

# **COUNTERPOINT**



## Determining Industry Policy

by  
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### 1. Introduction

On 24 January 1992, the editorial writer of *The Australian Financial Review* contributed in now familiar fashion to the debate on industry policy in Australia. Responding to emerging questions about Australia's uncompetitive approach to business taxation compared to Asian countries, and the prospect of sectoral priorities being established, the editorial concluded:

Targeted assistance is, in its base form, closeted protection and its resurrection would be regrettable . . . The Economic Statement will be one sign of whether the Prime Minister can resist the politically appealing short-term options of appeasing rent seekers and seeking to pick winners . . .<sup>1</sup>

These comments crystallised my objective in writing this essay. First, the invective is now commonplace. Terms such as “appeasement” and “rent seekers” disparage those who argue for another course. It seems no longer possible to debate the issues.

Second, and this is the irony, the editorial coincided with *The Bulletin's* feature on Singapore which tells us that Singapore's new Strategic Economic Plan (SEP) aims to turn that country into an “advanced developed country” by 2030 with a per capita GNP equal to more than that of the United States.<sup>2</sup> The plan describes areas of regional and R&D priority. The article also describes the recent investment made by Singapore's Economic Development Board (EDB) in a \$260 million plant to produce advanced memory chips—an investment co-ventured with Texas Instruments, Hewlett-Packard and Canon.

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1. Editorial, *The Australian Financial Review*, 24 January 1992, p.14.

2. *The Bulletin*, 21 January 1992, p.70.

† Boston Consulting Group, Melbourne.

A paper prepared for the conference entitled Creating the New Australian Economy held at the Australian Graduate School of Management, University of New South Wales, 14–15 February 1992.

On the same day, I also read a comparative survey<sup>3</sup> of approaches to industry policy in the U.K., Germany, France and Spain prepared by The Boston Consulting Group. It notes that the total value of state aid to manufacturing in Germany is more than double that of the U.K. It also documents that the U.K. dramatically reduced its industry support throughout the 1980s while German support actually increased.

Rent seekers? Appeasement? No, the central issue in the industry policy debate in Australia is why the strategies being pursued in many of the successful economies cannot even be discussed. This essay attempts to explain why this is the case and offers some suggestions on better ways to proceed.

Lack of agreement on solutions usually means that perceptions about the *causes* of underlying problems are not commonly shared. In the absence of greater shared understanding, the possibility of widespread community acceptance of difficult solutions is diminished. This is true in the current debate, where “economic rationalism” is either the disease or the cure depending on one’s point of view.

I approach this subject with caution because of the complexity of the issues. But it seems to me that the perspective of conventional economics is seriously flawed when it seeks to explain the performance of *firms* that operate in higher value added industries. As these industries are important to Australia, the purpose of this essay is to describe these shortcomings and outline the implications for industry policy in Australia.

Before heading into my subject, it is important to explain my position in the debate. My working hours are spent with firms on issues of competitiveness and competitive strategy. If I have any expertise, it is in this area. I know how firms compete and what leads them to invest; what differentiates firms from their competitors and what factors lead to commercial success and failure. I work as part of The Boston Consulting Group, which over the past 25 years has been known throughout the world for its conceptual contributions to business strategy thinking and for its application of micro-economic disciplines to strategic issues facing firms. This work involves international as well as domestic markets. In the past twelve months alone, my Australian colleagues and I have been involved in competitive strategies in such diverse arenas as forest products in South America, cardiac pacemakers in the U.S., beef exports to Japan and rubber-based products from Malaysia. All of this work is done for individual firms and involves analysis of competitive prospects and development of market strategies. It involves detailed assessments of business economics—those factors affecting costs, responsiveness, quality, relative prices and the like. It draws on competitive

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3. Industrial Policies in EC Countries: A Comparative Study, 1991, the Boston Consulting Group Inc., unpublished.

strategy concepts and models developed over the past two decades which have revolutionised the way good managers think about competitiveness in their businesses.

I am therefore a student of, and a keen believer in, competition and competitive markets. As such, I am more at home with the “economic rationalists” in the current debate than with those who wish for a return to our protectionist past. This past has been a disaster for our country—an *inward* focused protectionism that has led to a non-specialised economy composed of internationally sub-scale firms and all manner of poor practice.

The “economic rationalists” have done Australia a service by rejecting this inward protectionism. To do this—in fact, to overthrow any dominant ideology—an alternative world view has had to be on offer. The neo-classical economist’s paradigm has conquered the intellectual debate in Australia and the steady drift of public policy is towards its implementation. Vested interests remain strong, but the decline in tariff protection is a testimony to the victory of the free-trade idea. By 1993, Australia’s tariff and non-tariff barriers will be among the lowest in the world when agricultural as well as manufacturing tariffs are taken into account.

Notwithstanding all of the above, my colleagues and I part company with current thinking on important issues. Mr. Keating, as Treasurer, criticised our AMC proposals as “mere embroidery on the fabric of policy”. I am not too uncomfortable with that if it means that what is most important for Australia is to pursue micro-economic reform and maintain the macro-economic fundamentals—the savings rate, interest and inflation rates—at competitive levels. But while industry policy may be the embroidery on the fundamentals, it is also very important and this is where I take issue with prevailing opinion.

The models developed by business strategists over the past two decades to explain the success and failure of firms in higher value-added industries have still to be grasped by economic policy makers. Thus, some of the policy prescriptions that have been pursued in Canberra are inappropriate.

If invited to influence formulation of industry policy in Australia, I would simply seek to alter policy makers’ understanding of what determines success and failure for firms. I would focus on those categories of industry that are both *traded* and where *competitive advantage* rather than *comparative advantage* is key to the market outcomes. In these significant instances there can be justification for intervention and special support. It is what the process of getting it right consists of, that is the focus of this contribution to the current debate.

This essay is organised into two main sections. The first section describes the business strategy paradigm and contrasts it to the economist’s model. In particular, the crucial distinction between *comparative* and *competitive* advantage is highlighted. In the second section, the more interesting implications for policy that derive from a business strategy perspective are described. They are:

1. The importance of individual firms in the traded sector.

2. The definition of relevant competitors.
3. The usefulness of a portfolio view.
4. The importance of “vision”.

Finally, a brief conclusion will comment on practical issues relating to implementation.

## 2. Different Paradigms

The models through which we interpret complex reality are important. They enable us to see causality and lead us to choose between outcomes. We are all captive to our models. The inward-focused protection that leads to import substitution has obviously had strong logic for its believers. But the real issue is whether our models are helpful or not.

Clues to understanding the industry policy debate are to be found in the different paradigms employed. Most of the heated public debate is focused on the solutions that are proposed. Should we support TCF industries or give tax breaks for The Very Fast Train? Less frequently, however, are the underlying assumptions or “truths” laid bare for all to see and evaluate.

It is perhaps because I am a lapsed economist that it took me some time to understand the guiding beliefs of the economic policy makers and journalists who so dominate our national debate. Their views rest on an important proposition: “To intervene in the economy is to *always hurt oneself*”. There is no ambiguity here. This view finds expression in many ways. Free trade is beneficial to all—“it is the technique which allows everyone to share in the low cost advantages enjoyed by others”. Anti-dumping legislation is based on a fallacy—“if foreigners are really selling below cost, it means that they are transferring wealth to local customers. Why should the local government be so paranoid about foreigners making gifts to the population?”

