THE AUSTRALIAN

Stakes too high for lost causes

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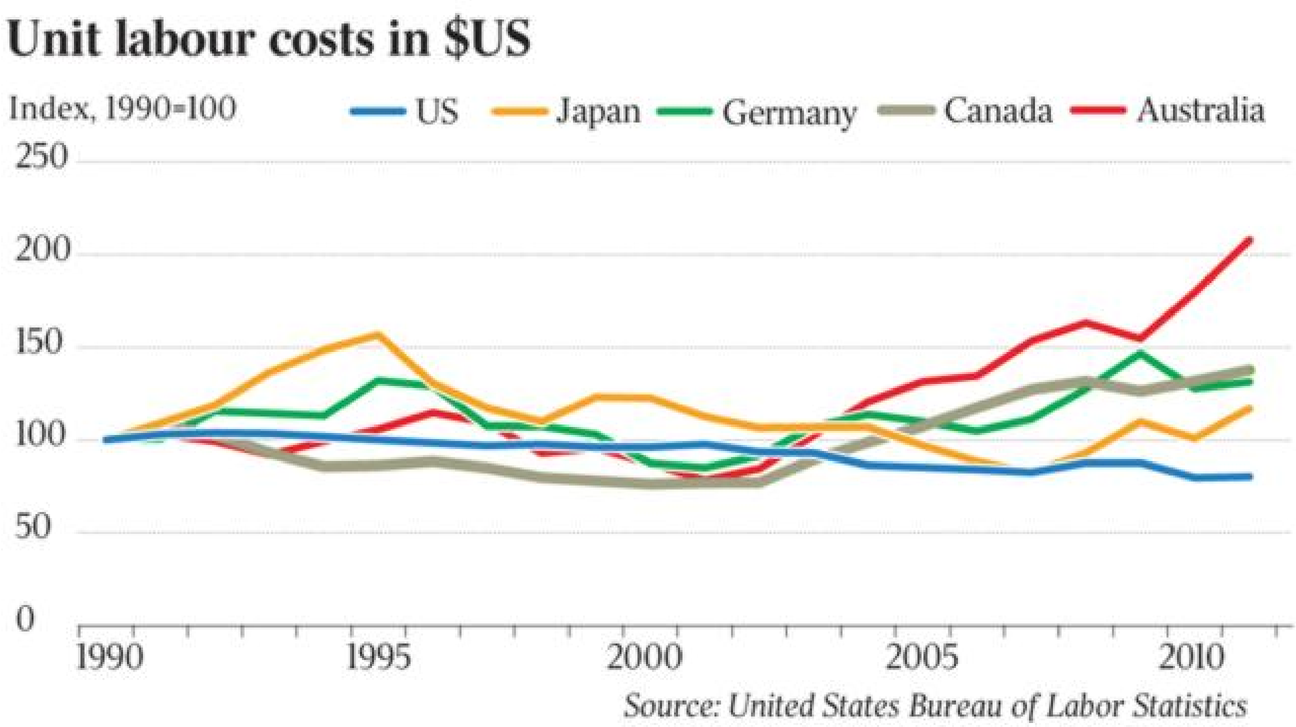

