

Going International—A Review¹

1. Introduction

In debates over the future of Australia's manufacturing sector, one is tagged as either a supporter of level playing fields or an interventionist. That is neither accurate or constructive, and hides a great deal of the common ground on key issues. Some of that common ground bears stating from the outset: microeconomic reform needs to be pursued vigorously and rapidly, especially in transport and energy generation; confusion on environmental issues and excessive delays and uncertainty about project approval processes must be substantially reduced; flexibility in the labour market needs to increase markedly; taxes on business inputs need to be replaced by a goods and services tax; and there needs to be a sustained reduction in real interest rates.

In short there is strong agreement on the strategy of removing impediments to export and, more generally to competing in world markets.

The disagreements largely arise over whether there is any positive assistance that Australian governments can apply to encourage and accelerate change, and over the likely shape of Australian industry in the future. These issues are time-dependent—that is they depend in part on the stage of the economic transformation Australia is going through—and they also depend on more than an analysis of comparative advantage using neoclassical economics. As with the solution to any set of continuous adjustment, the initial conditions—Australia's endowment of resources, people and businesses—critically affect the adjustment path, and probably the long term outcome.

Professors Yetton, Davis and Swan have blended an analysis of comparative advantage and firm strategy, structure and management processes in addressing these issues. The result is provocative and challenging, and a major contribution to the debate over industrial development—particularly for manufacturing—in Australia.

2. The Starting Point for Internationalisation

Australia is a small (0.3% of the world's population) country, with a relatively high share of the world's rich people, a larger share of the world's land mass and an even larger share of the world's natural resources. Our culturally closest markets are not our geographically closest markets. Australia's manufacturing industry has developed behind tariff barriers, in two major spurts after World

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Wars I and II.

The Australian economy has, of course, changed much before. Figures 1(a), 1(b), 1(c) and 1(d) show the broad sectoral composition of the economy at thirty year intervals over the twentieth century. There have been major swings: enlarging the size of the rural sector (by establishing an export wheat sector) after World War I; the postwar industrialisation of the 1950's; and the rise of the mining and service sectors over the past thirty years.

Figure 1(a)

Australian Economic Structure 1900/01 (Share of GDP, per cent)

What is different now is that Government policy has committed Australia to a higher degree of internationalisation, the broad thrust of which business generally agrees with (though with some major differences regarding the implementation). Floating the exchange rate, eliminating foreign exchange controls and cutting the general level of tariffs (outside automobiles and textiles, clothing and footwear) have sharply increased access by Australian companies to the rest of the world, and will sharply increase the exposure of Australian manufacturing industry to international competition. The economy is thus in midst of a major transformation on a large scale. The diversification overseas by many large Australian companies over the 1980s has probably made that change irreversible.

Figure 1(b)

Australian Economic Structure 1930/31 (Share of GDP, per cent)

3. The Three Waves

A commonly accepted view of the impact of this is that Australian business is responding by “going international” in three waves:

- investing overseas to enter foreign markets, through buying distribution and production outlets in foreign markets. Much of this has happened already, leading to the development of several major multi-domestic operations (such as Coca-Cola Amatil, TNT, Mayne-Nickless and so on);
- moving production off-shore, to optimise the costs of supplying world markets. A good deal of this has occurred, as companies have located production closer to final markets and have aimed to cut production costs. More of this is inevitable in response to cutting the tariff and as part of the process of moving out of low value-adding manufacturing; and,
- the “third wave” in which Australian firms export high value-added goods and services from Australia as part of their business strategy (strategic exporters).

Figure 1(c)

Australian Economic Structure 1962/63 (Share of GDP, per cent)

The “third wave” has not yet appeared to any significant extent, although the recession has forced many manufacturers to lift exports to maintain production. It remains to be seen whether these become strategic (rather than opportunistic) exporters.

Yetton et al. have augmented this basic analysis by looking at the business strategies of individual firms—for whom managing “one risk at a time” (either technology, product or market) is an important criterion. Their emphasis on risk management is very much in line with my own experience at the Business Council in discussions of factors relevant to decisions to move into new strategic businesses.

