PM's Taskforce Gives Manufacturing The Thumbs Up

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New technologies, the mining boom and changing consumer expectations are reshaping manufacturing - but is the decline in the sector terminal? A new report suggests not, writes Ian McAuley.

On Thursday last week, while most media attention was on asylum-seekers — boat arrivals and Julian Assange — the Government released the report, "Smarter manufacturing for a smarter Australia" by the Prime Minister's Taskforce on Manufacturing.

For the most part it had a positive reception, even from The Australian which focussed on its recommendations — investment in infrastructure, stimulus to the building sector, more opportunity for local participation in private and public projects and a reduction in business tax. It was left to Sophie Mirabella to make a catty reference to the carbon tax, even though the Taskforce saw clean energy technology as one of Australia's growth industries.

Roy Green, who was on the Taskforce, gave a synopsis of its findings on The Conversation, stressing its focus on innovation, in the widest sense of the term, covering not only product and process technologies, but also design, organisational structures, workplace relations, marketing and other activities.

Its specific recommendations are low key and largely uncontroversial. What the media has largely missed, however, is that its approach breaks with established ideas which have influenced the way policymakers look at manufacturing.

Historically we have associated manufacturing with modernisation. Those countries which have grown into sustained prosperity have all had strong manufacturing sectors. The development of Britain and the USA during the industrial revolution and of Japan following the Meiji restoration are the common textbook examples.

In Australia it was the manufacturing sector, protected by tariffs, that allowed us to develop an urban and well-paid workforce. Manufacturing was boosted under the Curtin Government's wartime powers, and was to provide employment for the waves of postwar immigrants.

Manufacturing expanded through to the mid-sixties. We wore Chesty Bonds underwear and Fletcher Jones pants. We watched television on an Australian-made AWA or Thorn receiver. We built ships and airplanes. We drove Australian cars, if we could afford them. Before each election the Menzies Government would announce the establishment of yet another car plant — at one stage we had six companies making cars, in a market of no more than 500 000 vehicles.

By the 1970s we found that the model was no longer working. We had become locked into a high-cost and technologically conservative industrial structure. Tariff protection brought us expensive and poor quality consumer goods, with the costs falling heavily on the poor. Many manufacturing jobs were tedious and poorly-paid. Above all, our industry culture encouraged "rent seekers" — those who sought privilege and protection from the discipline of the market — rather than innovators and entrepreneurs. (That dysfunctional culture persists to this day.)

As tariffs fell manufacturers felt the effects of competition on two fronts. Industries which are intrinsically labour-intensive, such as clothing, were unable to compete with firms in countries with low labour costs. Industries relying on mass production, such as automobiles, found they could not achieve the scale economies enjoyed by firms with big domestic or export markets.

In more recent times another pressure has emerged in the form of a huge appreciation in the Australian dollar exchange rate, which since 2000 has risen by about 60 percent on a trade-weighted index. Our mining boom, spurred by public generosity to the sector, has been the main cause of this boom, and even more recently there has been a rush of foreign capital into Australia seeking the safe haven of one of the few remaining countries with an AAA sovereign credit rating.

Some economists (usually in secure employment themselves) accept the inevitability of such developments. If we sell minerals to the world and import what we can, then we will all be better-off, as demonstrated by the crude arithmetic of economics. In time all we will have are a few industries protected from international competition by natural factors, such as bricks and bread, but that's OK.

This view overlooks the nature of commodity cycles. Even if the China boom continues, in time other countries will develop their mineral industries, and once mines are developed, commodity prices will fall and our exchange rate will revert to around its long-term level. It's fanciful to think that those firms which have closed in the boom will re-open and all will be well again, because we will have lost our skills. And even if the boom continues, do we want to live in a country with the economic structure of an oil-rich sheikdom? As a Kuwaiti once said to me "we can provide people with everything they need, except meaningful work".

It's tempting to go from that prognosis to an advocacy of policies to support manufacturing, but that may be a logical trap. It is correct, as the Taskforce points out, that prosperous "developed" countries, tend to have strong manufacturing sectors, and that on indicators of productivity and product and process sophistication Australia fares poorly. But is manufacturing a path to prosperity, or is it that there are factors in prosperous, developed countries which allow a strong manufacturing sector to emerge?

Protectionists and free traders, those on the "left" and on the "right", may have been too locked into the former way of thinking. The Taskforce, in its economy-wide perspective, seems to have unshackled itself from this thinking. It acknowledges the importance of what it calls "supply side" factors which influence business costs, including transport infrastructure, the National Broadband Network, and the regulatory environment — all of which fit with traditional policy approaches. But its emphasis is on management and how we may get synergies around clusters of activities, some of which may be manufacturing (such as food, clean energy, health and medical technologies) and some of which may be services to manufacturing.

Policymakers have been too captured by an increasingly meaningless "manufacturing" vs "services" view of the world — manufacturing is where the good, skilled jobs are, while the service industries involve flipping hamburgers and driving taxis. This frame has distorted our thinking, and has led us to overstate the decline of manufacturing, much of which is no more than a statistical artefact, because many manufacturing firms now outsource activities such as security, cleaning, transport and payroll management that they once carried out in-house.

These are now classified to other sectors. Some manufacturing activities have shifted sectors: for example the furniture industry used to make cupboards and wardrobes, but these are now made in the residential building sector. Some manufacturing activities such as printing newspapers are quietly disappearing, but we still have a media industry.

The general development is that over the last fifty years the cost of machinery has tumbled, and firms, wherever they are in the world, can use much the same processes. At the same time the cost of skilled labour has generally risen, but most processes require little labour. That means there is little competitive advantage to be had in controlling production techniques or labour costs — what used to be called "direct costs" in manufacturing firms.

Rather, the competitive edge goes to those who can develop markets and who can make best use of the services which surround manufacturing. Indeed, many would consider manufacturing to be an adjunct to service provision — a 180 degree shift from traditional thinking.

As simple as all this appears, it means a basic shift in institutional arrangements, such as the way our government departments, industry associations and trade unions are organized, and, as the Taskforce suggests, a very different approach to public policy — a long way from the obsession with input costs (particularly labour costs) which dominates our "productivity" debate.