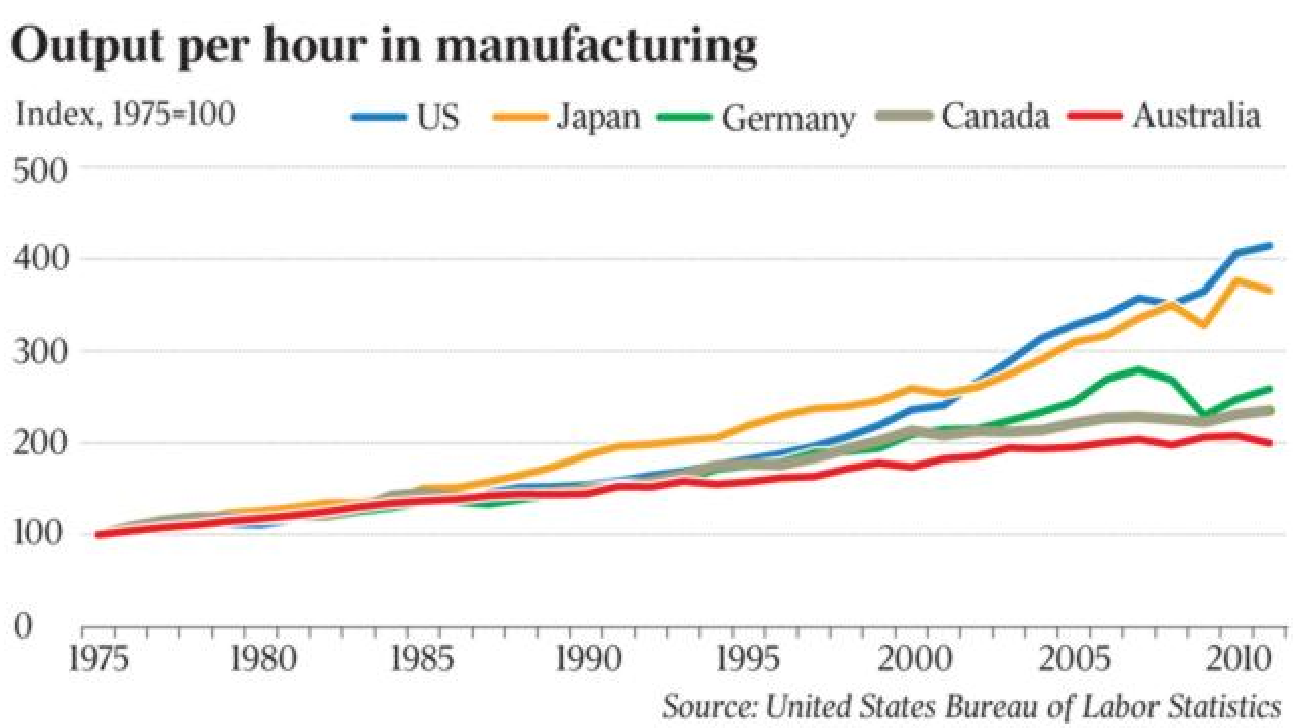

AND then there were none. Late in May last year, Ford announced it would cease its vehicle assembly and engine production in Australia in October 2016; just before Christmas, General

Motors Holden followed, with its closure due to occur by the end of 2017; and last week was Toyota's turn, with its manufacturing operations also set to close by the end of 2017.

However, the pain won't end there, as the parts producers, who account for around three-quarters of the industry's employment, struggle to adjust. And with overall unemployment rising, the pressure on governments to "do something" will only increase.

But if there is a lesson to be drawn from the industry's prolonged agony, it is that governments are far better at postponing the inevitable than at changing economic realities. Yet government after government offered false hope to the industry's workers, while throwing taxpayers' dollars at ventures that could never pay their way. And the risk now is that rather than learning from that failure, we will see the mistakes repeated, not merely in manufacturing but in areas stretching from aviation to drought relief.

That the car industry's manufacturing operations are unviable is scarcely news. Along with high input costs, the small scale and fragmentation of the local market meant those operations could survive only if they were heavily protected; once the tariff walls came down, and assistance was provided as subsidies with a visible and growing budgetary cost, the writing was on the wall.

But that the industry's end was a death foretold does not mean nothing was done to bring it about. On the contrary, the rising likelihood of demise seemed to trigger a process of self-destruction similar to the kind that evolutionary biologists have analysed in plants.

In that process, a parasite that is symbiotic to a plant's growth while the plant is healthy unleashes a feeding frenzy once it goes into decline. The gains from co-operation having been exhausted, the parasite turns on its host, extracting as much as it can before the host's collapse, thus making that collapse all the quicker and more certain.

That the mechanics of the industry's end are more complex than that analogy implies is obvious. Yet it is also clear that as the industry entered its last act, its costs spiralled out of control. International comparisons of competitiveness are fraught; but the US government's Bureau of Labour Statistics finds Australian car producers' overall compensation costs (expressed in US dollars) increased far more rapidly than those in other high-income countries. Simply blaming that on the appreciation of the Australian dollar would be facile. Obviously, a rising exchange rate meant even unchanged Australian labour costs would translate into a greater amount at world prices; but what made Australia distinctive was that the pressure that created on the industry led to so little offsetting response.

After all, Australia is hardly alone in having experienced rapid currency appreciation: since the collapse of Bretton Woods in the early 1970s, large gains in the value of the currency have occurred at least once for every significant car-producing country. Moreover, Germany, Japan and South Korea have each gone through sustained exchange rate appreciations, challenging their firms' ability to compete domestically and internationally.

Faced with that challenge, firms in those countries secured far-reaching wage moderation and greatly increased efficiency.

