*WEEK ON THE DRY SIDE 278

The Motor Car Decision

John Hyde

Better commodity prices have given us a breather, but with respect to Mr Keating and Mr Noakes, Australia is not yet off the Argentina road. When the Argentinians trod the road from excessive debt to poverty and civil strife, each improvement in their terms of trade and each rescheduling of their debts seemed to them like the end of the road---an opportunity to relax after the travail behind, rather than an opportunity to strengthen their economy for the travail ahead. Their problems overwhelmed them, not because their luck ran out, but because they reached a point where an ordinary measure of luck was not enough.

Australia's greatest danger now is that our government, faced with possible defeat and in search of electoral popularity, will lose its resolve---it will panic, just as the Fraser government panicked in 1982. There are signs of impending hysteria in caucus and Mr Keating's discovery of an economic miracle is even more dangerous nonsense than Mr Lynch's discovery of a resources boom. Nevertheless, there are also signs of a party resolved to see responsible economic management through: while the treasurer was discovering his alleged miracle, the government took a generally sensible decision on the motor industry.

The motor car decision was important not only for its political message, but also in its own right. It will reduce quite massive hidden transfers. The immediate purpose of any protection is to allow goods to be sold at higher prices, and thus protection has the same price effect as a selective consumption tax. The consumer tax equivalent of transport equipment protection is $1.3 billion each year. By adding to their costs, this tax makes other industries less competitive than they would be without it.

Many people believe that the Australian manufacturing sector as a whole is uncompetitive. They support this belief by pointing to Australia's relatively high wages, relatively strict environmental standards and relatively comfortable work styles, and ask how Australians can compete with people who do not adopt these standards. Such muddle-headed critics have the cart before the horse.

Australia can afford these high standards (if somewhat fewer of them in the immediate future than we have enjoyed over the past seven years) only because most of our industry is reasonably efficient and some of it is very efficient. This is also true of the manufacturing sector. The sector's reputation suffers as a whole, however, because of presence within it of two sub-sectors: passenger motor vehicles (PMV), and textiles, clothing and footwear (TCF). Between them these two sub-sectors are responsible for around half of the manufacturing sector's consumer tax.

While consumer tax equivalents measure the costs to consumers of protecting producers, one of the ways the benefits gained by the protected industrial processes can be measured is as "effective rates" of protection. Effective protection is the help the government gives an industry minus the costs imposed on that industry by the government's help to other industries. For example, if a process adds half the value of an item whose final price is doubled by the presence of a 100% tariff, and if inputs which add the other half are priced in a free market, the effective rate of protection for the protected half is 200%. If the inputs are also protected, then the cost of their protection is deducted from the effective rate for the process in question. Effective rates can thus be negative, as they are, for example, in the case of most miners.

The effective rate of protection for the TCF and PMV industries combined was 120% in 1986/87; whereas the rate for the rest of the manufacturing sector was a mere 14%.

Both TCF and PMV sectors have been protected by import quotas and both are subject to complicated "plans". The plans implicitly reject the principle of arm's length rule by law and thus open up considerable opportunities for corruption.

The plans were designed before "The Great Depreciation". The IAC now says: "...the currency depreciation has improved the competitiveness of the local passenger motor vehicle industry to such an extent that tariff quotas have been rendered temporarily redundant."

Two years later than he should have, Senator Button has grasped the opportunity to scrap PMV quotas. He has reduced the tariff from 57.5% to 45% immediately and to 35% by 1992. Had the quotas continued, new uneconomic practices would have grown up and their costs been passed on to car buyers. With quotas gone, the car industry's future capacity to raise the costs of other industries has been greatly reduced, and our ability to enjoy high wages, costly but otherwise desirable environmental standards, and comfortable working conditions has been enhanced.

Because the Yen is the currency which most affects the car industry, the industry has benefited from a real effective depreciation of some 40%. A 22% tariff reduction was therefore not enormously brave. Nevertheless, it was a step in the right direction.

Now we must ask the government what it is going to do about the TCF industries. Protecting this group taxes consumers $1.5 billion each year. The TCF tax is extremely regressive, hitting just those items that are a big part of the poor household's budget---caucus industry committee please note.

The Opposition and the Vehicle Builders Union both reacted in a responsible manner to the PMV decision. The debate has indeed come a long way, although not yet far enough. Senator Button's second reading speech to the Textile, Clothing and Footwear Development Authority Bill very properly told the TCF people that their plan was not immutable. Senator Austin Lewis led for the Opposition. By complaining about this warning, and by saying that it was "Australia's fault" that wages were high, he demonstrated the Opposition's willingness to play political games with the issue. The Minister's idea is to have low-cost industries which will sustain high living standards, rather than have low living standards which will permit high-cost industries. Industry plans are not an ideal way to approach the goal, but the underlying intention (low-cost industry/high living standards) is surely the right one.

ENDS