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# Auto industry in its death throes

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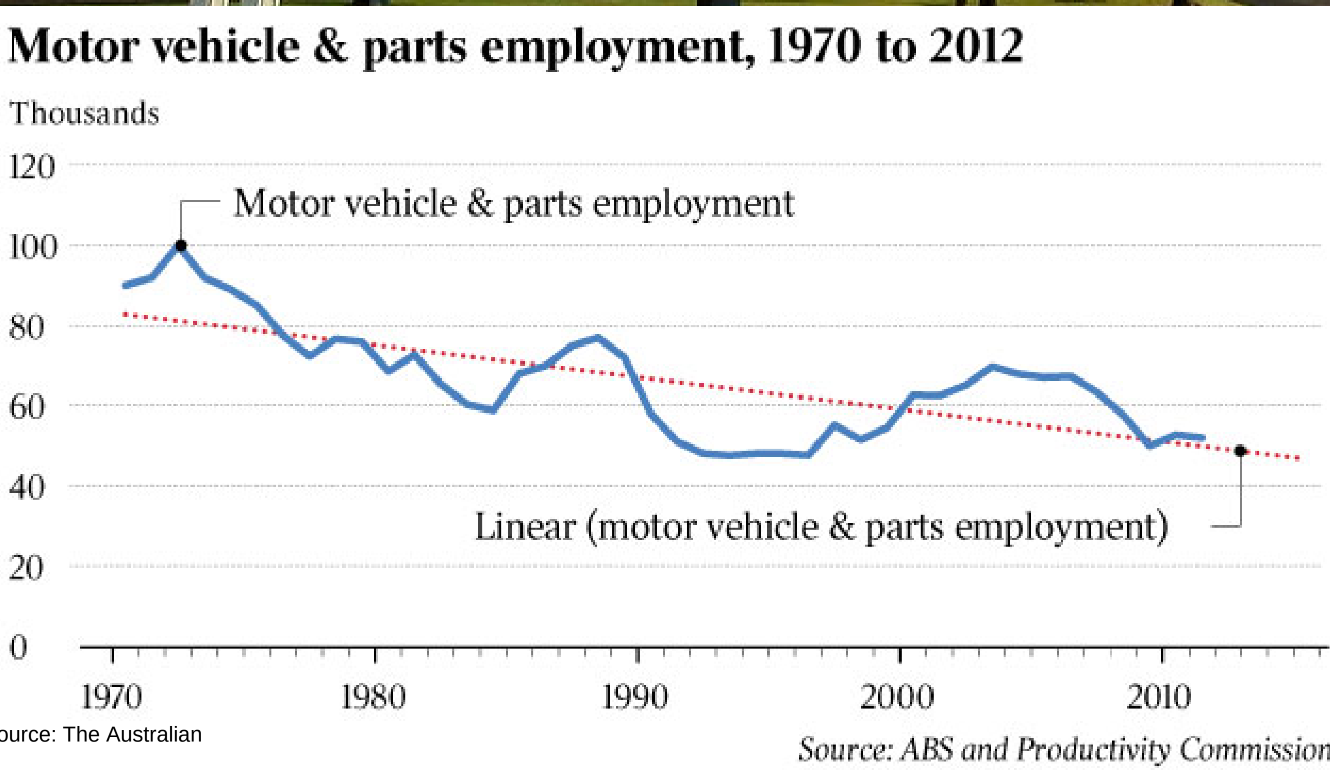
Ford's head office at Broadmeadows. Victorian government subsidies have kept flowing while production has shrunk. Source: Getty Images




Source: The Australian

**FORD'S workers are angry. And rightly so. Only weeks ago, both the Prime Minister and the Leader of the Opposition reaffirmed their passionate commitment to Australia's car industry. Now, with Ford announcing it will shut down carmaking in Australia in October 2016, their jobs will disappear.**

Ford's workers have been duped. And the deception has been going on for decades, as politician after politician has said what long ago they stopped believing: that assembling cars in Australia has a future. Backed by generous assistance, the result has been to attract into the industry workers who would otherwise have gone into activities that could stand on their own feet.

