



CHAMBER OF COMMERCE AND INDUSTRY
WESTERN AUSTRALIA

9 August 2006

The Hon. Bruce Baird MP
Chair
House of Representatives Economics,
Finance and Public Administration Committee
Via email: efpa.reps@aph.gov.au
Dear Sir,

Inquiry into the state of Australia's manufacturing industry now and beyond the resources boom

The Chamber of Commerce and Industry Western Australia (CCI) is the leading business association in Western Australia. It is the second largest organisation of its kind in Australia with a membership of almost 5,000 organisations in all sectors including manufacturing, resources, agriculture, transport, communications, retailing, hospitality, building and construction, community services and finance.

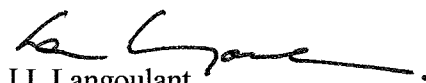
Most members are private sector businesses but CCI also has representation in the not-for-profit sector and the government sector. About 80 percent of members are small businesses, and members are located in all geographical regions of WA.

CCI is pleased to make this submission to the House of Representatives Economics, Finance and Public Administration Committee Inquiry into the state of Australia's manufacturing industry now and beyond the resources boom.

Our submission seeks to demonstrate the current economic environment in Western Australia in the context of the national economy, the future prospects for the State's economy, the general policies that should be adopted to realise the opportunities now and beyond the boom, as well as industry policies that could potentially give rise to significant negative effects on economic activity in WA.

We look forward to further contributing to this Inquiry and would be pleased to participate in future stakeholder meetings as appropriate. Our Manager Industry Policy, Mr Trevor Lovelle would be pleased to make arrangements in this regard. Mr Lovelle can be contacted on (08) 9365 7560 or email Trevor.lovelle@cciwa.com.

Yours sincerely


J L Langoulant
Chief Executive



Inquiry into the state of Australia's manufacturing industry now and beyond the resources boom

Produced by the Chamber of Commerce and Industry of Western Australia
August 2006



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AND INDUSTRY
WESTERN AUSTRALIA

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The Western Australian Economy

Overview

Western Australia's economic expansion over the past four years has made it the economic powerhouse of the nation. By and large, these good times have been the result of a dominant resources industry, which has been increasing production and investing in new capacity in order to meet strong global demand for its key commodities – particularly from China.

The WA economy has grown on average by 4.1 per cent a year (the second highest of all States), compared to the national GDP average growth of 3.3 per cent, over the 15 years to 2004-05.

Output from WA accounted for over 11 per cent of national Gross Domestic Product in 2004-05. On a per capita basis, WA's output was the highest of all States.

Exports and business investment are the key reasons why economic growth in Western Australia has exceeded the national average – both of which are reflective of the importance of, and requirements for, the State's dominant resources sector.

One of the key distinguishing features of the WA economy is that it is highly export focussed.

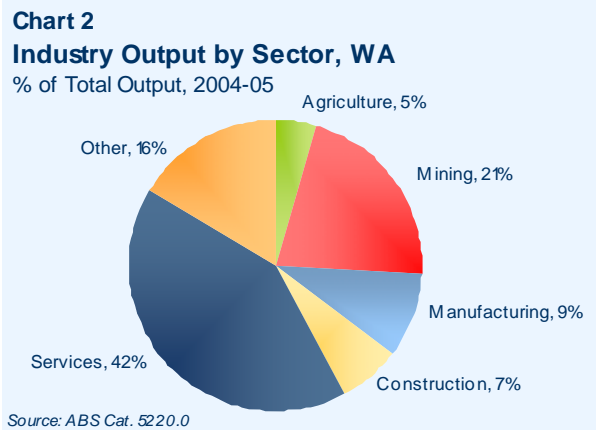
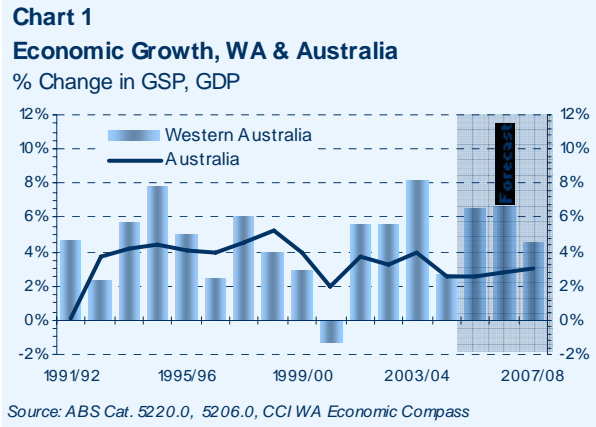
Western Australia is the biggest exporter of all States and territories in Australia, due largely to its rich endowment of natural resources.

Over the past 15 years, WA exports have increased on average by seven per cent per annum, and its share of total exports nationally has increased to around 30 per cent (from around 22 per cent in 1990-91).

Petroleum (oil, LPG, LNG, condensate), iron ore, gold, nickel and alumina are the dominant mineral exports, while agricultural products such as wheat and wool and elaborately transformed manufactured items also make important contributions to WA's export earnings.

Business investment is the other key driver of the WA economy.

Over the past 15 years, business investment in WA has increased on average by over six per cent per year, although there are typically large variations due to the lumpy nature of investments undertaken in the resources sector.



Business investment accounts for around 15 per cent of total output from the WA economy, compared to 10 per cent nationally – which underlies its importance to the State economy.

During times of high levels of business investment, this proportion increases further.

Above average economic growth in WA over the past 15 years has ensured strong labour market conditions. Employment growth has averaged 2.3 per cent per annum over the past 15 years, compared to 1.6 per cent nationally. The unemployment rate has also fallen progressively over this period – reaching a low of 3.5 per cent in May 2006 (from 10.6 per cent in 1990-91).

