

## THE AUSTRALIAN

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# After running on empty for years, car industry stalls

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GM Holden boos Mike Devereux on Wednesday. Source: News Limited

**IT has been the longest goodbye. After all, it was 65 years ago that Ben Chifley launched the FJ Holden; only a few months before, his government had nationalised Qantas. That those twin symbols of the Chifley Labor government's post-war order are now crumbling is hardly surprising. But no matter how obsolete that order seems, its legacy remains at the heart of the political divide.**

Central to that order was the goal of "Fortress Australia". Just as restrictive immigration would keep out the Asiatic hordes, so tariff protection would promote manufacturing self-reliance, while the industrial relations system guaranteed "a wage fit for Australians". And having a flag airline of our own would cement Australia's place in an emerging world aviation system that the Chicago Conference of 1944 had ensured would be based on bilateral agreements between nation-states.

That Fortress Australia would be costly should have been obvious from the outset. When the first FJ Holden rolled off the assembly line in 1948, manufacturing productivity in Australia was barely 70 per cent that in Britain; our productivity in agriculture, on the other hand, was 300 per cent higher. Producing each additional car therefore imposed an opportunity cost on the Australian economy nearly five times that in Britain.

Nor had the relativities much improved by the time the millionth Holden passed down the Dandenong production line on October 25, 1962. By then, manufacturing accounted for nearly 30 per cent of gross domestic product and of employment; and the unions had reached the zenith of their influence, enrolling

more than 60 per cent of the labour force.

But keeping the system going required cripplingly high protection. The average duty on manufactured imports fell from about 40 per cent in 1946-47 to just more than 20 per cent in the early 1960s; but the tariff on motor vehicles remained at between 40 per cent and 50 per cent, increasing the distortion in favour of the car industry. Americans could buy a new car with 25 weeks' average earnings; given our barriers to trade, Australians needed twice that.

The first chink in the protectionist armour came with the Whitlam government's 25 per cent across-the-board tariff reduction in 1973. Intended to curb inflation, Gough Whitlam's move provoked a fierce reaction, with Holden immediately announcing 5000 sackings. Bob Hawke led a furious campaign against the cut, with claims it would send Australia's economy "back to the stone age".

As the government caved in, the outcome was an 85 per cent local content requirement that, along with other measures, doubled and then trebled protection for the car industry, in exchange for a pledge from Holden that every retrenched worker would be re-hired.

That set the pattern for the next 40 years: all reductions in tariffs on cars would be accompanied by new subsidies and non-tariff barriers to trade; and, whenever these seemed insufficient, the firms would threaten to leave and the unions would threaten the government.

But even so, the writing was on the wall. By the mid-70s, the Japanese producers had burst on to the world stage, with high-quality models they could transport cheaply thanks to the development of "roll on, roll off" ocean liners; not even the inefficiency of the Australian wharfs could completely offset their landed cost advantage. Combined with the onset of stagflation, the result was to plunge the domestic industry into crisis.

Thus began the death of one thousand cuts. Holden closed Pagewood (NSW) and Acacia Ridge (Queensland), while Chrysler sold its Tonsley Park plant in South Australia to Mitsubishi in 1980. Chrysler's departure was eventually followed by Nissan, which left in 1992, while Ford closed Homebush in 1994. The cuts went on and on; yet at each painful step, more assistance poured into the industry.

As of the late 80s, taxpayers funded the development of new Falcon and Commodore models, along with a bewildering array of export credits, investment grants, research and development subsidies and adjustment assistance for workers affected by the industry's woes. Adding in the tariff and non-tariff protection consumers paid for, it would have been cheaper to give just over \$1 million to every worker in the industry in 1985, in exchange for immediately closing the industry down; instead, policy prolonged the death throes for as long as it possibly could.

That is not to deny that effective rates of assistance to the industry were progressively reduced: from a peak of 140 per cent in 1984-85, the Button plan began a process that brought them to 20 per cent by 1996-97 and then to about 10 per cent in the 2000s.

However much the community had been forced to pay, at least change was crawling in the right direction.

And after the traumas of the mid-80s, all governments accepted that the shape of the Australian economy had to be determined by global market forces.

But the election of the Rudd government in 2007 marked an abrupt reverse march. An indication came

soon after the election, with the decision to task a hand-picked panel, chaired by Steve Bracks, to review the industry's future, bypassing the Productivity Commission (which until then had been responsible for all reviews of industry assistance). Even more striking, however, was Kevin Rudd's decision to grant greater subsidies than the panel itself recommended, with industry minister Kim Carr boasting that thanks to those subsidies, "there is every reason to be optimistic about the nation's automotive industry".

Yet at the same time the government was undermining the industry's viability through the Fair Work Act and the carbon tax. And the dramatic appreciation of the exchange rate exposed the industry to the full force of international competition.

Faced with those conflicting forces, Labor wanted to have its cake and eat it too: to bask in the consumer gains from lower import prices, which accounted for up to one-third of the large real income gains the mining boom brought, while still preserving an economy moulded along 40s lines.