These propositions are accepted as so evident that they barely need justification. The Hughes Report (1989) analysed Australia’s export performance and deals with interventionist policies in about a page. It concludes that these countries would be richer if they hadn’t intervened.

In public debate at the AGSM’s forum on industry policy in July 1990, organised to debate the Garnaut and AMC reports, Roger Douglas gave a spirited apologia for his policies, citing as examples New Zealand deregulatory achievements in three industries; forest products, banking, and dairy products. He posed many rhetorical questions such as: “Why haven’t we been as successful as the Swiss in moving to higher value dairy products?” His answer, of course, was to be found in interventionist policies and moribund producer boards. During question time, Mr. Douglas was asked for his views on why the Finns, who are so strong in higher value-added paper products, intervene actively in this industry; why the Swiss have for so long protected the ownership of firms like Nestlé

against foreign control; and why Japanese banks, still highly regulated, account for nine of the ten largest banks in the world. One would have thought that these were quite reasonable questions given that Mr. Douglas had chosen to cite these three industries, but he answered the question in all of five seconds, simply saying that they would all be better off if they hadn't done these things. Answers such as this are profoundly disturbing to those of us who know that the Finns, Swiss and Japanese have quite sophisticated perceptions of their own best interests.

Our conclusions are determined by our beliefs. Evidence is interpreted in light of those beliefs. For example, all parties look at MITI and confirm their own pre-formed judgements.

The Industry Commission in its 1989/90 Annual Report devotes a chapter to Strategic Trade Theory and The East Asian Experience. It concludes that the lesson from Japan, Korea, Singapore, Taiwan and Hong Kong is that "industry-specific assistance far from being a pre-requisite for success is likely to be harmful". This conclusion may or may not be correct, but there is no mention of Japanese tariffs in the 1960 to 1980 period which were high even by standards which today make Australians embarrassed. This was the period during which Japanese industrial power was created. No mention is made of the total embargo on car imports between 1952 and 1965. A business executive has cause to wonder when trying to reconcile these conclusions with views such as those in a recent CEDA publication, *Towards Free Trade Between Nations*.

The tariff system in Japan employed an escalating scale under which low rates were levied on raw materials and progressively higher rates were imposed on goods as their level of processing increased. As a result the effective rate of protection, that is, the degree of protection provided, was higher than the normal tariff . . . These import restrictions had the effect of erecting high entry barriers against imported goods. They also worked to isolate Japan's domestic market from international competition and to secure it for Japanese companies. Within this home market, protected from overseas competition, Japanese firms gradually expanded their scale of production. In doing this they gained international competitiveness by steadily reducing their long-term average costs and securing economies of scale (Wakasugi 1989, p.77).

If one's models assert that intervention is harmful to oneself, it must be very difficult to come to any other conclusion. The Industry Commission in the aforementioned assessment mentions one Singapore intervention to cite its failure to encourage high value-added manufacturing by mandating wage increases. It makes no mention of Singapore's continued policy of targeting—for example, its tax holidays for pioneer industries, its inducements for headquarters to locate in Singapore, and its direct equity investment in manufacturing. Are we really to regard these actions as self-inflicted injuries?

Canberra's confidence that it is correct is considerable and it even claims a tutoring rôle, something that successful Asian economies must find breathtaking:

Australia's efforts to open foreign markets appear to have been impeded by a lack of appreciation within the countries concerned of the cost of support policies to their own economies and of the benefits from reform . . . But (Australia) can influence international development in two other ways—through “demonstration” effects and the power of ideas. The May 1988 announcement of tariff reductions by Australia was an important example of the demonstration effect . . . (Industry Commission 1989/90, p.13).

The view that intervention and selective treatment across industries is a “shotgun blast at our own foot” (Ross Garnaut's term)<sup>4</sup> is deeply embedded in the belief systems of our economists and economic journalists. As such, one can appreciate their genuine dismay when confronted with proposals for special depreciation allowances, slower run-down of tariffs, anti-dumping cases, proposals for government grants and the like. They “know” that any concessions are unfortunate compromises to vested interests that make our eventual recovery that much more difficult to achieve.

But are they correct? Do conventional economic models really explain reality? Is intervention always a dead-end street? Against what logic can we explain Singapore's combination of zero tariffs and positive investment incentives? Do the Germans really believe that their tax incentives for investment in specific regions is no more than a “shotgun blast at their own foot”? Is the Japanese approach of graduated tariffs that facilitate entry of low value added products at zero tariffs (e.g., logs), while having higher tariffs on the value added products, a clever strategy or simply a distortion that benefits Japan's trading partners?

Over the past 25 years, business strategists have worked with different paradigms—not simply because they wanted to be different, but because competitive reality has forced them to. The key to understanding this is to understand *competitive advantage* between firms. It is now dawning on some of us that this means something quite different from *comparative advantage*. When this distinction is understood, intervention policies pursued in some of the more successful economies begin to make more sense.

In higher value-added businesses, competitive advantage is usually created by firms rather than endowed by countries. Competitive advantage is different from comparative advantage. *Comparative* advantage determines which countries best grow wheat and trees, refine alumina and make cheap garments. *Competitive* advantage has more to do with who makes machine tools, microchips and toothpaste, operates a bank and makes cars. *Comparative* advantage depends on endowed factor costs and is owned by industries in countries. *Competitive*

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4. Quoted in *The Australian*, 30 November 1990, p.5.

advantage is owned by individual firms and rests on cost advantages created through such things as scale or proprietary technology, or rests on market price power that results from brand strength or service capabilities.

It is not an accident that business strategists are not usefully employed in monopolies or perfectly competitive markets. Business strategy has most relevance when firms are engaged in markets where the effects of each firm have profound impact on the others. Presumably, these are the worlds that economists describe as oligopolies, where there are imperfectly competitive markets. It also describes most industries that exist today in manufacturing and services trade. Here, competition between firms is the critical determinant of outcomes. As such, there is no inherent logic to the domicile of these businesses, as there is in industries where the advantages are endowed.

Competition between firms is a dynamic process, not captured by static models. As in warfare, the ground shifts but competitive advantages can be long lasting. That is why business strategists are so interested in those factors that appear to lead to historically determined outcomes. The failure of new competitors to succeed in newly deregulated Australian banking and airline industries, for instance, is very much tied up with the scale advantages and strength of consumer franchise built by existing competitors during regulatory protection. That the protection has been lifted has not changed anything significantly because prior protection has determined outcomes in the free market. Thus, studies that show import penetration in Japan has not increased markedly as tariffs were reduced, do not prove that tariffs were ineffective. As is evident in the Australian examples, a legacy of protection can alter outcomes even after free market conditions are later introduced.

In this sense, economic policy makers and commentators are naïve when they now point to reduced protection in Japan as proof of its non-efficacy. An alternative view is that these countries no longer need protection from new entrants—any more than Westpac or Ansett do. When *competitive* advantage has been so achieved, free trade makes sense even to the most committed interventionist.

The “business strategy” notion of competitive advantage can be illustrated as follows. Nearly thirty years ago, business strategy thinking took a sharp turn. Experiences in the rapidly growing semi-conductor business demonstrated that a firm’s unit costs fell as cumulative output increased. Known as the experience curve (and based on long established notions of the learning curve) the strategic implications were obvious. The firm who can capture experience will preempt its competitors. Advantage is created and possessed by specific firms.