In recent times, strong labour market conditions have brought with it increasing evidence of widespread labour shortages and associated wage pressures. The June quarter CCI-BankWest Survey of Business Expectations found labour shortages were an issue for as many as 70 per cent of WA businesses.

Key Sectors

Mining

The resources sector is the State's dominant industry, accounting for over 21 per cent of Western Australia's economic activity. It is also the State's fastest growing sector, increasing on average by almost 10 per cent per annum over the past 15 years. By contrast, the resources industry nationally only represents around five per cent of the Australian economy.

The growth in the resources industry has also contributed to the growth of other sectors, in particular the construction sector (through business investment and construction engineering) and the manufacturing sector (through downstream processing of mineral and energy resources). There also exists a growing number of small and medium sized businesses that service WA's resources sector in the areas of engineering and design, geophysics, fabrication and construction, training, electrical engineering, process engineering, asset management and development.

Although the mining sector makes a significant contribution to the overall economy in relation to total output, in terms of employment it is only a small employer – employing only around five per cent of the total WA workforce. However, over the past five years, total employment in the sector has increased by 51 per cent (or 18,400), making it one of the fastest growing sectors in terms of employment in WA.

Services

The services sector continues to expand rapidly in line with the economic development in the State, with growth in the finance and insurance and property and business services sectors particularly strong. By 2004-05, the services sector¹ accounted for almost 36 per cent of total output (up from almost 34 per cent in 1990-91) and employs over half of the State's workforce.

Property and business services are the largest service industry in WA, representing 10.9 per cent of total output in 2004-05. It is also the second largest single industry in the State, behind mining. Other key service industries are retail trade (5.6 per cent of total output), transport and storage (4.6 per cent) and finance and insurance services (3.9 per cent).

By employment, the largest service industry is retail trade, which accounts for almost 15 per cent of the WA workforce. The property and business services industry is also a major employer – with almost 12 per cent of the WA workforce employed in that industry. It is also one of the fastest growing sectors by employment, with the number

employed in property and business services rising by almost 30 per cent (or 27,900) over the five years to 2004-05.

In 2004-05, the services sector nationally represented around 45 per cent of total output, which is significantly higher than the contribution of the services sector in Western Australia. This is largely due to the larger finance and insurance and property and business services sectors (particularly in NSW), which together represent over 20 per cent of the national economy (compared to around 15 per cent in Western Australia).

Construction

Western Australia's construction industry has also grown rapidly, reflecting both the booming housing market and the large scale building and engineering construction projects being undertaken in the mining and resources industry.

Reflecting this, the construction sector has expanded by 7.7 per cent per annum over the past five years, with particularly strong growth of 11.4 per cent in 2004-05.

In 2004-05, the construction industry accounted for seven per cent of total output.

The construction industry is also a large employer in Western Australia – employing almost 10 per cent of the total workforce in 2004-05.

The number of people employed in the industry has risen strongly in recent years, reflecting the high levels of activity. Overall, employment has risen by 35.5 per cent (or 27,500 persons) over the five years to 2004-05.

Manufacturing

Growth in Western Australia's manufacturing industry has also been strong in recent years, with annual average growth of 5.1 per cent per annum over the past five years. This reflects the emergence of a stronger and more competitive manufacturing sector that has focussed in on niche markets (such as shipbuilding) or has leveraged off the state's competitive strengths in resources (such as downstream processing of mineral and energy resources).

However, given the relatively higher growth in other larger sectors of the economy – particularly mining and service industries, the contribution of the manufacturing sector to the WA economy has remained relatively stable, averaging around over 9.5 per cent of total output over the five years to 2004-05.

Chart 3
Employment by Industry, WA
% of Total Employment, June 2006

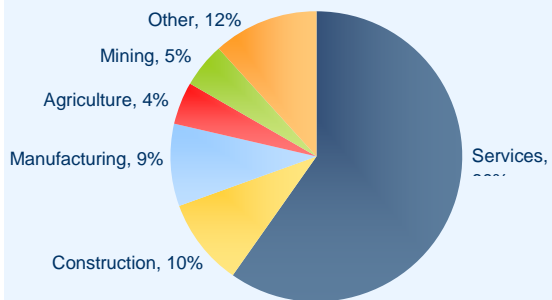
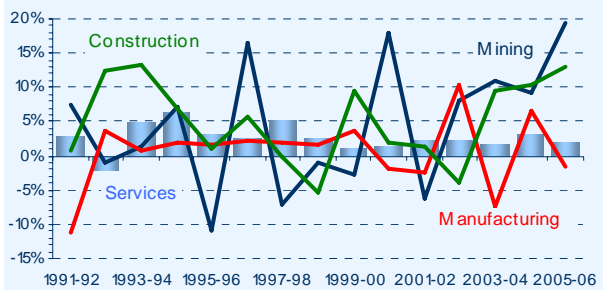


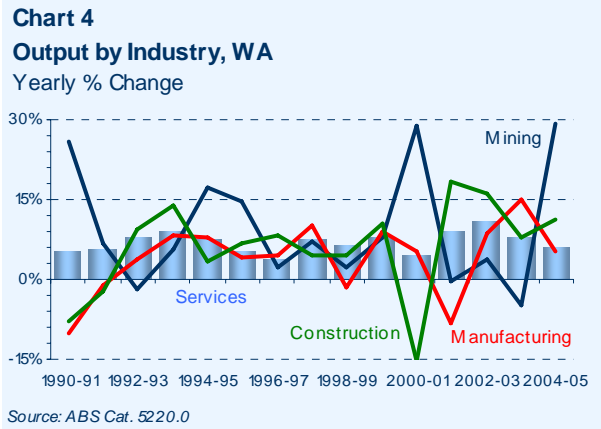
Chart 5
Employment by Industry, WA
Yearly % Change



Source: ABS Cat. 6203.0

Western Australia's manufacturing industry is also relatively smaller than Australia's manufacturing industry, which accounted for over 12 per cent of total output in 2004-05.

