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Productivity Commission
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To whom it may concern,

Re: Review of Automotive Assistance Position Paper

I am writing to express my dissatisfaction with the findings of the Productivity Commission's Review of Automotive Assistance Position Paper. It appears that this paper attempted to achieve the objectives of satisfying political realities whilst still achieving some trade barrier reform. However, whilst this paper may satisfy shortterm political realities it fails to attempt to understand the political economy and the political consequences of trade barrier reform and at the same time fails to present a clear argument against the total removal of all Automotive assistance trade barriers in a timely fashion.

The Commission's paper admits that the Automotive Industry receives a level of assistance, including direct trade barriers, that is far above almost every other Australian industry. However, what the paper fails to identify is why this particular industry should receive a differentiated level of assistance or in fact why it should receive any assistance or protection at all (the paper notes the effective rate of protection is currently 20%).

It is the Commission's belief that the value of all assistance and protection given to the Automotive Industry is about \$1.4 billion a year until at least 2005. The paper gives an estimate that the Automotive Industry employs 55000 people, therefore the level of assistance equates to \$25 454 per job per year!!! However this figure doesn't include the distortions created by the taxes used to generate the direct assistance (in other words that shadow cost of the Commonwealth Government raising taxation, which is probably at least \$1.2 for every \$1 raised).

I can not possibly think of any efficiency reasons that could possibly justify this huge amount being spent on supporting a particular industry and I also can not think of any equity reasons to justify the level and form of the assistance. Even with the reductions in trade barriers recommended by the Commission, the amount of assistance per worker will still remain unjustifiably large and in an unjustifiable form, especially with the trend of decreasing employment in the Automotive Industry likely to continue.

It is claimed that productivity in the industry is increasing, at its basic level this means less resources, including labour hours, are needed to produce the same amount of

outputs. In practical terms it is easy to see why an industry that becomes more productive often employ less labour and therefore this will probably continue to occur in the Automotive industry as past trends have indicated (there has been at least a 30% decline in employment in the industry since 1991).

The inclusion in the Commission's paper of positive externalities generated by the Automotive Industry is a fuzzy argument that does not carry a lot of weight. Whilst industries that are open to international competition do generate positive externalities for the country, the fact that the Automotive Industry has a high level of protection means the externalities it is likely to generate are at best not very significant. This argument however doesn't even take into account the fact that if Australia didn't have Automotive Industry assistance then resources would be allocated elsewhere (to where we have a comparative advantage) and possibly to industries that generate far greater positive externalities in comparison to the Automotive Industry. There is clearly no case on efficiency grounds to give the Automotive Industry any assistance.

Also the Commission's failure to incorporate in its paper in any detail the dynamic benefits generated by free trade (and therefore the dynamic disbenefits generated by protection) is ridiculous. It is clearly known, though admittedly not easily quantifiable, that the dynamic benefits of moving towards free trade are far greater than any immediate one-off benefits.

In addition the paper fails to justify the remarkably slow rate of reduction that it recommends in relation to reducing industry assistance and trade barriers. All economic arguments that have been made in the past to justify indefinite or indeed finite trade protection have all been subsequently proven to be incorrect. I can not possibly believe the Commission would make the argument on "infant industry" grounds, a theory that has been thoroughly disputed in economic circles. If the argument is made on the grounds of employment, the protectionists' last bastion, it is clear from recent economic analysis and from a simple observation of protected industries that trade barriers don't save jobs let alone create them and it is also becoming increasingly clear that the reduction of trade barriers does not have any significant consequences for inequality in relation to wages.

These points taken in aggregate leave a question mark over the efficacy of the Commission's modelling. The most significant points are that: the dynamic benefits of removing trade barriers was not included in the modelling, the modelling assumed net benefits from giving assistance to the Automotive Industry and that the modelling does not seem to take into account the shadow cost of raising taxation revenue or the dynamic benefits that could be gained by removing assistance and allowing resources to be allocated more efficiently. In addition not one of the modelling options included in the paper showed the outcome of removing all trade barriers and all assistance to the Automotive Industry from 2005. Also the terms of trade effects are not adequately explained in the paper as they appear to be initial effects and don't take into account the dynamic implications to the terms of trade of a shift in resource allocation towards more efficient industries that could cancel out any initial effects.

Therefore I am left to assume that the slow rate of reduction in assistance and protection is based purely on political reasoning. However the Commission has failed to fully analyse the political economy of trade protection and it has clearly ignored

past political lessons in relation to reducing trade barriers. The simple message history has given us is that reducing trade barriers in a timely fashion is the only way to ensure they will be removed. In political terms putting off reducing trade barriers is like putting off going to the dentist, you know that one day you should do it as long as its not any time soon.

Unfortunately the paper appears to be a political step by the Productivity Commission in an attempt to avoid some of the criticism that its papers have drawn, in the past, especially from political circles, which are often influenced by the density of protectionist groups. What is also disappointing is that the paper fails to fully outline and in fact deliberately downplays the benefits of free trade. In an era when the virtues of free trade are again under threat from "pop policy makers" and uninformed sections of the public it is sad to see the Productivity Commission not making a strong and elegant case in favour of free trade. It is also disappointing that once again a major review of trade barrier reform has failed to attempt to investigate the most efficient ways to compensate the losers of the reform to help mitigate the concentrated negative social and therefore political consequences.

In closing I would like to point to an opinion piece that appeared in The Age on July 22 by a former director of the Industries Assistance Commission Martin Feil entitled "Car industry's Lazarus act converts the commissars". This piece was written in direct response to the Commission's Automotive paper praising it for its thoughts on industry assistance. The fact that the paper has attracted the support and respect of "pop policy advisers" should tell the Commission something about the standard of the paper they have produced. The article notes that the inquiry in 1997 undertaken by the Commission that recommended the removal of all trade barriers and assistance was followed immediately by the government deciding there would be another inquiry. It is hard not to see the paper produced as not being politically influenced.

The article goes on with respectable economic pearls of wisdom such as "the government should have the sense to never say never to the car industry", "The commission actually walks away from its commitment to resource allocation theory", "The one major piece of recidivism in the report is the comment that the automotive industry should not receive indefinite preferential treatment over other manufacturing activities. My question is: why not?", "This approach is not about handouts. It is about the *community* (my emphasis) investing in industries we need" and that the Commission should return to the job of advising government on how they can "invest *community funds* (again my emphasis) to help those industries deliver economic and social benefits to the Australian people."

The Review of Automotive Assistance Position Paper produced by the Productivity Commission is an extremely disappointing document from an organisation that is meant to be one of the pinnacles of economic policy advice in this country. It is also disappointing because it opens the door for "pop internationalists" and quasi-protectionists to have their views seriously listened to by those in power.

Regards,

(signature)

Joel Thompson