The term “competitive advantage” is used carelessly by many people today. It has over the past twenty years become a buzz-word. But few business executives really understand it. Its true meaning is this: “To possess an advantage that bestows economic gain in the form of lower costs or higher prices and which cannot be matched or replicated by competitors”. This non-replicability means that

competitive industries consist of winners and losers. Non-replicable advantages may include strong brands, better ore grades, high market share, proprietary technology, proximity to market and the like. Such advantage is a relative, not absolute concept. The size of one's advantage relative to competitors is the direct determinant of profitability.

To take an example, market share is a common source of competitive advantage. In many (though not all) industries it offers returns to scale. Numerous studies show correlations between profitability and market share. The PIMS data which covers thousands of U.S. and European businesses is best known and *on average* demonstrates increasing returns to scale (see Figure 1).

Source: PIMS database.

### **Figure 1**

#### **Profitability and Market Share**

If scale is the basis for advantage in an industry, *relative* market share is of critical importance. Because there is no more than 100% of market share available, it follows that if a firm has 70%, the remaining competitors are destined to achieve poor returns. The benefits of 70% share are not replicable by competitors. Their response must be to take share from others (a zero-sum game), accept lower returns, exit the business or attempt to redefine their participation in the industry with new products or services (in which case they will be subject to the same contest with other competitors who attempt to do the same thing). Individual firms

create and possess the competitive advantage and through their strategies have dramatic influence on each other—this is a long way from the economist's comparative advantage model.

Only two years ago, while engaged in the AMC work, I read with interest Peter Drucker's book, *The New Realities* (1989). He described a new form of international trade which he termed *adversarial* trade, something rather different from the complementary trade that underlies oft-quoted examples of England and Portugal trading textiles and wind in the days of Adam Smith and David Ricardo. He writes:

Adversarial trade changes the basic rule, and drastically. In the first place, it can no longer be assumed that competition is entirely beneficial—the basic postulate of the economist. It was one of the very great triumphs of nineteenth century economics to prove—against serious doubts—that competitive trade is ultimately beneficial to both partners . . . the aim in adversarial trade, however, is to drive the competitor out of the market . . . when the attacking country is still closed to imports—or at least severely restricts them . . . the competitor under attack cannot win . . . Adversarial trade thus challenges the conventional assumptions. Clearly, protectionism that shuts off one's own country is the wrong answer. It can only make one's own industry even less competitive. But free trade is not the answer, either (Drucker 1989, p.131).

Higher value added industries are dominated by examples of competitive advantage. In the deregulated Australian industry, new banks could not achieve market share, particularly in retail, to be viable. Distribution barriers and switching barriers which reinforce the strength of brand franchises are the problem, not banking competence. Compass Airlines understood at the point of its collapse that significant share of the full-fare paying customer (that is, the business traveller) is one of the keys to survival in the Australian domestic airline industry. Arnotts' strong brand strength in biscuits, based upon acquisition and cultivation of strong brands over decades, has seen off many competitors including two of the world's great companies, Nabisco and Westons. On the other hand, Arnotts' entry to the U.S. biscuit business failed for two reasons that mirror image their Australian success. The strength of the franchise that enables the oldest universities to attract a disproportionate share of the best students is a further example of market outcomes influenced by events long past.

The important distinction that business strategy makes is this: competitive advantage is created and possessed by individual firms and institutions. Once established, it can often be defended to secure above-average returns. The sustainability of competitive advantage varies across industries depending on the potential to build brand loyalty, the extent of returns to scale and the like.

On the other hand, *comparative* advantage is possessed by regions, whole industries, by countries. Firms are simply beneficiaries and they share the advantages with other firms—a warm climate that grows oranges or wheat,

geological formations that contain oil, low labour costs that aid labour intensive processes, cheap hydro-power that is useful to aluminium processing.

Commentators on industry policy appear limited to using comparative advantage models. This is the model applied by most economists and financial journalists. It is also the world in which Australian farmers and miners live, and a logical reason why the chief executives of our mining companies and farmer representatives often argue against incentives for manufacturing and services. Unfortunately, there is no hint at why they reject as self-evidently wrong a strategy that is extensively employed by successful economies such as Germany and Singapore. Business executives also espouse their support for free trade because its ideology is apparently in keeping with what they perceive "free enterprise" to be all about. At a private level however, many are confused. They are unable to reconcile the public platitudes with the realities of the market place. The further firms in Australia proceed down the value-added chain in traded goods, the more sceptical their Chief Executives are about the unambiguous merit of free trade when facing uneven playing fields off-shore. Their views may, of course, be self-serving, but there may be a more honourable explanation than that.

An important difference between industries in which comparative and competitive advantage apply is this. With comparative advantage, intervention is ultimately a no-win game. Here, our policy makers are correct. European agricultural subsidies clearly cost their consumers plenty for no permanent gain. The immediate impact will be depressed returns for Australian farmers, and Australia's wheat production will be curtailed. Wheat land will be put to other uses or left idle. But the nature of this industry is such that the European subsidies do not dent Australia's comparative advantage. It endures because it is based on endowed factors such as climate. When subsidies are removed, land in Australia can and will revert to wheat. This is a valuable insight from the notion of comparative advantage. European subsidy of agriculture cannot shift comparative advantage and therefore makes no economic or strategic sense, unless the gains are to be justified in social terms.

Industries in which competitive advantage applies, however, can operate according to a different set of rules. Because this advantage is created, it can remain with the firm that is the immediate beneficiary. Protection or other assistance can alter outcomes. Protection can provide conditions within which firms can achieve levels of performance that are subsequently sustainable *without* protection. Viewed in this way, while protection may incur costs, in competitive advantage industries these can be regarded as an investment from which future benefits may flow.

This is the crucial distinction. European subsidy of wheat farmers is wasteful and all sides lose. This is because the underlying competitive relationship between Europe and, for example, Australian farmers remains unaltered. Australia's cost advantage is endowed and in the long term undiminished by European investment. But European protection of Airbus Industrie is an altogether

different matter. This is an industry driven by competitive, not comparative advantage. Protection of Airbus Industrie inevitably weakens Boeing and McDonnell-Douglas, perhaps irreparably so. Whether this is a good thing for the world is not the issue here: the question is whether it will be a net plus for Europe. Most economists argue that it *must* be a bad deal for Europe while business strategy frameworks are of a more open mind. It is high risk because it attacks well entrenched competitors, but ultimately it will depend on the cost-benefit outcomes and there is no necessary presumption of success or failure. The issue is whether Airbus builds cost and service capabilities that enable it to achieve margins that are superior to the American competitors and which can be sustained in open competition to the point that more than recoups the investment.

In summary, this is the critical issue in the debate. The public policy debate is dominated by the economist's paradigm that affirms that *all* government interventions and market distortions are self-inflicted harm. No room is left in the debate for the possibility of intelligent and effective intervention. Those who argue its case are ridiculed. In this sense, a dangerous fundamentalism has returned. Twenty-five years ago, it was a courageous thing to oppose Australia's protectionist approach. We have now moved to the other extreme where advocacy of *any* government incentives and targeting is a career-limiting move in Canberra. This is notwithstanding the fact, for example, that Germany has been a leader in the use of differential incentives through the tax system to promote investment in particular areas, or that Singapore targets particular industries for support.