As a result of Yetton et al. arguing that the third wave is unlikely to arise from the current stock of internationally competitive Australian companies (with a very small number of exceptions). The most likely sources are foreign-based manufacturing firms, emergent Australian firms who are in the process of becoming strategic exporters and one-off high value-added projects for which Australia is one of several possible locations.

Figure 1(d)

Australian Economic Structure 1990/91 (Share of GDP, per cent)

4. Will There be a “Third Wave”?

For this writer there seems little doubt that, provided that the basic policies stay in place long enough, we will ultimately see a broader base of internationally competitive firms exporting goods from Australia. Broadly speaking, and providing the current confusion over environmental and project approval processes can be resolved, we can reasonably expect to see much greater development of Australia’s natural resource base and the development of industry clusters centred on adding value to commodities. Some development of niche markets in areas where Australian expertise or knowledge provides a competitive edge also seems likely, and we are also likely to remain part of the global production of automobiles, aircraft and so on. Manufacturing in Australia is likely to move sharply away from highly traded areas in which we have no underlying competitive advantage. Exports and imports will increase significantly as a share of GDP.

Those conclusions flow directly from assuming that we enhance our national strengths and reduce our weaknesses by making structural reforms, achieving world class performance in labour and capital and removing other impediments to our national advantages. The strength of economics is that it can identify the

pattern of changes that will result from those changes. But economics generally tells us little about the time-frame of those changes, the costs of adjustment and whether either can (or should) be shortened.

Ultimately, it is firms and enterprises that compete in markets, and therefore it is their strategies, organisation and management processes that determine how they will respond to opportunities.

Developing an understanding what is needed to be internationally competitive as a strategic exporter, and the implications of the principle of “one risk at a time”, become critical, in my view. The interface between neoclassical economics and business strategy, organisation and management is not well understood at present. But it is this issue that fundamentally will determine the pace of response to the new rules and where a better understanding is urgently needed—both for public policy and for businesses that have set themselves the task of become internationally competitive.

Competing successfully in any market requires a sound grasp of customers and institutional arrangements and a strong competitive advantage. Australian companies have successfully entered European and North American markets—most commonly as multi-domestics. That is sound business economics, because those markets are more like our own and many leading Australian companies have well-developed skills in managing medium-sized (by world scale) firms at remote locations.

The same factors explain to some extent why Australian manufacturing companies have generally not been successful in competing in Asian-Pacific markets. For a company with little or no past access to those markets there are at least three types of risk: understanding the customer needs (a risk on the product); the institutional arrangements (a risk on cross-cultural differences); and distributional access (finding a domestic partner). Those factors do not explain why Australian companies have withdrawn from Asia, however, and that subject deserves much closer analysis, particularly by those companies that are aiming to enter those markets in the future.

To state the obvious, expectations by those not in business about the time-frame for profitably marketing manufactured exports to Asia need to be realistic. Pointing to the rapid growth of the Asian-Pacific economies simply identifies a possible difficult business opportunity—it does not guarantee success.

5. Risk-Sharing as a Business and National Strategy

What then does this mean for economic policy and for business? There is a great deal with which I agree in the policy prescriptions in “Going International”. A great deal boils down to creating the environment in Australia that encourages strong business investment.

Within the paradigm of “one risk at a time”, Government can cut business risk by substantially lifting the efficiency of Australia’s infrastructure—particularly energy generation and transport (critical for adding value to raw materials).

Effective and rapid action in those areas would cut costs of producing from an Australian base, and increase reliability. Reform in these areas should be an urgent priority.

Indeed, if Australia is to increase the effective reach of Australian-based exports of products that are presently multi-domestic in nature, then sharply improving the quality of the transport system is a key strategic priority.

Beyond that, Government could usefully concentrate assistance on the “ball-carriers” that are of a sufficient size to become strategic exporters. There is also a good case for encouraging medium-sized companies to grow to become strategic exporters, with strong domestic competition being an important nutrient. Impediments to size in trade-exposed sectors need to be removed, including in the operation of the *Trade Practices Act*. The objective of assistance must be to reduce the business risks faced by the “ball-carriers” in moving into overseas markets—if it does not do that, then it has no real point.

