore are to lower the the relative world supply of food and to increase its relative demand. Together these influences will increase the world relative price of Australia's exportable (food) and correspondingly lower the relative price of its importable (cloth): the terms of trade have moved in Australia's favour as a result of its imposing the tariff on imports of cloth.

The imposition of an export subsidy may analysed in the same way. In this case the subsidy paid for food exports raises the relative internal price of food. (Local food producers will tend to sell to Australian consumers only if the price they get from domestic sales is the same as the (higher) 'price' they get for exports (which includes the the subsidy payment.) More food will be produced and less demanded. The relative price of food (Australia's exportable) will tend to fall; the relative price of cloth (Australia's importable) will tend to increase: the export subsidy has resulted in a deterioration in Australia's terms of trade.
The magnitudes of any terms of trade effects depend on the relative size of the country imposing the measure. A small country will have comparatively little effect on world supply and demand and consequently will have little effect on world prices.

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