In line with the above average growth in the manufacturing sector, the number of people employed in the sector increased by 7.7 per cent (or 7,100) over the five years to 2004-05.



The manufacturing industry employs 9.3 per cent of the total WA workforce.

Other

The relative contribution of the agricultural sector to the WA economy has also fallen over the years, despite growth of over seven per cent per annum since 1990-91. By 2004-05, the agriculture, forestry and fishing sector represented 4.5 per cent of total output (down from 6.6 per cent of total output in 1990-91).

The tourism sector has also become an increasingly important part of the WA economy and is spread throughout the State – from the Kimberley region in the north, right down to the South West region. Because of the way industries are classified in Australia, it is very difficult to determine the value of the tourism industry to the WA economy².

Instead, the tourism industry fits across the range of other industry sectors – such as the retail, accommodation and transport sectors. That said, research undertaken by Access Economics on behalf of the Western Australian Tourism Commission found that in 2001-02, the tourism sector accounted for 3.1 per cent of State output.

Infrastructure services – energy, communications, transport and water – are a large part of the WA economy, accounting for more than 10 per cent of total output. However, the significance of these sectors to the State's economic performance and standard of living goes well beyond this direct contribution due to the fact that infrastructure is a key input for businesses and is central to the basic quality of life for households.

Future Prospects

Looking forward over the next five years, it is likely that the State will continue to leverage on its comparative advantage in resource extraction and processing which should bring with it further economic growth and development. Increased diversification within the sector has also encouraged the exploration and mining of a broader range of commodity resources and opened new export markets – helping insulate the economy from fluctuations in demand for key commodities.

The strength of the WA economy has also meant that it is an increasingly desirable place to live. The State's population growth is second only to Queensland, with more people migrating from other states and from overseas to take advantage of the employment opportunities that exist, and until recently its more affordable housing market.

High levels of population growth will not only boost the supply of labour which supports the economy, but have numerous spin-off effects through the increased demand for housing and other services.

By virtue of its geographic location, it is likely that WA will be able to develop further its relationship with, and take advantage of, the growing opportunities that exist in the rapidly growing Asian economies. Importantly, opportunities are likely to emerge beyond the traditional resources industry and to services industries such as education and training, professional services and tourism.

Overall, it is likely that the resources sector will continue to dominate Western Australia's economic growth profile over the next few years, boosted by continued strong global demand for resource commodities from its increasing number of export markets. Some export markets will be likely to grow in importance over this period (such as India), while China is likely to become the State's major export destination, as its remarkable growth record continues, particularly in the lead-up to the 2008 Olympics.

This demand will encourage further investment in the resources sector and the economy more generally, with over \$120 billion worth of investment projects either under construction or being considered.

While this should ensure that WA continues to grow at a robust pace over the next five years, continued diversification will mean that it is better placed to respond to, and accommodate, future challenges as they arise.

Policies for realising opportunities

Introduction

The opportunities being addressed in this section relate to the second focus of 'The Inquiry into Australia's Manufacturing Industry Now and Beyond the Boom'. As set out in document inviting submissions dated 26 May 2006 that focus is as follows, "the state of the country's manufacturing sector (and the goods and associated services) including opportunities and challenges from the expansion in global trade (in particular by China)".

CCI considers that, notwithstanding the likelihood of greater competitive pressure on Australian manufacturing (owing to the expansion in global trade), it is important to consider policy options designed to address the possible consequences of that competitive pressure for the Australian economy as a whole and in their proper context. This in turn requires two things:

1. An accurate assessment of other related phenomena, particularly, of the extent of the growth in mining and resources exports driven by increased global demand. But also an appreciation of both emerging and yet unknown opportunities for economic growth offered by trade liberalisation.
2. A realistic assessment of the ability of government to effectively minimise the effects of anticipated competition and an appreciation of the possible conflicts that may arise between policies designed specifically for the manufacturing sector or parts of it and other sectors experiencing growth in the Australian economy.

In parts I and II of this submission CCI has sought to provide the Inquiry with detail regarding the dimension, quantum and forward estimates for the growth in Western Australian economy consequent in substantial part on the expansion of the mining and resources sector in Western Australia. And further, CCI has sought to provide information to the Inquiry which puts the growth in the WA mining and resources sector in its proper context by noting the growth in manufacturing and allied industries

in Western Australia that has developed in consequence mining and resources export growth.

In addressing the challenges and opportunities that should inform the development of industry policy in Australia in the light of the expansion of global trade CCI considers that the appropriate analytical path is to reconsider the basic tenets of sound industry policy under the heading of 'The Fundamentals of Industry policy'. And then to consider specific areas where the policy demands arising from the different sectors of the Australian economy are likely to be divergent such as in the areas of trade, business assistance and infrastructure policy and suggest principles for dealing with competing policy demands.

The Fundamentals of Industry Policy

This Report at Appendix 1 sets out the results of CCI research into the process of defining industry policy and classifying variant models of industry policy.

That research confirms what has been previously identified in a joint CCI and Chamber of Mineral's and Energy Paper 'Developing WA's Future'³, notably that:

Traditionally, industry policy has comprised narrow assistance and protection programs targeted at businesses grouped by characteristics such as employment size, industry sector, location, market, or activity. It has often disregarded the consequences of selective assistance for businesses falling outside the realm of such initiatives, or of inconsistent approaches between agencies and government.

