

The future of manufacturing isn't in a return to the past

(Article published in 'Management Today', the monthly magazine of the Australian Institute of Management, March 2014.

Australia's manufacturing sector has been going through particularly tough times in recent years. Manufacturing output has fallen by almost 10% since the onset of the global financial crisis, even as the Australian economy has grown by more than 13%. Employment in manufacturing has fallen by almost 135,000, or 12½%, even as total employment has increased by 7½%. The volume of manufacturing exports has fallen by around 7% since 2008. Manufacturers' pre-tax profit margins almost halved between the 2007-08 and 2012-13 financial years. And the level of manufacturing investment in 2012-13 was, in real terms, the lowest in a decade.

The manufacturing sector's woes have attracted a great deal of public attention in part because Australians, like people in many other countries, tend to think that manufacturing is intrinsically more important than other forms of economic activity, and that countries cannot be prosperous if they don't have a large and healthy manufacturing sector.

Manufacturing does have significant linkages with some other sectors of the Australian economy. It uses about 38% of the output of Australia's agriculture, forestry and fishing sector; 33% of the output of the professional, scientific and technical services sector; and around 12% of the output of the energy and transport sectors. It still provides around \$30bn of export income annually (although that now represents less than 10% of Australia's total export income, down from over 18% in the mid-1990s). It accounts for around 20% of Australia's R&D effort. And it is still Australia's fourth-largest employer, providing work for almost 950,000 people.

Nonetheless, Australia has *never* been particularly good at manufacturing, in the sense of being capable of producing a broad range of goods which can be profitably sold in domestic or foreign markets in the absence of either 'protection' from foreign competitors or subsidies from governments. Australia's domestic market is too small to achieve the scale required, in most cases, for local manufacturers to be internationally competitive. And we are, in most cases, too far away from major export markets to achieve the required scale through exports. Nor have we invested in acquiring the skills and expertise which would allow us to be competitive in manufacturing whilst continuing to pay relatively high wages (as Germany and Japan have done over many decades).

Australia has only *ever* had a relatively large manufacturing sector when successive governments forced Australian consumers to pay relatively high prices for what were often poorly-made goods (through combinations of high tariffs and restrictive import quotas) in order to guarantee local manufacturers a market (and their employees jobs).

And even that wasn't especially successful: manufacturing's share of Australian GDP and employment fell from nearly 30% in the late 1940s and early 1950s to about 15% and 18%, respectively, in the early 1980s – even as levels of 'protection' from imports rose.

The programs of unilateral tariff reductions begun by the Hawke Labor Government in the late 1980s, and continued by subsequent governments through to the early 2000s, brought the 'effective' rates of protection for manufacturing down from an average of around 25% (including over 100% for motor vehicles and parts) to an average of 5%. These have certainly played a role in the ongoing decline in manufacturing as a share of Australian GDP and employment – to 7.1% and 8.3%, respectively, in the 2012-13 financial year.

But they have not been the only factors. The steady rise in the A\$ has played a significant role; as has the growing prowess and competitiveness in manufacturing of an increasing numbers of 'emerging' economies, particularly in Eastern Europe and Asia.

But so has manufacturing's poor productivity performance. Contrary to the oft-repeated assertion that manufacturing is a high-productivity activity, output per hour worked in Australian manufacturing is only 73% of the economy-wide average, down from around 90% in the 1990s. 'Multi-factor' productivity growth in Australian manufacturing has averaged just 0.1% pa since the turn of the century.

From a different standpoint, precisely because Australia *does* have significant comparative advantages in mining and agriculture, and because the sum of the various sectors' shares of GDP by definition cannot exceed 100% (a point which many people have difficulty grasping), it is almost inevitable that Australia will have a smaller manufacturing sector than most other 'advanced' economies. To insist otherwise – as some still do – is to insist that Australians accept either a lower standard of living than they would have otherwise, or that the economy produce a range of goods and services which differs substantially from that which Australians and foreigners want to purchase, merely in order to achieve some pre-conceived notion as to what size the manufacturing sector ought to be.

Apocalyptic predictions of the 'death' of Australian manufacturing are simply hyperbole, intended to goad politicians into continuing policies which haven't worked in the past and won't work in the future. There are encouraging signs that the Abbott Government will resist that sort of pressure. Manufacturing does have a future in Australia. But it isn't likely to be a large part of the future for the Australian economy, or Australian employment. That will almost certainly lie elsewhere – not just in minerals and energy, but (if we make the right choices), in sophisticated agriculture, in intellectual property, and in both basic and higher-value services.