Technology transfer, research and development, education and skill-formation and so on are all key areas where public sector assistance can be focused more effectively on national priorities. This is not a case of picking winners so much as applying economic development priorities to scarce public sector spending, and harnessing it much more effectively with business activity. Doing that effectively will, however, call for much better understanding of the business and commercial realities of business operating from Australia, as well as far better communication between government and business on the process of going international.

Going International: Export Myths and Strategic Realities—Implications for Public Policy and Politics²

This application of management analysis to the reasons for Australia’s poor export performance sheds new light on what should be one of Australia’s prime preoccupations. Combining this approach with general equilibrium modelling adds further insights.

Going International picks up several interesting features of the contemporary “big business” scene. The central theme is the unexpected growth of

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Australian transnational corporations. Here they are called “multi-domestic” firms to stress their tendency to produce—as other transnational firms do—wherever it is profitable for them to do so. Until the 1970s, the Report confirms, Australia had few transnational corporations. In the 1970s there was some investment in East Asia and the Pacific. Many of these investments were abandoned in the 1980s despite the remarkable growth of their host countries, as large Australian firms sought direct foreign investment in New Zealand, Northern America and Europe, which they saw as less risk-prone than Asia.

The authors rightly stress that in Australia, as in other home countries”, firms, not industries, move into international markets whether as investors or exporters or both. The Report’s emphasis on large scale as an essential component of internationalisation in most instances is also realistic. Australian transnationals are also seen as niche marketers, specialising in such products as shoe polish, aspirin, and, more recently, yeast, rubber goods, ready-mixed concrete and beer.

In some respects the study might benefit from some modifications. Some small producers successfully export a large share of their exports if the Australian market is too small to be viable. Clothing, medical supplies, pharmaceuticals and instrument makers have thus broken into international markets with exports and have begun to produce abroad, albeit on a small scale, that, as the authors correctly point out, makes little difference to the Australian balance of payments at least in the short run.

The Report is perhaps too tentative in dealing with the large firms’ contribution to the balance of payments through the repatriation of profits. For some of these firms, earnings abroad are already larger than Australian earnings, and the repatriated income is net, whereas exports are gross. They require considerable imports.

The conclusion that there is no sign of a shift to investment in the neighbouring Asian countries is very interesting. Only time will tell whether some of the small investors will become big firms and whether some of the big firms, now slowly and tentatively turning to Asia, will follow through. Surely, the more adventurous firms will not be able to resist the beckoning markets in the Asian neighbourhood.

The (modified) ORANI modelling results are persuasive, confirming that the positive effects of microeconomic reforms have been underestimated. It is argued that while the stimulus of microeconomic reforms to mining may not be as great as has been hitherto supposed, the impact of the competitiveness of manufacturing industries is likely to be considerable. Not all firms within each industry will respond by exporting more or investing abroad, but some will undoubtedly do so.

The emphasis on “value chain investments” (large-scale primary product processing) is not compelling. Italy’s remarkable economic renaissance on the basis of small-scale high-value exports, the rôle of a toy (Lego) in Denmark’s

economy and many other “widget” successes are too well documented to suggest that “value chain” investments are the only, or even principal, way ahead.

The authors reflect divisions in the community in their attitudes to key issues in “industrial policy”. Their advice accordingly seems to include “picking winners” as well as “letting the market decide”. Policy choices are ultimately for politicians: all that analysts can do is indicate the choices available. This *Going International* does most effectively.

Going International: Export Myths and Strategic Realities—Implications for Public Policy and Politics³

1. Introduction

Going International: *Export Myths and Strategic Realities* is the latest addition to what must now constitute a virtual library of benchmark reports and secondary and tertiary studies of Australia’s industrial outlook. Because the issues reviewed involve the forecast and desired pattern of industrial activity—a key determinant of the pattern of jobs and levels of national income—and the rôle of government in producing these outcomes—these are ultimately questions of national political strategy. These matters were last decisively settled in 1909 as part of a process which culminated in the emergence of the two-party system—indeed they provided the bi-partisan foundation for that system. National political strategies are properly durable. Change should elicit vigorous intellectual debate. It would be equally surprising if the politics of change were not turbulent. Yet one hopes a future student will be able to trace through present processes of enquiry, debate and political conflict, ever more comprehensive definitions of the central empirical issues, more precise refraction of the values that are at stake and, through succeeding political responses, an ultimately successful process of adaptation, however “success” comes to be defined.