The proposals contained in 'Developing WA's Future', were originally designed to inform the development of State government industry policy in WA. However, that Paper makes basic recommendations to the effect that the single most important industry policy role for government relates to the provision of a microeconomic environment that will maximise sustainable economic growth. Insofar as that Paper draws conclusions regarding the best practice for the fundamentals of industry policy, those conclusions are the immediately relevant starting point for any consideration of industry policy which considers the issue of industry policy in the specific context of the present resources boom.

CCI considers that the best practice of industry policy necessary involves three features:

1. The primary attention of government to the provision of a micro-economic environment that will maximise sustainable economic growth. From the recent experience of WA industry this will likely involve ensuring competitive, flexible and efficient systems of;
 - Taxation;
 - Industrial relations;
 - Regulation;
 - Management and behaviour of government business enterprises,
 - Education and training
 - Labour market relations; and
 - Planning and infrastructure policies.

Inherent in the provision of the appropriate microeconomic environment is the need for both Commonwealth and State governments to promote, rather than

hinder, economic change. Particularly, change designed to enhance the competitive environment for Australian industry.

2. In ensuring, as set out in 1 above, that the fundamentals of the business climate are competitive, flexible and efficient; government should create an environment in which businesses succeed on their respective merits. Conversely, government should not select individual businesses or, particularly, types of businesses for preferential treatment. Policies which favour particular industry sectors invariably penalise other business sectors which, for whatever reason, do not accord with the government's perceptions of the day as to where economic activity should be encouraged and so distort the competitive environment. In this sense competitive neutrality should be an absolute and fundamental requirement of sound industry policy⁴
3. In accordance with the priorities set out at 2 and 3 above, industry policy must be a single whole of economy strategy. Consequently, industry policy must be conducted in a co-ordinated way and must encompass all of government's direct interaction with the entirety of the private sector, that is to say it must take account of all the various means by which government affects business performance.

With particular relevance to the focus of the present inquiry, an inherent feature of a whole of economy strategy must be the absolute avoidance of particular industry policies which have a duality effect between State economies.

This is to say that industry policy initiatives which may be characterised by the following three characteristics should be strictly avoided:

- Where a single Commonwealth industry policy initiative is designed to assist a particular category of industry; and
- Where the category of industry, by its geographical location, plays a greater role in the economy of one or a few States of the Commonwealth; and
- Where it is reasonable to expect that the institution of a particular Commonwealth industry policy initiative (designed to assist a particular category of industry predominantly located in one or few States) has the potential to adversely impact on industry sectors predominantly located in other States.

The second principle of competitive neutrality, as will be set out below, would recommend strongly that business assistance programs (or other forms of industry policy) which seek to benefit particular industries or industry sectors. should be avoided or, at least instituted in a manner as to minimise the distortion in markets and competition which inevitably arise from subsidies or other forms of assistance.

The third principle is closely related to the principle of competitive neutrality but acknowledges the potential for significant and harmful competitive imbalances and inequities to result from the particulars of any single Commonwealth industry policy in a federation, where there exist fundamental differences between State economies and particularly in the mix of business sectors which constitute the industry structures in different States.

Policies with the potential to impact negatively on WA

In its paper, *Developing WA's Future*, CCI dealt individually with a number of issues to demonstrate the way in which the principles above should find practical application in specific industry policy. The issues dealt with in that Paper included political and economic stability, labour markets, the environment, energy policy, project approvals, the knowledge economy, education, research & development, exploration, financial management, business assistance, investment facilitation and economic infrastructure. In any of these areas it is possible to identify specific industry policies, which if applied would breach principles of competitive neutrality. It is also possible to consider a number of policies which breach competitive neutrality and which (because of interstate economic differences), whatever their intended benefit have the potential of significant adverse economic effects in one or more States.

For the purpose of this submission it is useful to consider three areas specifically, notably those of business assistance, economic infrastructure and trade.

Trade

In its paper 'Australia-China Free Trade Agreement' CCI set out the possible implications of the pursuit of this agreement for WA and the Australian economy at large. The nature of a potential FTA with China has direct implications for any consideration of the Australian manufacturing industry.

Without setting out the full detail of the previous CCI Paper on this issue here a number of summary points pertaining to the issue of trade with china can be noted here:

- In October 2003 Australian Trade Minister Mark Vaile signed the Trade and Economic Framework between Australia and China with Chinese Vice Minister for Commerce, Yu Guangzhou, in the presence of Prime Minister John Howard and Chinese President Hu Jintao.
- The Trade and Economic Framework sets the direction for the future direction of the expanding trade and economic relationship between Australia and China. A key element of this framework is the commitment to undertake a joint feasibility study into a possible free trade agreement (FTA) between Australia and China. The feasibility study is aimed at identifying the opportunities and challenges of such an agreement prior to any decision being taken to commence negotiations.
- China is playing an increasingly integrated role in the global economy as it continues its extensive program of economic and institutional reform. Paramount among China's reforms have been those linked to its accession to the World Trade Organisation (WTO) in 2001, which has opened China's doors to trade and extended its business links into the region and beyond.
- Australia enjoys strong and wide-ranging economic complementarities with China which bolster economic and trade ties. China has become Australia's third-largest merchandise trading partner and over the 2003-04 financial year moved ahead of the United States to become Australia's second-largest merchandise export market.
- China has recently become Western Australia's second largest trading partner, due to strong growth for Western Australia's key commodity exports such as iron ore, alumina and petroleum. Recent contracts, such as signing of a \$25 billion contract to supply China with LNG over the next 25 years, will be expected to further boost Western Australia's exports to China from 2006.