Yet Australia's car industry was born out of a fallacy: the belief that a small, resource-oriented economy was merely a large, manufacturing-based economy waiting to grow up. From the 1920s on, but then with renewed vigour after the end of World War II, the myth of national development underpinned the conviction that as our economy expanded, an ever broader range of industries would achieve scale economies, prosper serving the domestic market and provide well-paid employment to a rising population.

Protection all around was therefore portrayed as merely transient, allowing the baby elephant that was Australia - with its body parts in awkward miniature - to blossom into a strapping adult, capable of supporting the same full kit as its British parent. Sure, while that happened, some industries would require much more help than others; but that was just a bump on the road.

This was a delusion to end all delusions. It ignored the gains from international specialisation and the costs protecting inefficient industries imposed on globally competitive export sectors. It taxed consumers both directly, as tariffs and quotas forced prices to levels that would make Australian production profitable, and indirectly, by reducing national income. And with the emergence of Japan and then of the other Asian exporters redefining manufacturing best practice, the harm it inflicted escalated as its benefits shrank.

But it was by no means readily shaken off. Rather, as the difficulties became apparent in the 1970s, protection to the motor vehicle industry nearly quadrupled, with the effective rate of assistance (a measure of the protective effect of a tariff) going from 37 per cent in 1973-74 to a peak of 140 per cent in 1984-85. By that year, in other words, each $1 of value added in the industry was costing the economy $1.40. And even with that, the auto firms were struggling to make ends meet.

Starting in 1985, the Button car plan, with its rationalisation of domestic production, brought a reduction in tariffs. The effective rate of assistance fell far more rapidly than the nominal tariff itself, declining by nearly two thirds in the five years to 1989-90, but the impacts were cushioned by the exchange rate (which itself fell steeply in the mid-80s, making Australian cars more competitive) and by generous commonwealth subsidies.

Like the high tariff they replaced, those subsidies were intended to be temporary. But in the long history of industry assistance, nothing lasts like a passing phase. As production has shrunk from nearly 500,000 vehicles in 1970 to barely 200,000 this year, and employment with it, the subsidies therefore have kept on flowing.

According to the Productivity Commission, the car industry has received some $19 billion in assistance during the past decade - an amount equivalent to nearly $30,000 for each of its 50,000 workers each and every year. But even that is an underestimate, as it excludes the effects of a host of protectionist measures, including preferential government procurement, restrictions on importing second-hand cars, and unique Australian technical standards. And while overall assistance was decreasing, albeit too slowly and unevenly, under John Howard, both the Rudd and Gillard governments have scaled it up as the industry's crisis has deepened.

That crisis is partly the flip side of the resource boom. Mining's expansion has increased the opportunity cost of using skilled labour and other inputs in manufacturing, increasing wages and other costs and squeezing margins. At the same time, the high exchange rate has made imported vehicles more competitive, all the more so as excess capacity in the global car industry forced prices down.

Together with cost increases from the Fair Work Act and from the carbon tax, those factors have translated into mounting red ink, with accumulated losses on local production of $3.5bn since 2003. But the severity of the problems also reflects more enduring forces.

Worldwide, the car industry is undergoing a fundamental transformation. Consumer demand has fragmented: the standard sedan, once the status symbol of the middle class, is in sharp decline, while the rule of thumb that related a car's price to the length of its wheel base has broken down. There is now a demand for small luxury cars, as there is for cars that are large but priced to entry levels.

Faced with those trends, successful producers have greatly increased their product range: there are now some 5000 models on sale worldwide, an increase of more than 1000 in a decade. And with the high dollar allowing Australian consumers access to the best the world has to offer, more exacting standards have become the norm, making the Australian industry's conventional products seem uninspiring if not positively bland: a trend reflected in resale values, which now decline twice as rapidly for Commodores and Falcons as for imported cars such as the Mazda 3.