Take Japan: in 1970, its unit costs of producing cars were 30 per cent below those in the US, thanks largely to lower wages. But that advantage disappeared as the yen's effective exchange rate nearly doubled. So the Japanese producers reacted by putting a lid on wage growth and raising product quality, while increasing productivity nearly three times as rapidly as their American competitors.

The result was that by 1984 the Japanese producers’ cost advantage was even greater than it had been before the yen soared.

Much the same can be said about Germany, not only immediately after the end of Bretton Woods but also more recently. From 1999 to 2010, a period that saw a substantial rise in the euro, German unit labour costs, expressed in US dollars, increased far less than those of the other European countries, thanks to greater wage moderation and more rapid technical advance.

But there were few signs of such adjustments here. Rather, while estimates are not available for the car industry alone, multi-factor productivity (which measures output per unit of input) in Australian manufacturing was actually lower in 2011-12 than a decade earlier.

Yet wages growth in manufacturing accelerated (even exceeding the growth rate of wages in mining), dramatically worsening the effect of the rising dollar.

Whether the assistance the industry received encouraged that process or merely accommodated it will always be controversial. What is certain, however, is that public largesse allowed it to go on for much longer than it otherwise could have.

Over a period of years, the industry was therefore able to attract the employees whose futures are now threatened.

True, most will eventually find jobs in other activities. Yet studies of the closure of Mitsubishi’s operations find that well more than half of those retrenched suffered a decrease in income, an outcome entirely consistent with similar studies overseas. That finding is telling, not least because it contradicts the claim that the industry’s high wages merely reflect its workers’ ability to secure well-paid employment elsewhere.

Far from developing skills that are especially valued in the economy as a whole, and hence deserving of public support, much of the industry’s employment is relatively low-skilled, and while skills are acquired on the job they are rarely highly portable.

But as well as being telling, those significant income losses are also worrying, for the danger of hardship now extends from the assembly sector to the much greater numbers employed producing parts.

No doubt, some parts producers will survive. However, the production of auto parts is very closely tied to the designs and specific requirements of individual assemblers; and it is difficult for component suppliers to operate without tight, ongoing links to the firms that put vehicles together and take overall responsibility for their quality.

As a result, while 75 per cent of the value added in a vehicle comes from components the assemblers purchase, the component suppliers are far weaker than those in say, computers, where design and branding are only partly under the assemblers’ control: “Intel inside” means something to buyers of PCs, but “Delphi inside” would never sell a car.

Once the assemblers shut down, the local component firms will therefore be stranded, and only a handful can remain viable through export sales or by diversifying their product range. The job losses announced so far are consequently likely to multiply.

Unfortunately, there is little reason to believe adjustment packages, such as those implemented to assist workers and communities in earlier shut-downs, would do much to ease the pain.

While the evidence is mixed, the Productivity Commission's recent report on the industry is right to question whether those programs are effective, much less provide value for money. Nor is pessimism about those programs surprising.

The fact of the matter is that once people have been attracted to an unviable industry, and communities have come to depend on them, public policy does not have a magic wand that can turn back time. At Holden, the average career has lasted 17 years, at Toyota, 13; turnover is likely to be higher in the parts industry but there, too, many workers' human capital will now be hard to change.

Unable to make everything right, governments should therefore accept that policy failures, such as those that have scarred our auto industry, have costs that are as high as they are enduring. And that should caution against interventions that lure resources into traps from which exit is painful and laborious.

But history shows that the political pressures to intervene, and to keep ill-judged interventions in place, are not about to disappear. Paul Keating, for example, played an important role in starting the process of removing protection, with the then opposition's strong endorsement; but once John Hewson suggested the future of the car industry be left to market forces, Keating didn't hesitate to reverse course, launching his 1993 election campaign with the promise that "We will make sure that Australia keeps its car industry."

Now, Labor lacks any credible plan for ensuring the industry's future; but that won't stop it attacking the government for facing the facts. Yet Labor's opportunism cannot be an excuse for perpetuating past errors, much less extending them to new areas. The car plants being prepared for closure, and the families preparing to lose their livelihoods, surely prove the stakes are just too high.

As cabinet members consider Qantas's request for loan guarantees, and Barnaby Joyce's proposal to scale up assistance to drought-affected farmers, they should therefore have Ford, Holden and Toyota firmly in mind. The embodiment of lost hopes and lost opportunities, they are the legacy of other good men and women who once sat in those chairs. Their intentions were honourable; their results will haunt communities for years to come.