The result was a proliferation of subsidies the Labor government refused to fully disclose, much less properly cost. As recently as March this year, Julia Gillard triumphantly announced a \$275m "strategic co-investment" package with Holden, in exchange for which she had "won this guarantee: Holden will be in Australia producing cars for at least the next 10 years".

Gillard's claims were delusional, but her statement that there was a strong case for an "ongoing program" of industry assistance showed how far Labor had retreated from accepting the inescapable realities of structural change. Instead, Labor seemed to have convinced itself the age of Chifley could be resurrected and garbed in new, taxpayer-funded, clothes.

Little wonder the Parliamentary Budget Office estimates transfers to industry grew 70 per cent more rapidly than commonwealth spending overall in the decade to 2012-13. And little wonder Labor's rhetoric has now descended into nonsense.

The "multiplier" assertions are an extreme case in point. Advanced by GM Holden chief executive Mike Devereux, and echoed by the unions and by Labor's most senior figures, these claim that each dollar of assistance provided to the industry somehow causes \$18 of additional economic activity.

Even the mechanics of Devereux's calculation are incorrect. But what is truly remarkable is the ability of the proponents of these claims to ignore the fact that applying exactly the same logic to mining would show a "multiplier" 150 times greater than that for the car industry. As a result, the implication of their analysis is that if the average year's automotive assistance had instead been spent on mining, we would be \$130 billion better off - an amount equal to 9 per cent of GDP.

It is difficult to imagine the Labor reformers of the 80s falling for such a crude parody of economics. But exactly the same fudge and mudge is beginning to make its appearance in the context of Qantas, with vague references to national defence thrown in. To draw that link is not to suggest Qantas's predicament is anywhere near as desperate as that facing the car industry. With its 65 per cent share of domestic air travel, and 84 per cent of travel by corporates, Qantas's market position is extremely strong. But it remains a high-cost carrier and its domestic earnings are insufficient to offset the very low yields it secures on its 30 per cent of the international inbound and outbound market. Qantas's earnings are therefore well below its cost of capital and seem set to fall further as competition intensifies.

Underlying those competitive pressures is the changing shape of international aviation. The post-war regime governing the industry was based on each country having its own flag carrier and restricting access to landing rights so as to guarantee that carrier a high share of the market (at consumers' expense).

That regime is now disappearing internationally; for Qantas, it is effectively long gone.

Instead, the world is moving towards "mega carriers" controlling dense flows of traffic at strategic hubs. And nowhere is that happening faster than on the longest routes, such as those between Australia and Europe, which require an intermediate stop. Eventually, only the carriers with a commanding position at those stops will secure the economies of scale needed to compete; and only they will have access to the capital that running a global airline demands.

Up to now, that process of integration has mainly involved strategic alliances and marketing hook-ups; but it is entering a new phase of direct investments, mergers and acquisitions. Excluded from that process by restrictions on foreign ownership, Qantas faces ever higher financing costs and, ultimately, the risk of withering away.

Yet here, too, Labor refuses to face global realities. Ignoring fiscal constraints, it would rather finance Qantas's de facto renationalisation, with all the leeway that would give the unions to destroy the airline's efficiency, than accept the end of the Chifley-era flag carrier.

Unfortunately, Labor's reversion into economic isolationism will make it more difficult for the Abbott government to steer a rational course. And the Nationals' lingering sympathy for interventionist solutions can only compound the difficulties. Across the political divide, the escape from reform may therefore find many allies.

Yet looking to the future, there is a stark difference between the two sides of politics. It is strikingly apparent in the make-up of their younger parliamentary cohorts: the Coalition's are almost entirely committed globalists, focused on allowing markets to underpin future prosperity in an open economy; Labor's are almost entirely union apparatchiks, dependent on what is all too often the most retrograde force in Australian society.

That battle between these will undoubtedly take time to play itself out. Nor will it flow along a smooth course, without twists and turns. But one thing is certain: 65 years on, there is no going back to the world of the FJ Holden. To think otherwise, as Labor's present leadership seems to, is to condemn the country to inevitable failure: and with plenty of unnecessary grief along the way.

Magic Multipliers	Assistance (\$m), 2003-2013	So-called "Economic Contribution" (\$m), 2003-2013	So-called "Economic Multiplier"
Devereuxnomics - Holden	1,800	32,800	18.2
Productivity Commission method - Holden	3,000	4,600	1.5
Devereuxnomics - Mining	7,000	3,050,000	435.7
Productivity Commission method - Mining	4,928	1,144,811	232.3

Notes: 'Industry Assistance' sums budgetary assistance (including direct subsidies and tax concessions), and tariff assistance. An industry's 'Economic Contribution' sums the returns to capital (profits) and labour (wages) plus taxes less subsidies. The two main flaws in the Devereuxnomics method are that (i) it does not include tariff assistance, and (ii) includes intermediate inputs, which grossly overstates Holden's economic contribution because these inputs have alternative uses in the Australian economy.