To make matters worse, market fragmentation has not reduced the economies of scale, which continue to dictate annual production runs in the order of 250,000. Volkswagen can achieve those runs by assembling up to 25 different variants off a single platform; the local assemblers have no prospect whatsoever of matching that performance.

And with the centre of gravity of world production shifting to rapidly growing markets in China and emerging Asia, the global market seems set for a further steep fall in unit costs, pushing what remains of Australian production deeper into the red.

Yet $10bn of additional assistance, in the form of tariffs, tax concessions and handouts, is set to pour into the industry over the balance of this decade.

Even if employment stabilised at 30,000 that would translate into a $50,000 subsidy per job per year to no useful end. Whether the industry survives long enough to secure that funding remains to be seen.

Bob Hawke once quipped about a proposed policy that it was "as wise as peeing into a bushfire: unlikely to solve the problem, all too likely to damage the instrument".

As both the government and opposition gear up to throw good money after bad, one might have hoped they would draw some lessons from the experience to date. And there is certainly no shortage of lessons to learn, with three standing out.

The first might be called the "rotten-apple theorem". Losers are much better at picking governments than governments are at picking winners. And as the $1bn Ford has received in the past six years attests, the firms with the greatest bargaining power are those closest to going under because they have the most credible threat of inflicting job losses and political pain.

Moreover, the larger and more unionised they are, the stronger that makes them. The result, time after time, is the assisted survival of the unfittest, preventing the transfer of resources to what otherwise might have been flourishing rivals.

A second and related lesson is that breaking up is hard to do: when things go pear-shaped, governments find it far more difficult to cut losses than firms find it to incur them. And adding to the harm, firms are especially keen to shift costs on to the community when times are tough, while governments find it hardest to terminate bad projects in periods of economic difficulty. The outcome is that the tougher the economy, and the harsher the competitive environment, the greater the burdens shifted on to future taxpayers.

Finally, no bad deed goes unpunished - but it's the innocent who suffer. When government subsidises one group of import-competing firms, that reduces imports of the goods they produce and so the exchange rate rises, harming the other trade-exposed firms that are not equally favoured. The community therefore gets three distortions for the price of one: resources are misallocated between activities; having given in to one group of firms, the pressures to give in to others become ever stronger; and, last but not least, taxes must be raised (or more worthwhile spending cut) so as to pay for the subsidies.

But important as they are, those lessons will hardly prevent more firms and industries from clamouring to join the assisted survival club. After all, even firms that are hopeless at attracting consumers, and unions that could scarcely secure members if they had to do so without government's help, can prove formidable in that most vital market of all: the market for excuses.

No surprise, then, that Ford, far from being shamefaced about the public funds it has received, boasts of a claimed "multiplier" that merely reflects the sheer mass of other resources the industry has consumed, compounding the waste. No mention, of course, of the fact that had those resources been used elsewhere in the economy, they might have yielded products consumers valued at more than their cost.

Nor do the unions show any sign of remorse, despite having consumed somewhere between one-third and one-half of the subsidies from taxpayers in wage rises far outpacing those in other industries. True, jobs will now go; but publicly subsidised retrenchment packages will reflect the higher wages the unions extracted.

And no contrition at all from the government, which continues to claim, contrary to all the evidence, that the car industry, now dwindling into insignificance, is crucial to our future competitiveness.

Yet it is the sheer hypocrisy that is most telling. There isn't a politician in Canberra who believes Australians will be assembling cars in a decade. But neither is there one who is willing to say so, even in guarded form. They all know this industry will die; they just want the final moments to occur on someone else's watch.

Every day, around this country, general practitioners, specialists and nurses break the bad news to a patient and their family: sorry, it's not going to work out and you need to plan on that. That is agonising for them, as it is devastating for those affected. But they do it because it is the right thing to do.

It is surely reasonable to expect our leaders to show no less courage: to at least tell the varnished truth, so those who will be affected can plan, rather than persist with an unvarnished lie. Until they do, they will have no right to complain about the rent-seekers who besiege them; and the workers at Ford will have every right to their anger.