In have drawn the distinction between comparative and competitive advantage in bold contrast to emphasise their fundamental difference which is that comparative advantage refers to factor cost advantages usually *endowed* in countries or regions, while competitive advantage is *created and owned* by individual firms and is the means whereby one firm is a more successful competitor than another.

As with any classification, the boundaries are grey and it is necessary to explore the implications of recent work which emphasizes the importance of clusters and the national infrastructure and the like. [Michael Porter's work is the most cited contribution in this area (Porter 1990).] To the extent to which these environments can be developed and shared by all firms, they hold some of the same attributes of comparative advantage.

Firms interact with their surrounding markets, suppliers, competitors and institutional environment, sometimes creating a very complex *system* that itself has advantages over the systems of its international competitors. Such "systems" may produce advantages that are shared by *all* firms (in this sense they are like comparative advantage) yet they are *created* (in this sense they are like competitive advantage). This has been termed "dynamic comparative advantage". Firms participating within the system can draw on the advantages. Examples might include Japan's car, office equipment and home electronics industries, California's Silicon Valley and Italy's wool, textile and fashion garment industry. The shared

access to skills, leading edge customers, research specialities, supplier skills and the like reinforce the competitiveness of individual firms. National propensities to work hard or to be engineers rather than takeover lawyers and property entrepreneurs can also be a shared resource from which firms can draw. An impenetrable distribution system or a xenophobic bias against foreign products are other examples. These insights have led to recent interest in the industry policy debate of government's rôle in facilitating the development of better physical infrastructure, education, savings habits and the like. That much is acceptable to the level playing field advocates provided that it does not lead to sectoral targeting. In fact, the development of industrial clusters—for example, the Malaysian latex industry or Japan's strategy for developing a lead rôle in High Definition TV—are examples of this more targeted approach.

While an aim of policy should be to promote development of such an environment in Australia, it should not be confused with the competitive advantage possessed by firms. Even within the Japanese market where firms can share the national propensities for success, there are the usual patterns of winners and losers among firms. It was, after all, in the motorcycle cluster in Japan that Honda effectively demolished Yamaha. ("Slaughter" was the word used by Honda's chairman.)

In the light of this discussion, it becomes clear that successful regions or nations without comparative advantage such as Japan, Taiwan and Singapore have had little choice but to *create* advantages. This they have done by creating an economic environment that is conducive to success and by pursuing policies that attract and nurture firms with the ability to win in overseas markets.

These ideas can be drawn together into a simple framework, shown by Table 1, which identifies the three sources of advantage that are potentially available to support the development of strong traded sector businesses. This framework enables us to understand the reasons for market outcomes in the different areas of the traded economy. Without this understanding, the policy perspective must be flawed. A good example concerns the increasing level of intra-industry trade, a phenomenon that makes little sense if one seeks to explain this reality in terms of comparative advantage. On the other hand, intra-industry trade (such as Germany, which is both an importer and an exporter of our cars) is quite plausible if one understands that the automobile industry is largely driven by firm-specific competitive advantage.

The case made in this paper is that micro-economic approaches, especially as developed by business strategists in an applied way, have much to contribute to the industry policy debate. In particular, the proposition that dominates public policy—"to intervene in the economy is always to hurt oneself" is incorrect. Thus, while macro-economic theory is powerful, and largely convincing, it should be very cautiously applied in those higher value added and traded areas of the economy where the outcomes of competition between firms are important to the national interest.

**Table 1**

## Source of Advantage

Type of Advantage	Source	Beneficiary	Description and Policy Implication
Comparative advantage (as traditionally defined)	Endowed	All firms in industries, regions	Cheap resources, low cost labour. Endowed advantages remain critically important to Australia's primary industries. Micro-economic reform of ports, transport and power generation are policy priorities that support our <i>comparative</i> advantage in these areas.
"Dynamic" comparative advantage	Created	All firms in industries, regions	World class physical and human infrastructure, as well as clusters that develop capabilities useful to all firms. Here, Australia is weak and policy objectives should be the enhancing of physical infrastructure, a better educated workforce, labour market reform, support for R&D and generally ensuring that industry structures remain competitive. The importance of clusters argues for some special support for industries or sectors that realistically hold promise (e.g., food exports to Asia).
Competitive advantage	Created	Individual firms	The fostering and nurture of world class firms. Policy issues here involve anti-trust responses to scale in traded businesses, tax regimes relative to overseas competitors, anti-dumping policy, government purchasing, overseas market development support, export facilitation as in the automotive industry, and the like.

Business strategy concepts make an important contribution to the debate. They are based on the experience of firms in imperfect markets. Beyond the commodity businesses, all of our traded businesses operate in imperfect markets. They are based on dynamic not static models where outcomes are strongly influenced by past events and the capacity of firms to preëempt the key factors for success. They lead to different interpretations of the data and as such should be given a reasoned assessment.

### 3. Other Implications for Policy

Understanding the basis of competition between firms leads to different ways of thinking about important industry policy issues. These include:

- the importance of individual traded sector firms;
- defining the relevant competitors;
- the usefulness of a portfolio view; and,
- the importance of “vision”.

#### 3.1 *The Importance of Strong Firms in the Traded Area*

Economists talk about industries and sectors. In comparative advantage industries, the relevant unit is the industry—the wool industry, wheat growers, coal miners and the like. There is no significant distinction to be made between one producer and another. But in competitive advantage-based industries, particular *firms* are all important. The firm is the competitive entity, the relevant unit of activity. Accordingly, policy makers have to become more attuned to the competitive success factors for particular firms in these industries. This will be difficult for those whose past practice has been to interpret reality through ASIC codes and ABS statistics. But only ten firms account for nearly half of Australia’s exports and so the task of dealing with firms on an individual basis is not overwhelming!

Internationally competitive firms are the “crown jewels” in value-added industries. Possession of a leadership position or a strong international capability is a rare and precious thing. By definition, possession of competitive capability that yields cost and price advantages for a firm is largely at the expense of competitor firms. Strong competitive leadership positions are thus few and far between. An outstanding competitor, General Electric Company, seeks businesses that are “Number One or Two in industries where the prize for winning is large”—in other words, clear leadership in industries that offer strong potential to dominate competitors (largely because strong returns to scale exist). Pacific Dunlop seeks businesses which hold brand leadership and potential for low cost sourcing. Such businesses provide the basis for continued prosperity for a firm. Of necessity, if a firm owns the strong brand, its competitors own those that are weak; if a firm holds the low cost position, its competitors occupy the high cost positions.

Firms that possess these attributes are the backbone of economic development in higher value-added industries. The importance of Samsung, Sony, Boeing, Atlas Copco, Philips and Ciba Geigy to their home countries’ economic development cannot be understated. Australians, however, have ambivalent views of leading businesses and are suspicious of size. They certainly do not see a goal of policy as the attraction and nurturing of internationally capable firms with a focus on international markets.

Policy for the traded sector has different requirements when compared to non-traded businesses. But Australian policy makers appear uncertain about the legitimacy of the distinction. Clearly, traded businesses are affected by inefficiencies in the non-traded sector and so reform must be wide ranging. But many economists will argue that investment in a local shopping centre is as valuable as investment in an export business. As the balance of payments deficit persists, however, sentiment is changing and the importance of traded businesses is increasingly acknowledged.

