The Australian

Julia Gillard's policy to prop up inefficient firms will be counterproductive

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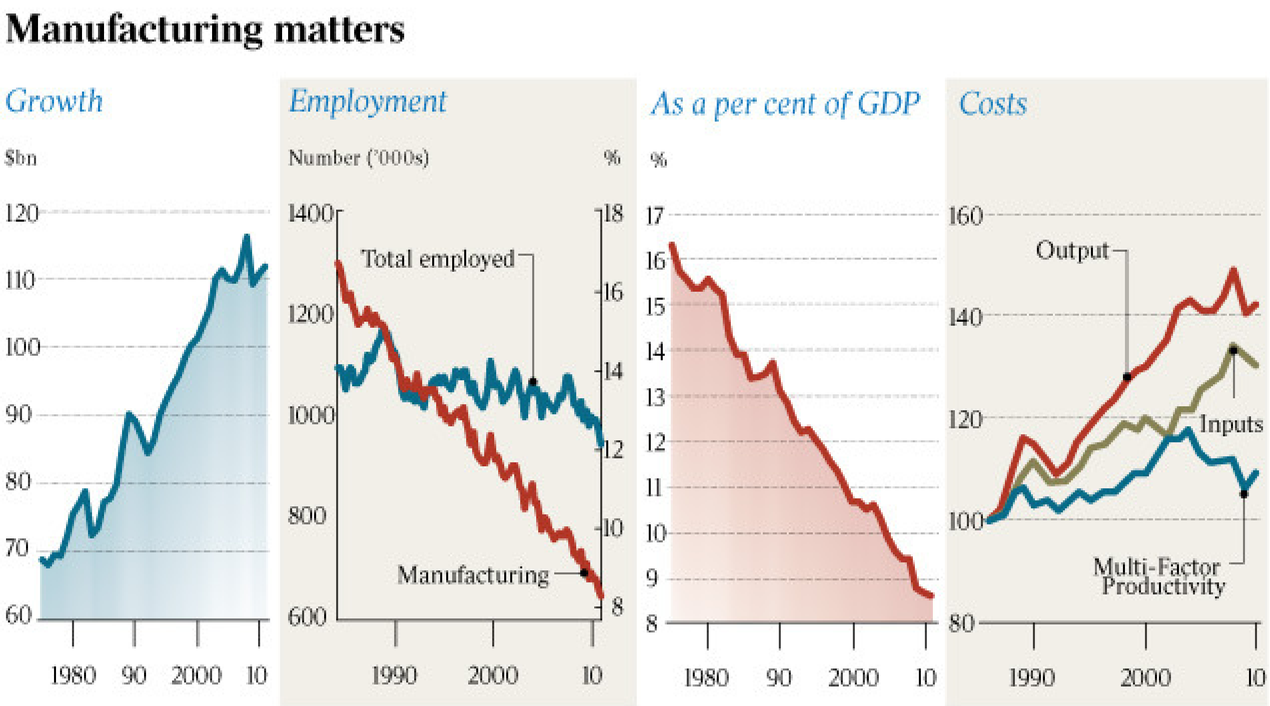

Source: The Australian

ACCORDING to Julia Gillard, things are difficult for Australian manufacturing as the resource boom threatens "to hollow out other sections of the economy".

To prevent that, "we are working with manufacturing, we are working with the car industry", she says, which translates into "dishing out taxpayers' money".

But the Prime Minister's statements bear no relation to the evidence. To start with, rather than falling, value-added-in manufacturing is about 60 per cent higher now than in the mid-1970s (see chart 1).

It is true manufacturing employment has declined in terms of numbers (shown on the left axis of chart 2) and as a proportion of the labour force (right axis).

But in Australia, as in other high-income economies, that trend has been continuing since the 1970s, and has nothing to do with the mining boom.

The same is true for manufacturing-value-added as a share of total value-added (shown in chart 3), where the decline also began long ago.

These trends simply reflect the shift to an economy dominated by services. But that doesn't mean there are no problems.

Because there is a big problem, although it has gone almost unnoticed: manufacturing productivity has taken a nosedive. In fact, it is in manufacturing our productivity crisis is most acute.

Look at chart 4: what it shows is that while total value-added-in manufacturing has remained roughly constant since

2003-04, the inputs manufacturing uses have increased significantly.

As a result, multi-factor productivity (which measures output per unit of all inputs, and is an indicator of "bang for buck") has declined, a phenomenon virtually unique in international terms.

It isn't that unusual for mining to go through periods of productivity decline: that can happen when you get to ore bodies that are harder to extract or have lower ore content. Moreover, mining investment often involves long lead times, so there can be a substantial lag between the build-up of capital and when the flow of benefits. Once investment is in place, output picks up and productivity levels resume growing. But manufacturing isn't like that. Sure, in severe recessions, low capacity utilisation can lead to productivity declines. But outside of recessions, productivity levels don't fall.

Yet in Australia, they have.

That could partly reflect structural changes in manufacturing. Some sectors are expanding, and are investing ahead of demand, so their input use is rising more rapidly than their output.

That is especially true for manufacturing industries linked to mining, which are emerging as world leaders. But the flip side is that there are parts of manufacturing that are in decline.

There the pattern should be first reduced capacity use, and then exit, freeing resources for more productive uses. But that exit isn't occurring on the scale at which it should. Nor will it, if Gillard and Kim Carr have their way.

Rather, by propping up one inefficient firm after another, they will allow them to hang on and continue using resources, so perpetuating our manufacturing productivity crisis.

It is not easy to think of a worse policy approach, nor of one that will ultimately prove more costly. It ensures we waste the boom years and find the going more difficult when tougher times come.

A sensible government would instead allow adjustment to occur, targeting any assistance to help workers who lose their jobs to find new ones that will last, rather than being dependent on continued government handouts.

And it would rethink regulations, such as the industrial laws, that curb productivity in the economy as a whole.

But that, of course, would cause trouble with the unions.

Far easier to blame mining, and waste taxpayers' money papering over the cracks.

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