Where might this report stand in that perspective? In a nutshell, the report’s central empirical finding is that Australia’s existing successful international firms—the so-called multi-domestics—will not “pull through” exports from Australia. They will not “solve” our external deficit problem, if “problem” this is.

3. Ian Marsh, Australian Graduate School of Management, University of New South Wales.

This is because they do not operate in the tradeable sector of manufacturing. Their skills and competencies—considerable as they are—sustain other activities. What is to be done? Here the authors diverge. The report does not obfuscate. There is common ground but there are also significant differences concerning the scope and rôle of government and the status of interest groups. In the accumulating library of reports, this one, will, I think, ultimately be found most significant for its airing of these differences. A richer debate about public policy might perhaps ensue. More distantly, this report also perhaps points to a possible future political coalition—or more accurately the return of an older “Deakinite”-Labor coalition in some contemporary variation. These possibilities are considered in more detail below.

2. Public Policy Implications

Public policy implications arise from the way the report fertilises and advances understanding of the issues and possible remedies. These concern both the facts about the likely future of the multi-domestics and the theories in the light of which these facts are to be assessed.

First, as already indicated, our existing multi-domestics will not “solve” our trade deficit. Policy makers need to look elsewhere. This is an important empirical finding that should move debate to new terrain. There are other important empirical findings in the report—for example, concerning Australian investment in north and south Asia—which also invite attention.

Second, this report endorses the view that a manufacturing sector and manufacturing exports are essential to our continued prosperity as a nation. This is not argued in detail. The report declares itself almost in passing. It suggests manufacturing is important because the terms of trade favour ETMs. It quotes approvingly the observation of the Hughes Report that Australia is the only industrial country that has not increased its proportion of merchandise exports to GDP during the past thirty years. In this context, it is notable that no nation anywhere has yet succeeded in transforming its economic base from dependence primarily on resources and commodities to value-added manufacturing and services.

Third, in developing policy for manufacturing, the Report invites policy makers to adopt a much more finely grained specification of potential exporters. This arises at both the generic and the industry or activity level. At the generic level, the report proposes a new taxonomy of firms. Indeed, the authors declare: “We intend to change the existing mindset and policy viewpoint . . . we conclude there are at least four different generic types of manufacturer. Successful policy initiatives for each group must necessarily be focused and different.” (Other parts of the report make it hard to believe all the authors concurred in this last sentence.) The four categories proposed are: multi-domestics, foreign-based manufacturers, mobile links in resource anchored value chains, and emergent strategic exporters. This classification is a considerable advance. One hopes it might quickly enter and refine policy debate. It might also push political rhetoric towards more realistic

appraisals of export possibilities. For example, we might be freed from expectations such as those associated with the stillborn *J*-curve.

At the industry or activity level, the report suggests specific areas for manufacturing exporters. Through an analytic process described as multi-attribute modelling a number of categories of manufacturing activity are selected and, after subjection to various manipulations on the ORANI econometric model, found to have considerable potential to contribute to exports. I leave it to the heirophants to judge the arcane vocabularies and procedures that surround this reading of the auguries. What most impressed this reader was the compelling simplicity of the procedure that was adopted to select eleven manufacturing activities judged to possess export potential. These activities included fishing, petroleum and coal products, iron and steel, food products and chemical fertilisers. Evidence of their export potential was reinforced by an analysis that used a comparative statics methodology. If policy makers should choose to become more focused in their interventions, this illustrates the quite simple analytic techniques by which potential areas of opportunity might be identified. One can imagine other approaches that attach more weight to demonstrated or emerging consumer demands in prospective markets.