A strategic view of the economy argues for vigorous competition policy in the non-traded sector, but readiness to be a touch more pragmatic in dealing with the traded sector. In non-traded businesses such as retailing, hotels, beer making and transport, the success or failure of individual competitors is of little interest where public policy is concerned. The government's rôle is to ensure that competition is vigorous and the Industry Commission's rôle in this respect is extremely important. But in traded businesses where competitive advantage is at stake, uneven playing fields *are* an issue. Here, a policy goal should be to attract and nurture strong firms.

To those who appreciate the importance of firms, it is stunning to see the detached way in which many economists and policy commentators view the survival prospects of firms under zero tariffs or no anti-dumping legislation and the scant regard they give to difficulties firms have in migrating from our current generalist industry structures towards ones that are more specialised. As surprising is their refusal to acknowledge that well performing Australian firms may warrant support to offset the handicaps caused by slow progress in Australian reform and support given to their overseas competitors. The Canberra mentality is that manufacturers are mostly incompetent and those that ask for assistance are simply seeking soft options. While this may be true for many firms, it is no longer true of many of our leading companies who are already successfully involved in offshore locations.

This relaxed view of corporate survival is an end product of the prevailing models through which we see the world. In the world of perfectly competitive markets where comparative advantage is endowed factor cost advantage, the loss of firms now will be unfortunate for the owners but eventually they will be replaced as normal market conditions return. To draw on the earlier example, when the Europeans stop subsidising wheat, new growers will return to the Australian industry and surviving growers will expand. The transition costs may be serious, but the injury is not permanent. Eventually, the nation that has the endowed advantage will win.

In competitive advantage industries, however, competitive firms driven out of business by dumping, through denied access to overseas markets, or through the weight of Australian market inefficiencies will in most instances never return. If Australia loses its firms in the car industry, it is unlikely that they will ever be re-established, because competitive advantage is mobile and the capability to serve

the Australian markets will be established in any one of a dozen nearby countries. Even if devaluation of the currency and productivity gains led to cost advantages, businesses that have been destroyed in this way will not necessarily be relocated in Australia because cost is only one factor in determining competitiveness in many industries.

Economists' models find the dynamics of competition difficult to contain. As a result, the policy debate assumes little about the *time* dimension to competition between firms, although some concession is given to infant industry arguments in the literature. The most important point to recognise, however, is that competitive advantage is built over time. Scale is built, experience lowers costs, consumer franchises are established. Accordingly, it makes no sense to argue that Japanese reduction in official protection is an argument that automatically applies to our situation. Recent analysis of Australia's few high value-added exporters show that most of the top ten receive some form of targeted assistance<sup>5</sup> which confirms that Australia is at a very early stage of development, perhaps analogous to Japan in 1950 and Thailand today. Policy appropriate to Australia today has to be related to where our industries sit in their stage of development. Japan does it—their car tariffs are now gone but the “three year scrapping rule” persists and is one example of a policy that preserves competitive strength in the industry. It is a tragedy that most of the past thirty years in Australia have been wasted, but a start is needed to develop a stronger industrial base. Great care has to be taken to ensure that restructure of our industries achieves the best and most sustainable result.

It is for these reasons that a major objective of industry policy should be to define a set of “carrot and stick” incentives to speed the difficult restructure of our industries in order to maximise the chances for internationally efficient firms to be salvaged.

### *3.2 Defining the Relevant Competitors*

Business strategy concepts emphasise the importance of identifying the relevant competitors. This means identifying those competitors whose economics influence our own. Put another way: who in this industry sets my performance requirements—prices, quality, service levels and costs?

Inability to understand this is a frequent source of business failure. A common failing occurs when a firm “averages” its costs across a wide range of products and market segments—arbitrarily allocating overheads. This leads to “average” prices being set in ways that do not reflect true costs-to-serve and

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5. The “Top 10” in 1990 included Ford, GM Holden, IBM, Hawker de Havilland and Nissan, all of whom participate in export facilitation of partnership programmes. BHP Steel, whose reconstruction was facilitated by the Steel Plan, and Kodak are also in the “Top 10”.

essentially means some products are cross-subsidising others. A more focused competitor is able to price more accurately, gain share which in turn leads to cost advantage. This is a common reason for the failure of traditional market leaders. It has been termed “the peril of average costing”.

When a business strategist observes the industry policy debate some familiar themes arise. For example:

- Australia’s policies are invariably compared to OECD averages which are hardly relevant to nearby countries where our manufacturing and service industries are most likely to compete.
- Absence of domestic distortions is regarded as infinitely more important than allowing firms competitive parity with their overseas competitors (e.g., in depreciation rates).
- Trade practices approaches are often driven by domestic market considerations and can understate the importance of international competitiveness.

Australia’s tariff and protection levels are usually compared to OECD averages. These comparisons typically show Australia’s protection levels to be reason for shame. But for most countries, trade in manufactures is concentrated locally.<sup>6</sup> For example, Canada and Sweden are two countries often compared to Australia but both benefit from proximity to huge markets that are relatively open. Australia’s case is different—it is far from major markets and those that it is closest to have very high protection levels.

To consider the situation in which Australia trades, it is instructive to take those products and markets that are realistically accessible to us and identify the competitive hurdles we have to cross to export successfully. Exporting TV sets to Denmark and wine to France may be unlikely, but paper to Japan, tyres to Indonesia and woollen sweaters to Korea should not be too far fetched. What barriers do we face?

The Hughes Report is illustrative of the prevailing public policy perspective. It asserts that:

Many Australian exporters believe that world markets are biased against them. In popular parlance the “playing field” is not even. But except for agricultural markets, this is largely a misconception . . . Australia is still a relatively highly protected country in relation to other industrial countries in terms of tariffs (Table 3.2) . . . (Hughes 1989, pp.17–18).

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6. See analysis of this in *The Global Challenge*, report to the Australian Manufacturing Council by Pappas, Carter, Evans and Koop/Telesis, 1990, p. 140.

Table 3.2 in the Hughes Report compares Australia's tariffs with Canada, the European Community, U.S., Sweden and Japan. No mention is made of any country in our region (other than Japan). Would it have been too much to expect data such as the tariff barriers on products shown in Table 2 that might reasonably be part of Australia's exports to its region?

**Table 2**

Tariffs on Value Added Products (%)

Country	Lightweight Coated Paper	Woollen Fabric	Aluminium Wheels	Wine	Tinned Fruit
Indonesia	30	25 to 40	20	40	40
Thailand	35	60	35	60	60
Malaysia	30	25 to 40	20	5	30
Korea	9	9	9	40	50
Taiwan	12.5	10	17.5	50	40
Japan	4.1	6 to 9.6	4.1	21	15 to 35

Source: Austrade.

The point here is not to defend Australia's high tariffs, but rather to question the way in which our policy makers and academics say that the problem is a figment of business' imaginations. Our experience as consultants is that there are some firms in Australia who have made prodigious efforts to upgrade their performance to close to world class levels, but whose future is definitely threatened by barriers and other supports given to their regional competitors.

To take another example, forest products is an industry that is important to Australia's export future. What are the regional tariff barriers? These are the numbers that directly impact Australian exporters, not OECD averages (see Table 3).

The situation faced by Australian companies is that they are surrounded by markets in the Asian region that are demonstrably protectionist, where OECD averages do not apply. But even OECD countries have barriers on products that should be part of Australia's exporting future (see Table 4).