- While commodity exports to China have been significant, services exports to China are also growing. With China's growth pushing its population's living standards and disposable incomes to new highs, this should create further opportunities for increased trade in professional services, education and tourism, as well as increased trade in consumer goods.
- These gains will be consolidated through implementation of the Trade and Economic Framework, which sets the agenda for strengthening and expanding Australia and China's trade relationship over coming years. It is also expected to provide a sound foundation for each side to take advantage of new commercial opportunities, focusing on identifying opportunities for closer cooperation and developing strategies to promote business opportunities in areas of high potential.
- A key element of this framework is the commitment to undertake a joint feasibility study into a possible FTA between Australia and China. While trade barriers have been reduced as part of China's accession to the WTO, significant barriers still remain, particularly in the agricultural sector. However, Australia also has a range of barriers that impact on the free flow of goods and services with China (particularly in relation to business and student visas). Removing these restrictions will be crucial in helping to deliver the likely benefits from a FTA with China.

China has become one of Western Australia's most important export markets, and as a result developments in the Chinese economy can have pronounced effects on the Western Australian economy. China is now Western Australia's second-largest export market, with exports valued at \$4.4 billion in 2003-04. Over the past 15 years, exports to China have grown by an average annual rate of 18.4 per cent – double the average annual growth rate of total exports. A key driver in the development of Western Australia-China trade has been the close complementarity of the two economies, and especially Chinese demand for Western Australian minerals. Demand for resources such as iron ore, petroleum and alumina has been rising due to China's rapid industrial expansion.

Iron ore is Western Australia's single largest export product to China. Iron ore exports grew by an average annual rate of 23 per cent between 1988-89 and 2003-04, to reach \$1.9 billion. Confidential items, which include alumina, are Western Australia's second biggest export product to China, and have also grown strongly, by an average annual rate of 24 per cent since 1988-99. In 2003-04, exports of confidential items totalled \$1.1 billion.

Strong Chinese demand for commodities such as iron ore have underpinned a number of major export deals for Western Australia, with the Minister for State Development earlier this year announcing that Western Australia had won a record 25 year \$11.6 billion iron ore export deal with China.

Investment activity in Western Australia's resources industry has risen in order to meet this demand. Some of the recent announcements include a \$1.4 billion multi-user railway and port facilities in the Pilbara, the \$1.8 billion Ravensthorpe Nickel Project, a \$600 million expansion of Alcoa's Pinjarra alumina refinery, as well as significant expansions to existing BHP Billiton and Hamersley iron ore mines.

Another significant development in Western Australia's resource trade relationship is China's increasing demand for energy. At present, coal is the main domestic energy source in China, providing approximately 70 per cent of the country's energy needs. However, with many coastal cities having been banned from burning coal for environmental reasons, there is strong demand for cleaner energy such as natural gas.

This has provided significant opportunities for Western Australia due to its large reserves of natural gas. In October 2002, the North West Shelf venture was chosen to

be the sole supplier of LNG to its first LNG project in the Guangdong Province, with three million tonnes of LNG to be supplied each year for 25 years. The contract is estimated to be worth \$25 billion in export income for Western Australia. This deal should see between \$700 million and \$1 billion worth of LNG exported to the Guangdong Province annually from 2006.

This agreement was followed by the announcement in October 2003 that the China National Offshore Oil Corporation had committed to purchasing \$30 billion of Gorgon LNG in return for a 12.5 per cent stake of the Gorgon gas field, once the project commences. Exports of petroleum have increased considerably in recent years. In 1988-89, Western Australia exported just \$7.8 million worth of petroleum to China, but by 2003-04 this had increased to \$473 million.

China also has strong linkages with other sectors of Western Australia's economy. Wool is Western Australia's third largest export commodity, totalling \$256 million in 2003-04. While demand for wool was relatively subdued in the past, it has picked up in the past five years as a result of decreased protection under China's WTO commitments, growing by an average annual rate of 25.3 per cent.

Refined products such as pig iron and pigments and paints are also important export earners for Western Australia. In 2003-04, exports pig iron totalled \$207 million, while exports of pigments and paints totalled \$127 million. Both products have also grown strongly in recent years.

China is also an important export market for services such as tourism and education. While data specific to Western Australia on the importance of these service exports is not available, the trends in services exports nationally highlight their likely importance to Western Australia.

As part of its accession to the WTO on 11 December 2001, China agreed to undertake a series of commitments to open and liberalise its regime to better integrate with the global economy. Within three years of the WTO accession, all enterprises in China would be granted the full right to trade internationally. China's WTO agreement also commits it to progressively reducing a wide range of other trade and investment barriers, with the average tariff level reduced from 17 per cent to 10 per cent by 2005.

Already we are seeing the benefits from the liberalisation of the Chinese economy, through increased global trade and investment. However, high tariff rates still apply to a range of goods, in particular agricultural goods, with an average rate of 17.4 per cent. In addition, import quotas exist on a range of agricultural goods such as wool, cotton, grains and sugar.

The opportunity for some or all of these barriers to be removed as part of a potential FTA with Australia presents significant opportunities for Australian and Western Australian exporters.

While the proposed FTA with China would be likely to significantly benefit Australia, the distribution of these benefits around Australia is likely to be uneven. Indeed, the reality is that Australia's textiles, clothing and footwear and motor vehicles industry will experience significant decline in the face of more intense import competition from Chinese producers.

This fact was acknowledged in a paper presented to the Conference on Free Trade Agreements in the Asia Pacific Region in July 2004 by ACIL Tasman.

Consequently, CCI acknowledges that it is appropriate that any Inquiry into the Australian manufacturing industry should consider the point that note that the Western Australia has more to gain from the trade deal than the rest of Australia, as China already features more prominently as an export destination for WA, and because of the

high degree of complementarity between the State's export profile and the current and likely future import needs of the Chinese economy.⁵

However, in the context of the present inquiry CCI recommends strongly against any policy measures which seek to enhance Australian manufacturing by retarding the FTA process with China.