Whether or not policy makers should adopt more interventionist approaches—in other words the extent of the positive rôle of government—is the nub of the difference among the authors. This surfaces at several points throughout the report and is made explicit in the final chapter. This disagreement is based on the different theories on which the authors draw to analyse particular elements of the overall issue and to judge what should be done. These alternative theories imply significantly different approaches to public policy. James Q. Wilson suggests the contribution of intellectuals to public policy debate lies in the provision of:

the conceptual language, the ruling paradigms, the empirical examples (note I say *examples* not evidence) that become the accepted assumptions of those in charge of making policy. Intellectuals frame, and to a large degree conduct, the debates about whether this language and these paradigms are correct. The most influential intellectuals are those who manage to link a concept or a theory to the practical needs and ideological predispositions of political activists and government officials. The most important source of intellectual influence on public policy arises out of the definitions of what constitutes a problem and what standards ought to be used in judging its problematic character.

He concludes:

In short, what intellectuals chiefly bring to policy debate, and what accounts for their influence, is not knowledge but theory. Theorising is not the same as empty talk. Good theory calls attention to obvious truths that were previously overlooked, finds crucial flaws in existing theories, and reinterprets solid evidence in a new light. And some theories, if adopted,

will make us all better off. The problem is to know which ones.

Deciding which theories to adopt to guide what elements of public policy should prove a vexed issue not only for public service advisors but also ultimately perhaps for politicians. The report only glances at the profound differences between the theories of neoclassical economics and a more empirical framework. These differences arise from method, premises and values. Neo-classical economics is deductive—that is it interprets empirical reality in the light of abstracted models which are (on other criteria) held to embody a perfection to which we should constantly aspire. It is individualist—to the point of atomism—in its normative premises and assumes away distributional concerns. Its theorems together provide a comprehensive framework within which the “problem” of competitiveness can be defined and the rôle and tasks of government determined. These theorems include allocative efficiency, comparative advantage, consumer sovereignty, diminishing returns to scale, the welfare gains of perfect competition and public choice. This framework of deductive theory constitutes a formidable intellectual, normative and ideological apparatus. The political program that follows includes the replacement of political relations by market relations (the so-called *level playing field*), contraction of the scope of government, a rôle for the state of night-watchman or gatekeeper and the treatment of interest groups as irredeemably selfish and self-serving and hostile to the public interest.

The alternative approach that is aired in this study is inductive. It proceeds from empirical analysis of the actual experience of firms and countries to a set of recommendations about the nature of the challenge of competitiveness and the possible rôle of government. This approach does not purport to embody an entire philosophy of government. But it is more sanguine about the beneficent capacities of government. For evidence it points to the rôle of government in the most successful contemporary states. Without minimising the problems of policy and institutional design, it does not regard interests—such as business firms or exporters or trade unions—as irredeemably selfish and self-serving. It assigns government a rôle in identifying national competitive opportunities and in orchestrating action between private interests to facilitate their pursuit by private firms. The agenda of government would include positive measures to encourage (dynamic) competitiveness as well as (allocative) efficiency. Government would adopt the rôle of “portfolio manager” of key national industries. It would use its control of market access, its ability to “bundle” purchasing and to negotiate offsets to encourage domestic industry and exports. Appropriate R&D and its diffusion would be stimulated. Trade practices legislation would incorporate appropriate definitions of competitiveness. According to this approach, neoclassical economics has a useful and positive contribution to make in defining the tasks of government in modern society. But in its hands, a set of theories that shine a light on a particular form of inefficiency, and that offer a partial explanation about the workings of our complex society, has been elevated into a complete philosophy of government.

These different approaches are both acknowledged in this report. Their separate implications are most evident as the authors explore the significance of their empirical findings. For example in reflecting on the ORANI simulations, the authors suggest these “indicate only what potentially might happen . . . the key issues revolve around identifying which type of firms will be successful in different export industries“ . Having identified so-called emergents, the “mobile link” and international manufacturers as the generic categories on which policy should focus, the authors suggest: “Policy can direct such government development expenditures as are made away from those areas with poor prospects towards those in which there are both relatively good prospects and an already emerging cluster of firms”. Later they argue simulation “identifies potential opportunities which should emerge as the environment changes”. But they go on to suggest:

simulation cannot give us much insight into two questions.

- *When*, and over what time horizon, will any projected manufactured exports actually occur?
- Do firms exist *now* to crystallise such opportunities, or are we dependent on new firms emerging to translate this potential into reality?