The above example illustrates another point of great importance to Australia—the escalating tariff rates as value is added (note Japan). Countries like Korea and Japan have raised this approach to an art-form. Averages are meaningless in this situation. For example, the EC permits tariff free import of raw

**Table 3**

Tariff Rates on Forest Products: Less Developed Countries (%)

Country	Sawnwood (Planed)	Plywood	Particle- Board	Newsprint	Kraft Paper
China	70	20	30	20	20
India	65	170	125	\$A30/t	180
Indonesia	20	30	20	5	Free-30
Korea	10	15	11	8-13	13
Malaysia	25	45	25	5	5
Philippines	30	40	40	30	50
Chile	11	11	11	11	11
Singapore	Free	Free	Free	Free	Free

Source: PCEK/BCG.

wool but imposes between thirteen and seventeen per cent tariffs on wool fabric imports. Japanese tariffs on wool fabric run between six and nearly ten per cent, while again the raw product is free of tariffs. To take another example, at least one Australian firm has been on the brink of investment in a lightweight coated paper plant in recent years, but export market risks have been judged unsatisfactory. The EC tariff on lightweight coated papers runs between seven and nine per cent, the Japanese rate is 4.1%. In these instances, the effective rates of protection on the *value-added* portion is considerably higher than the nominal rates.

When public policy commentators simply quote *OECD averages* as the standard against which Australian standards are to be judged, they do a great disservice to Australian firms who are attempting to engage in serious offshore competition. They also reveal a lack of strategic understanding about the basis upon which firms compete—not against averages but against cost and service capabilities in specific product/market segments. They reveal a lack of strategic understanding about an approach to industry development that encourages import of raw materials and components while building world scale in the protected downstream value added activities. This is particularly serious for Australia where resource processing is one of the more promising opportunities we have.

There are other ways in which we fail to define *relevant* competitors. Businesses today are learning that they must be internationally competitive. “Benchmarking” is the flavour of the month; companies everywhere are seeking to compare their costs, productivity, quality and responsiveness to international best

**Table 4**

Tariff Rates on Forest Products in Developed Countries (%)

Region	Wood Products				Paper Products		
	Logs	Sawnwood (Rough)	Sawnwood (Planed)	Plywood	Wood Chips	News- print	Kraft Paper
EC	Free	Free	4-4.9	10	3.2	4.9	6.9
Japan	Free	4.8	8	10	Free	Free	2.5-3.5
U.S.A.	Free	Free	Free	20	Free	Free	Free
Australia	Free	Free	Free	Free	Free	Free	Free

→ Increasing Value Added                      → Increasing Value Added

Source: PCEK/BCG

practice.

It seems strange therefore that while firms are urged to match their international competitors in productivity and quality, it is not considered important that they be able to match international competitors in (say) depreciation allowances. To economists, the absence of *domestic* market distortion is much more important. Differences across national boundaries in depreciation rates are seen to be irrelevant.

Economists appear primarily concerned about capital flows within the economy and they insist that no variation be accorded across industries. As such, the depreciation rate on a piece of equipment used in house building (a true non-traded industry) must be identical to that piece of equipment if used in a newsprint mill. Apparently, it does not matter if that equipment is offered more rapid depreciation in newsprint mills in New Zealand or Indonesia.

There is evidence that Australia's tax system is uncompetitive, particularly in the region in which we compete. Table 5 and Table 6 illustrate the greater speed with which competitor countries allow basic investments to be written off as well as the extent to which they are prepared to use tax incentives to target particular sectors.

Failure to understand the "relevant" competitors also has implications for trade practices. A critical difficulty for Australia is its small market size relative to other countries. As Michael Porter points out, domestic rivalry is very important. But he does not deal with the difficulty faced by companies aspiring to be world class in Australia, with its small domestic market and remoteness from major markets. Almost every internationally successful competitor has a strong domestic

**Table 5**

## Examples of Tax Incentives in Asian Countries

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Malaysia:	Tax exemption for five years for companies in manufacturing, agricultural or forest sectors which participate in promoted activities. Allowance of up to 100% of capital expenditure on factory or plant and machinery used for the purpose of an approved activity in manufacturing, agricultural, hotel or other industrial sectors.
Hong Kong:	Initial allowance of 60% of capital expenditure on machinery and equipment.
Thailand:	Tax exemption for three to eight years in industries eligible for promotion.
Taiwan:	Five year tax holiday for productive enterprises in “encouraged” category. Technology intensive businesses may defer tax holiday for one to four years after start up.
Singapore:	Plant and equipment written off over three years. Some equipment such as computers can be written off in a year. Tax holidays for “pioneer” industries. Tax reductions on manufacturers that export.
Korea:	Special depreciation allowances of up to 50% on machinery and equipment when used for eighteen hours per day or more.
Japan:	Accelerated depreciation provided for wide range of special situations such as designated development areas, machinery for manufacturing industry where the company increases import of “import promotion items”.

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Source: PCEK/BCG interviews.

base—in fact it is hard to think of an exception. Thus, in Australia’s case, in scale-based businesses, it may at times be better to trade off rivalry among domestic producers in exchange for size that permits firms to achieve the scale needed to tackle international markets. This is increasingly recognised in Australia with imports being seen as the alternative source of competition and rivalry.

**Table 6**

Proportion of Equipment Investment Deductible Within  
Two Years in Representative Industries (%)

	Light Manufacturing	Heavy Manufacturing	Information Technology	Electrical/ Electronics
Australia	34	25	60	17
Singapore	100	67	100	65
U.S.A.	65	49	65	49
Canada	40	35	40	35
U.K.	44	44	44	44
Germany	50	50	60	50
Japan	28	28	40	28
Malaysia	45	52	52	45

Source: International Tax Guides, PCEK research.

Business strategists see industry outcomes as the result of differences between competitors, regardless of whether those competitors are based locally or overseas. It is inconsistent to demand that firms perform on a par with competitors and deny them parity with them on those parts of their economics that are policy determined—such as interest rates, depreciation allowances, tax holidays and the like.

### 3.3 *A Portfolio View of Industry*

Business strategists see firms as portfolios of activities and businesses. Each business has its unique competitive circumstances and rôle to play. A major debate in business circles is over the “rôle of the centre”. What, if any, is its value-adding rôle?

One can only “lightly” use this analogy with government but it is instructive to do so. At one level, the economy is a portfolio of firms which vary in their competitiveness and growth potential. Here too, there is some debate about whether there is a rôle for the centre (that is, government). Other than establishing the best macro-economic settings and helping provide appropriate physical and human skill infrastructure, the prevailing wisdom in Australia is that government should have no rôle. It can add no value. This current wisdom has it that government should certainly not intervene or selectively support industry sectors. The real world is, however, a little more complicated than these beliefs allow.

In Australia, declaring one's unequivocal commitment to elimination of protection and subsidy is the only acceptable way to be regarded as a decent fellow in economic discussion. Purging automobiles and TCF of protection are propositions not to be argued with.

It is transparently obvious that for an economy to be successful, all sectors do not need to have world class productivity. It is even possible to have the lamest of lame ducks and still be rich.

Why does Japan tolerate its rice growers (who make Australian automobile manufacturers look good) and its multi-layered wholesale distribution networks? Why does Germany tolerate its farmers and continue subsidy of its steel and shipping industries, and provide massive incentives through the tax system for regional development? A business strategist looks at German and Japanese practices and senses a portfolio view of their economies. It seems apparent that these countries are prepared to operate sectors side-by-side that have fundamentally different competitive capabilities and prospects.