Several reasons exist why such a policy direction should be resisted.

1. While it is the case that the resource rich States stand to benefit disproportionately more than States with larger manufacturing sectors the potential for growth in the Australian economy by virtue of trade liberalisation with China is not a zero sum game as between the resources and manufacturing industries. The complementarity of Australia's trade pattern with that of China suggests that there would be substantial overall benefits from measures to remove trade barriers between the two markets. In the same ACIL Paper which identified the potential for increased competition for manufacturing industries it was estimated that the net economic benefits to Australia could be around \$10.3 billion in net present value terms⁶.
2. While growth has primarily been exhibited in Australia's traditional export products⁷, other significant and emergent industries can be expected to benefit from the pursuit of an FTA with China. Particularly, significant opportunities are likely to be presented across various States in Australia's growing services industries. Australian service exports to China are also rising, reaching \$1 billion in 2003 and making China our seventh largest services market. Growth in services exports is likely to grow strongly in the future, particularly as China's middle class expands. With respect to the potential for growth in the services area several matters are notable:
 - a. China's granting to Australia of Approved Destination Status (ADS)⁷ in 1997 has helped facilitate considerable growth in Chinese tourism to Australia. The tourism industry has been growing strongly across most states with Queensland still the dominant tourist destination.
 - b. New South Wales accounted for around 45 per cent of the Australian finance industry total factor income in 2003-04. Increased finance opportunities in the rapidly industrialising Chinese economy would therefore be expected to benefit New South Wales more than the other states, while the need for China to improve the viability, governance and openness of its financial sector could present growing opportunities for foreign financial institutions.
 - c. Education services are relatively evenly spread across the major states on a per capita basis, with Victoria's per capita market share slightly ahead of the other states. However, given Western Australia's close proximity to China relative to the other states, it might be expected to benefit to a greater extent than the rest of Australia from growth in the education services market.

Victoria and South Australia would be expected to benefit less from trade liberalisation with China because they are more economically reliant on basic manufactures, with relatively high tariff protection in the textiles, clothing and footwear and motor vehicle industries. However, while these states could face competitive challenges from Chinese imports, it is debatable whether these pressures would be significantly greater than those arising from China's accession to the WTO.

Most importantly however, CCI considers that the overall potential for growth in the Australian economy through the trade liberalisation process with China is too great to risk any part of that process by disproportionate consideration of some selective industry sectors who may stand to face greater international competition.

The establishment of a FTA with China is should be seen as an once-in-a-lifetime opportunity, and will help integrate Australia more closely with one of the world's largest and fastest growing economies. In doing so, that should lead to more investment, jobs and economic growth.

Industry Assistance

In its paper, *Developing WA's Future*, CCI made a number of observations regarding industry assistance programs, which observations are relevant to the present examination of Australian manufacturing.

That Paper noted that industry assistance programs are just one aspect of a comprehensive industry policy and that any consideration of such programs must properly be conducted in the context of an acknowledgement the far more important component of government industry policy remains to achieve the proper economic fundamentals so as to maximise the prospects of every venture might succeed, rather than giving assistance which benefits some businesses at the expense of others and, potentially, the community as a whole.

However, CCI also acknowledged the political reality that governments will continue to provide business assistance. Pursuant to that acknowledgement CCI maintains that industry assistance should be provided according to a set of guidelines designed to ensure the effectiveness of individual programs. Those guidelines are as follows:

Rigorous analysis demonstrating that the benefits expected exceed the costs should be adopted as the standard starting-point for all proposed government assistance. The various arms of government should adopt a standard method of cost-benefit evaluation.

Government must minimise the distortion in markets and competition which inevitably arises from subsidies or other assistance. In particular, the Commonwealth Government should avoid assistance which provides competitive advantage to one business sector over other business sectors.

Assistance measures must have clearly defined and measurable objectives reflecting demonstrable industry-wide needs and yielding identifiable benefits. Programs which fail to deliver the expected benefits should be eliminated.

Before offering assistance, the government must demonstrate clearly and conclusively that markets are not working efficiently – that what economists call 'market failure' exists – and that intervention will actually improve the situation.

Finally, all levels of government need to be accountable to taxpayers for the use of their funds. Whatever the form of the assistance, its nature and cost should be fully public: there is never any justification for hiding costs from taxpayers on the basis of 'commercial confidentiality'.

CCI has previously called for the Commonwealth to review its business assistance programs to create a more transparent and predictable evaluation process and to provide support in cases where there is a demonstrable market failure and where net community benefits are likely to be maximised. Further, CCI has previously recommended that there should also be a joint review between the Commonwealth and states aimed at achieving better consistency and co-ordination of assistance programs between jurisdictions.⁸

In considering the policy options available to maximise the global competitiveness of the Australian manufacturing industry, it is likely that some submissions to the Inquiry will propose the policy option of grants or other forms of direct assistance to the

manufacturing sector, or specific identified business types within the Australian manufacturing sector.

Following from the guidelines detailed above and from previous recommendations made to the Commonwealth government, CCI submits that calls for such policy measures should be strongly resisted. CCI considers that such a concept is fundamentally ill-conceived and represents a retrograde application of outdated and inefficient industry policies, whereby governments substitute central planning for market distributions of investment by picking one industry sector for special treatment amongst many. Indeed, CCI considers that so detrimental could be the effect of selective assistance policy that CCI would recommend that any such suggestions received by the Committee be considered in the context of the following points.