The report suggests the choice between the neoclassical and more empirical approaches is ultimately value based. This is surely not a sufficient account of the political judgement that is required. If it is the task of public policy analysis to air intellectual issues, it is the task of the political process to decide which “theory” best serves the public interest. This involves political judgements that are embodied in electoral and government strategies. This brings us to the political implications of the report.

3. Political Implications

Political strategy differs from public policy analysis in several respects. First, it should involve a more comprehensive assessment informed by, but overarching, all the relevant specialist and technical analyses—its frame is the public interest broadly conceived and the rôle of government in pursuit of that interest; second, it should be more concerned with underlying values and desired outcomes—the kind of people we are and might aspire to be; third, determination of the public interest incorporates political feasibilities—can a majority coalition be assembled to authorise action at the electoral level and/or at the level of the proposed generic sectors? This report ought to provoke reflection on a number of these issues.

The first political implication arises from the economic outlook. This report removes one potential source of succour for policy makers and politicians. It surely foreshadows economic upheaval and protracted dislocation? If

manufacturing exports are central to maintenance of our lifestyle, where will they come from? The conclusion opens on an optimistic note: "Our general findings . . . in relation to manufacturing exports export potential are quite optimistic." But qualifications are immediately introduced. It is not clear that the timing will coincide with national needs. Nor is it clear whether firms exist to realise such opportunities.

Second, the different theories that are drawn on by the report's authors point to different political strategies. As already mentioned, the free market approach implies a rôle for government no larger than that of night-watchman or gatekeeper. Where policy failure arises it enjoins ever more determined efforts to approximate the conditions of perfect competition. Conditions that breach this norm are to be considered deviant. Perhaps the most notable deviancy arises from collective action by citizens or firms in pursuit of some shared sectional interest. Thus, the free market protagonist writes: "It is the influence of special interests, which have dominated policy making in Canberra for much of the last seventy years, which is responsible for Australia's present predicament".

The interventionist strategy is perhaps less polemically sketched. It focuses on the asymmetric timing of gains and losses, the presumed irreversible and pervasive influence of governments, and the failure of comparative static methodology to illumine dynamic processes. In its specification of generic categories of firms, the possibility of a more positive rôle for government is clearly recognised. Interest groups—in this case the relevant firms and industries—are not conceived as irredeemably selfish. Nor are there overarching remedies. Each solution needs to be tailored to the circumstances of the case. Thus, trade practices legislation should be recast, federal-state purchasing arrangements need to be coördinated, strategies for particular categories of emergents need to be developed, strategies for capturing the mobile link in the value added chain should be investigated, strategies to attract foreign based manufacturers to Australia should be designed. Together these constitute some elements of a "positive" industry policy. In general this constitutes a pragmatic and non-doctrinaire approach with an emphasis on experiment and enquiry to determine what might work and to see what others do.

Whereas the interventionist approach suggests strategies *can* be formulated at the level of particular policy communities, this is anathema to *level playing field* protagonists. For the latter, national electoral strategies are required that create broadly based coalitions of winners. These coalitions "authorise" governments to take necessary punitive action against recalcitrant sectional interests which hamper realisation of the prosperity that would accompany unfettered market relationships.

In the period between 1900 and 1909 when Australia's present national political strategy was being conceived, the major political cleavage was between Free Traders represented by George Reid and a Centre-Labor combination represented by Alfred Deakin (and his advanced liberals) and the emergent Labor party. Neo-classical economics was then ranged against a more pragmatic and

“piece-meal” approach to the rôle of government. Ultimately the Deakinites won out. Contemporary Australia—notably its praiseworthy tolerance and high valuation of fairness—testifies to Deakin’s achievements. Present debates rehearse the array of issues and values that were contested in the 1901 to 1909 period. At least some of the political coalitions which are conceivable might equally repeat this earlier period. There might be grounds to welcome such a development. Our major political parties have yet to come to terms with the implications of the different remedies. This report, in its airing of alternative theoretical approaches may yet advance the development of new public policy strategies and political rhetoric and perhaps ultimately points to new lines of political cleavage. These must emerge if debate is to shift from a confined group of specialists to the political arena—the only place where our collective will to choose is itself open to mobilisation.