One can speculate on the reasons. Being good at some things requires *focus*. Reforming the whole country would be impossible. If a country is to successfully implement a reform programme in a given period of time, it can only be so large. Or, perhaps they do their sums differently. Rather than being worse off by supporting these sectors, might they actually believe that when all the social and economic factors are taken into account they are better off supporting a couple of labour intensive and inefficient industries? We are usually told that employment freed up from protected, subsidised sectors will find jobs in higher value-added rôles in industries that will be spawned by newly released competitive forces. But the OECD Report on Japanese Agriculture policies notes that "cattle raising and dairy farming are mainly carried out in remote or mountainous regions where alternative jobs are difficult to find" (OECD 1987, p.117). In the same way, might Japan's "inefficient" railways—heavily subsidised, losing money and overstaffed—provide cheap, competitive transport costs, keep people employed and provide an important part of the infrastructure?

Regardless of the reasons, understanding competitive advantage provides insights about the sectors of inefficiency that are priorities for reform. Inefficiency in rice production has no direct impediment on the competitiveness of Japan's export industries such as automobiles. Economists will rightly point out that a cost imposition is incurred, although whether this is more than social security costs and distress of unemployed rice growers is an issue. But these costs are only one factor determining today's competitiveness in the automobile industry. The impact of scale on costs as well as "time to market" and "quality" are probably every bit as important and rice growing subsidies impose absolutely no penalty in this respect.

The logic is that if one tolerates some inefficient sectors, they shouldn't be tolerated if they are an integral part of the value-added chain in one's traded industries. The lesson here for Australia is obvious. In an economy that relies on primary exports, our uncompetitive ports and transport system are a dreadful

mistake. In a country in which aluminium exports are one of the bright prospects, an uncompetitive power generation industry is a disgrace. But an inefficient TCF sector is rather similar to Japan's rice growers. It imposes cost on the community, but it has little direct impact on the competitiveness of Australia's traded sector.

The comparative advantage model is factor cost driven. But in higher value-added goods and services, the importance of these costs as a basis for competitiveness between firms is relatively low. The competitive paradigm now emphasizes scale, innovation, quality and time to respond. Inefficient sectors of the economy may incur cost penalties, but these impacts are much more serious if the inefficient sector imposes cost penalties *and* impedes service and quality as well.

The implication of this discussion for Australia is to question whether a more selective approach to reform is a better way to go. It would involve some consideration of micro-reform priorities, identifying where the leverage points really are. It may also involve agreeing to slow down the process of reform in labour intensive sectors until the employment situation improves.

### *3.4 The Need for a Vision*

To be successful, firms need a vision or sense of mission. The issue then is whether countries need one too. There seems to be a predominant view in Australia that the answer is "no".

It is not government's job to have visions. It is their job to provide information on which private sector investors can make decisions.<sup>7</sup>

Stating a vision is seen as a form of "picking winners" and is seen to lead inevitably down the VEDC/WA Inc. pathway. But this is too simplistic a view.

Strategy statements can be made at more than one level of abstraction. Vision statements are at the most abstract level. For example, at corporate levels in firms, the vision statement is broad: the focus is on things like branded goods, medium technology manufacturing, or capital intensive continuous process businesses. At this level, vision statements do *not* describe the specific businesses and products that the firm will pursue. While a "vision" provides a sense of broad direction and values, more concrete statements are appropriately positioned at the individual business or divisional level.

What does a vision mean when applied to a country like Australia? To be a *multicultural* country is a strategy statement at a high level of abstraction. Despite the level of abstraction it is an important and useful statement because it implies an act of will on behalf of the nation and a readiness to direct effort and resources towards its accomplishment.

In the economic sphere, the business strategist's instinct is that there is a need for directional statements of similar levels of abstraction. Interestingly, we had an example of a vision statement from Ross Garnaut when he articulated the strategic importance of the North East Asian region. This was a statement of strategy at a high level. North East Asia is important to Australia in ways that South America, Africa and Scandinavia are not. There are particular opportunities there and windows of opportunity. The findings informing the statement were based on analysis. They were not merely Garnaut's opinion to be traded against others.

The importance of making strategic statements such as this cannot be understated. At one level it is picking winners. Asia is more important to us than Scandinavia, we can suppose. If we can accept this, the implications for national strategy are important because it will determine our priorities in education, migration, deployment of foreign service staff, taxation agreements and the like. And it may even lead to the development of incentives for business development.

The calibre of Australia's economic debate is diminished because there is no acceptable discussion of vision based upon market realities.

In our work for the Australian Manufacturing Council two years ago, themes emerged which constitute part of what we believe Australia's vision must be. We agreed that Asia constitutes a window of opportunity that must be grasped because markets driven by competitive advantage are being established as economic development quickens. Other findings were that:

- Value added manufacturing (other than resource based) will not provide the answer to the balance of payments problem because in many instances world class operators will relocate off-shore to be close to world scale markets and leading edge customers. This sector of our economy will shrink in relative terms.
- Some participation in higher value-added manufacturing seems to be important. The Porter project in New Zealand noted that no country of more than small population (e.g., oil baronies) has achieved high standards of living without some participation in higher value-added manufacturing. Furthermore, we note that higher value-added *services* are frequently embedded in higher end manufacturing.
- Australia's prospects in global scale businesses (automobiles, telecommunications, pharmaceuticals, and aerospace) are small. Our "generalist" automobile industry which developed behind protectionist walls cannot survive in its current form, but there are parts of the value-added chain in this industry that we can secure, particularly if we trade market

access to multinationals. There are parts of the component structures that can be placed in any one of twenty countries, all within the arena of international competitiveness. *Incentive* to source from Australia will provide the basis for our participation. Our objective must be to specialise and achieve more scale than the Australian market allows.

- High technology businesses will be a small contributor because we are uncompetitive in the depth of the venture capital market, the market size and availability of leading edge customers. (Accordingly, Barry Jones' vision of Australia as a high-tech country was ill-advised.)
- Although we spent little time exploring Australia's export potential in services, there is reason to be sceptical about whether business services, education and tourism exports (to cite the most commonly favoured notions) can fill the export gap. Tourism is fundamentally a low value added per job industry and will not be an avenue which can sustain high standards of living. Studies in the Porter project in New Zealand emphasise that very little education investment is commercially profitable; the risk is that growing our education exports will mean cross subsidising Asian markets.

An implication of these statements is that Australia faces a situation where it is important that it makes the most of its resource based industries, both in their primary form and their value adding form (where competitive to do so). This is where the big numbers lie and we must capitalise on them.

That is a statement of strategy at a high level of abstraction and is no more picking winners than identifying the special significance of Asian markets.

The importance of some broad sense of mission (vision), even in market oriented economies, does not sit easily in the Anglo-Saxon countries. But we must address the issue—as Jonathan West, a member of Michael Porter's team reviewing New Zealand's industry policy put it at a conference similar to this at the AGSM last year:

One of the very few features that successful economies in the post war era do have in common is a very strong sense of national mission. That national mission always includes the central conception that they are going to export, and that they are going to export manufactures. There isn't a single experience that contradicts that feature (West 1991, p.240).