1. The economic boom presently being experienced in WA is in large part driven by demand for products that have historically exhibited the greatest levels of comparative advantage for WA Industry, notably; the mining, resources and agricultural sectors. Further, regular cyclical adjustments may be expected at some point to slow the high growth rates currently being experienced by the mining and resources sector in WA. However, the first two parts of this submission have sought to demonstrate that caution should accompany any characterisation of WA's present economic growth as either being somehow acutely susceptible to sudden downturn or narrowly based. The growth in mining and resources in WA has not only occurred across a wide range of resources and commodities but has been accompanied by an overall broadening of the economy and beneficial growth effects for the manufacturing industry at large (and also in the allied services area).
2. The economic diversification which is accompanying the present export growth in WA also demonstrates that any view that the impact of global competition requires direct government assistance for the manufacturing sector should be treated with caution. Such a view may both overstate the potential for decline in existing manufacturing and understate the possibility for growth in new areas of Australian manufacturing. In this sense, there is always a possibility for a decline in the size of some types of manufacturing in the face of global trade there is no empirical analysis which suggests that there will be a failure of the market to redirect investment and resources to fill the possible (albeit unquantified) gulfs in productivity and employment resulting from a possible decreasing competitiveness of some particular industry types.
3. In those instances where there does appear to be significant decline in a particular type of Australian manufacturing in the face of the expansion of global trade, CCI urges the Committee to recognise that while assistance programs may be significant in budgetary terms; there is simply no guarantee that, in the face of rapidly growing and adjusting international trade, any measure of direct government assistance could be effective to assist industry sectors most likely to face increased competition. In this respect CCI considers that the role of government in supporting industry has evolved significantly over the past thirty years and that the most notable feature of that evolution has been that the traditional industrial policy of government attempting to support any one particular industry sector, has properly fallen out of favour. Indeed it has been noted that "[W]hat was described as 'picking winners' appeared in practice to amount to spending huge sums shoring up ailing companies".⁹
4. Picking between products in a single narrow industry sector is a policy particularly susceptible to non-commercial considerations entering into decision making. The inevitable results of non-commercial considerations

inflecting investment decisions is the inefficient allocation of investment funds made for party political reason.

5. Granting targeted assistance in practice involves picking between sectors which inevitably results in the creation of a competitive disadvantage for other industry sectors, which, had they not been disadvantaged by subsidies to other industries may have proved more productive industries and resulted in greater net returns on investment. Consequently, the potential for opportunity costs is significant in a policy of this type.

As stated above the tendency for policies of this type to breach principles of competitive neutrality is particularly acute in federal systems which, as is the Australian case, display great variation between the economic structure and progress of different State economies.

Infrastructure

While we are presently experiencing an export boom in the mining and resources sector and while it is appropriate to consider the challenges and opportunities facing the manufacturing sector, CCI recommends that any policy development pertaining to manufacturing not be conducted or executed at the expense of a decline in attention to the policy needs of the mining and export industries.

In short, booms (particularly those in export industries) are equally as difficult to properly manage as other economic phenomenon including cyclical downturns in selected industries. This is particularly the case because of the heavy infrastructure needs of the mining and resources exports industries.

In a budgetary environment where expenditures are necessarily limited and in which various sectors compete for funding for both industrial and social infrastructure it is important not to take the growth in the mining and resources sector for granted. And further, to recognise that meeting the ongoing infrastructure needs of the mining and resources sector in an appropriate and timely way can have the effect of considerably prolonging the prosperity generated by the sector as a whole.

In 2005 CCI presented a submission entitled 'Exports and Infrastructure' to the Australian Government Taskforce.¹⁰ CCI made several recommendations in that submission some of which are repeated below. However, for the purposes of this Inquiry what is most illustrative regarding the 2005 Infrastructure Taskforce is that it was in effect prompted by the perceived weakness of Australia's export performance in the years immediately preceding 2005.

At the time of CCI's submission, despite the strength of the global economy, credits for exports of goods and services had fallen from a peak of more than 23 per cent of GDP September 2001, to a trough of 17.4 per cent in March 2004, wiping out more than a decade of steady export gains. A concern had emerged that a series of infrastructure bottlenecks had become apparent which had impeded some exporters (most notably in the Eastern States).

At the time of the taskforce sought submissions there was a widespread public perception that the two phenomena were linked and that infrastructure bottlenecks were a significant cause of an Australian failure to capitalise on strong growth in world demand. Whilst CCI in its submission had some concerns fully accepting this premise the very fact of the perceived necessity to address such a concern as recently as 2005 demonstrates that booms do not manage themselves and that it is critical for government's to pay particular attention to and properly manage infrastructure issues during periods of rapid expansion in exports.

In its Submission CCI made a number of broad recommendations that are generally relevant to the present consideration of manufacturing being undertaken in the context of a growth in Australian mineral and resources exports and in international trade generally. For instance CCI submitted that the Commonwealth Government should carry a greater share of the responsibility for funding the common user infrastructure necessary for industrial development, because it collects the main tax benefits from such projects.

In addition, several of the CCI recommendations are likely to bear directly upon the present consideration of manufacturing being undertaken in the context of a growth in Australian mineral and resources exports and in international trade generally. If it becomes the case that the manufacturing sector in Australia experienced a period of sustained competitive pressure from imported goods it is possible that segments of the manufacturing sector will make increased demands for the public provision of infrastructure as means of providing competitive advantage.

In assessing those demands into the future the CCI would recommend that the government proceed in knowledge of the principles set out below:

- Government should not use its capacity to shape industrial development through planning, regulation and the direct provision of infrastructure to manipulate businesses into sub-optimal investment in the pursuit of political objectives.
- While government infrastructure investment should only be undertaken in response to identified community demand, not all demand for infrastructure should be met. Government should only invest in infrastructure if it is affordable and can plausibly be expected to deliver benefits in excess of its costs.
- In order to maximise potential gains and ensure efficient operation, government investment must take place in the context of a policy environment that supports the effective use of assets, and is articulated with other investments.
- The issue of the appropriate supply of infrastructure is not a macro-economic question but a micro-economic one – is there evidence of unmet demand, congestion or over-supply in the operation of any given market or piece of infrastructure? If so, what if anything is the appropriate response?
- The twin processes of cost-benefit analysis and opportunity cost evaluation should move some way to establishing the link between value and cost essential to ensuring that expenditure on public investment delivers commensurate improvements in the value of the public capital stock.
- One of the most effective ways of ensuring that the creation of an asset is achieved at economic cost is to open the construction contract to competitive tender, with appropriately stated quality specifications. Doing business in public must be part of the cost of doing business with the public sector. Without transparency, there can be no guarantee of fair process, the risk of pork-barrelling increases dramatically and taxpayers and their parliamentary watchdogs cannot enforce accountability.
- Social spin-offs should not generally be used to justify the construction of infrastructure at more than economic cost.
- If the case for distorting investment decisions to fulfil social and welfare objectives is difficult and complex, the issues involved in considering whether to distort investment on the grounds of business welfare is much more clear cut. Governments should not do it.

- Except where explicit social and equity considerations apply, charging users the cost of providing services is the most efficient and equitable way of allocating resources.
- While it makes economic sense to require future taxpayers to contribute to the costs of accruing long-term assets from which they will benefit, it is not fair to load onto future taxpayers a burden of financing recurrent spending, corporate losses and superannuation liabilities incurred without any benefit to them.
- In the case of social infrastructure, government's role is to ensure that people have equitable access to infrastructure-based services. As with any other service its responsibility is to ensure that the service provided represents the best value for money possible. Whether the service is actually provided by the public or private sector is irrelevant. If the private sector is more efficient than government at delivering education or health services then government should meet its social objectives via the private sector.
- The justification for government provision of public goods does not lie in their inherent virtues or social returns. It lies in the fact that they are non-rivalrous and non-excludable, and that for these reasons the private sector will not supply them efficiently. If technology or other market changes mean that the good can be made rivalrous or excludable, the case for government provision diminishes sharply.

Conclusion

CCI acknowledges the potential for sustained competitive pressure upon the Australian manufacturing sector owing to the expansion in global trade and understands that the present Inquiry is a means of gathering information on the possible responses to that phenomenon which may inform the Commonwealth's industry policy.

In the present circumstances the Industry Minister Mr. Ian Mcfarlane has said "*At the moment our economic position is being carried by the resources boom ... We don't want to wake up in five years time and find that the boom is starting to turn down; and in the meantime we haven't been able to keep the manufacturing sector going*"¹¹

Whilst allowing for the existence of rhetoric in the above statement, views that it is within any government's capacity to maintain any given industry sector demonstrate that the development of robust and responsible industry policies is not something that governments generally find easily achievable. Often Government industry policy errs on the side of being "everything to everybody" as it reacts to problems which are often beyond its capacity to solve.

For the purposes of addressing the difficulties that may be caused by increased competition in manufacturing CCI has recommended three key principles for the implementation of industry policy. These principles are:

- Governments should provide a micro economic environment which maximises sustainable economic growth.
- Industry policy should be conducted in a coordinated way encompassing all of Government's interactions with the economy and in being co-ordinated should not involve policy initiatives designed to assist a particular category of industry predominantly located in one or few States where it may be reasonably expected that policy will disadvantage other States' industry.
- Government should create an environment in which businesses succeed on their respective merits.

End Notes

¹ The services sector includes accommodation, cafes and restaurants, communication services, cultural and recreation services, finance and insurance, personal and other services, property and business services, retail trade, transport and storage, and wholesale trade.

² The standard system of industrial classification used in Australia classifies industries based on the nature of goods and services produced by the sector. Tourism, on the other hand, does not depend on the goods produced but relies on the type of consumer – foreigner or resident. Therefore, expenditure by tourists can impact on a wide range of conventional supply side industries. Source: Department of Treasury and Finance, 2005, *Structure of the Western Australian Economy*, p.37.

³ Joint Chamber of Commerce and Industry and Chamber of Minerals and Energy, Paper, *Developing WA's Future*, December 2001 at 3.

⁴ Ibid at 3 and 4.

⁵ ACIL Tasman, *The Proposed Free Trade Agreement with China – A Commentary and Some Preliminary Analysis*, July 2004.

⁶ Ibid – noting that This analysis was based upon a number of assumptions, the most crucial being that between 2005 and 2015, all barriers to trade are removed. The ACIL Tasman analysis found that significant benefits would likely be achieved by Australia's agricultural sector – particularly the production and export of wheat and other grains. By contrast, the analysis found that Australia's output of textiles, clothing and footwear and motor vehicles and parts industries would decline significantly in the face of more intense import competition from Chinese producers.

⁷ In 2003-04, Australia's largest exports to China were iron ore (\$1.9 billion), wool (\$1.1 billion), crude petroleum (\$670 million), coal (\$325 million) and aluminium (\$276 million).

⁸ Chamber of Commerce and Industry, Paper, *Exports and Infrastructure*, A Submission to the Australian Government Infrastructure Taskforce, April 2005, at 2.

⁹ See Morris D and Stout D 'Industrial Policy' in Morris D. (ed.), *The Economic System in the UK 1985* (London: Oxford University Press).

¹⁰ CCI Submission *Exports and Infrastructure: A Submission to the Australian Government Infrastructure Taskforce*, April 2005.

¹¹ Khadem N., 'Macfarlane, Beazley put some R&D into R&D' The Age Newspaper 11 July 2006.