The economists who set policy in Australia are failing to respond to each of the three issues identified in this statement:

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7. Comment made by senior bureaucrat at a Canberra briefing in 1989.

- The notion of mission/vision in economic development is rejected as inappropriate. The market will deliver what it will.
- The particular significance of the traded area (exports) is dismissed. As mentioned earlier, it is argued that investment in a shopping centre has the same significance as investment in an exporting or import replacing business.
- No strategic significance is attributed to manufacturing and its rôle in securing high living standards in advanced countries.

The case for a vision for the economy can be argued on other grounds. First, it is impossible not to have a strategic direction. If it is not thought about, articulated and tested, it exists by default. This is true both of companies and countries. Wherever resource allocations are made, there is a strategy. The strategy may be smart or stupid, but it exists. Australia has over the past decades allocated many dollars and vast effort to infrastructure, training, overseas trade representation, and none of these allocations are neutral in terms of strategic impact:

- Would our readiness to reconcile environmental concerns with development have been more advanced (rather than have the Wesley Vale fiasco) if we had broadly agreed in 1980 that resource development was key?
- Would we have allowed the appalling port productivity to continue as long as it has if we had been convinced in 1980 that exports were important to our survival?

The point is that whether we like it or not, we do allocate effort and resources. In the absence of broadly agreed directions, these allocations will be made in suboptimal ways and at worst based on port barrel criteria.

Vision statements allow sensible discussion of strategic initiatives. A common problem in organisations is that if there is no consensus as to the “guiding ideas” that govern the broad direction of the institution, there can be no consensus about the details. (As a young consultant, I was told that every good strategy has at its core an idea. Hearts and minds must be captured before the detail can be sold.)

A politician recently expressed the view to me that Australians were incredibly conservative in that they usually reacted negatively to new initiatives and proposals. I suspect, however, that this is the wrong diagnosis. People are always conservative or argumentative when presented with grand proposals for which no context or sense of direction has been established.

A good case in point may be the Multi-Function Polis (MFP). I still do not know whether it is a good proposal or not, but it had little chance to capture public support in the absence of context which legitimised the strategic significance of high value added links to Asia. The public discussion about the MFP was

desultory, and inevitably so, because it was a strategic initiative proposed as a stand-alone idea. Imagine the different discussion that might have taken place if a vision for Australia's rôle in Asia had been previously debated and embraced? Similarly, the debates on Wesley Vale and Coronation Hill are hampered because their place in the overall scheme of things is not established. No-one has made the case that resource development is one of the few decent cards that we have to play.

Furthermore, an economic vision is important because there are alternative visions. The environmentalist's vision is on display, for example. This vision will always defeat a new pulp mill or wool scouring plant because the *need* for these has not been established. Perhaps an analogy may be SBS Television: its chances of survival are enhanced because multi-culturism has been reasonably well sold as a strategy, as part of our country's vision.

Visions, of course, can be appropriate or inappropriate. They need to be tested. Countries, like companies, will come unstuck if their visions are based on wish-lists rather than market realities. The case for North East Asia rests on the efficacy of the numbers. The case against relying on high-tech heaven rests upon commercial realities. Canberra cannot establish these perspectives alone because commercial realities are involved. But it is a legitimate rôle of government in a small country to foster the development of an agreed sense of direction, to facilitate the evaluation of visions and to use the agreed outcomes to build a greater sense of cohesion.

Visions aren't about VEDC's and WA Inc's. They aren't concerned with governments choosing specific petrochemical plants and solar powered tooth brushes as the growth products of tomorrow. They stem from conceiving the shape of our economic future based upon what we ascertain the market and competitive realities to be. This process involves understanding both the source of our *comparative* advantage in our resource-based industries as well as the basis for *competitive* advantage in value-added businesses.

#### 4. Implementation Issues

The objective of this paper is not to identify specific policy recommendations. I am not involved in the current deliberations in Canberra and I have limited working exposure to important areas—for example, industry policy issues in service industries. None the less, it is important to address practical issues that are commonly raised as objections to a more “interventionist” approach.

The most common argument is that even if intervention can in concept be justified, it will in practice be implemented poorly. “Governments cannot pick winners”. Or, “our institutional framework precludes effective implementation”. Or, as I am often told: “asking Australian governments to intervene is like asking an alcoholic to take another drink”.

Implementation problems are very serious issues, as they are for companies. But there is little prospect of effectively addressing implementation issues while the “in principle” case for intervention cannot even be discussed. Unless there is

an agreed framework which identifies the circumstances under which intervention should take place, there can never be a sensible view as to how to best do it in practice. Without theory, how can practice be guided so as to minimise the risks of failure?

This has a direct parallel with experience at the level of companies and institutions. Strategic planning as a process yields unsatisfactory results in many companies. *Fortune Magazine* asserted several years ago that “90% of corporate strategies fail”, a claim that no-one seriously contested! The reason for this problem has less to do with the *process* of planning and more to do with the quality of ideas and concepts that surround it. The planning *process* in an organisation rests on assumptions held by management about the way the world works. These assumptions determine the analytic content of the planning process. If those assumptions are based on faulty world views, the process itself will deliver poor results.

In the same way, we are wasting our time debating the process whereby industry policy is developed if there is no agreement about the appropriate rôle of government or whether, even in theory, interventions can work or fail.

Furthermore, the risks of government failure are invariably discussed in an unrealistic context. Talk naturally reverts to VEDC and the like. Similarly, no reference to MITI can be made without citing MITI’s alleged opposition to Honda’s entry to the car business (for example, Industry Commission 1989/90, p.61).

Governments have a very poor record of choosing successful industries or companies so in general they probably should not do so. But the issue should be put into context—the private sector is poor at selecting investments as well! Venture capital experience is that over half the investments fail. Very few small business start-ups survive their first two years. Michael Porter in his analysis of the success of company diversification programmes concludes that over half are failures (Porter 1987). The VEDC was an inappropriate involvement for government, not the least reason being that failure is politically indefensible. Yet the \$100 million lost to its venture capital investments is minute compared to private sector crashes, failed entrepreneurs and banking bad debts. It is microscopic compared to the cost to Australia that results from Canberra’s failure to foresee the magnitude of the current recession. Furthermore, the people who brought us the VEDC also brought us the Portland Aluminium smelter which is now one of Australia’s largest single exporting businesses and demonstrably world competitive as well.

A good working hypothesis is that Canberra is poorly placed to identify successful businesses. Accordingly, the preferred approach is to provide “market enhancing incentives” through the tax system rather than grants. These can be targeted on broad categories (e.g., export, resource-based, value-added) to minimise cost, but in general need not be too specific (coal, toothbrushes). They might at times be as specific as say, “food exports” or “wool processing”, but the incentives should be available to all firms. The German government is quite good

at using the tax system to provide selective incentives to regions and as their performance is good, a study of their approach would be instructive! In this way, firms still take the commercial risks and will only avail themselves of the incentives if they believe that they can create a profitable business.

The possibility of successful implementation will also be enhanced if there is serious and regular dialogue between business and policy makers. Neither side at present really trusts or respects the other. Dialogue involves serious learning from each other, not high profile visits for public relations purposes. My perception is that the experience of people in Canberra has been soured by years of pleas for government bail-outs. One politician tells me that the first question a prominent business executive asked at a recent meeting was whether the tax deductible lunch was to be restored. If this is their experience, it is no wonder that Canberra can see no further than the need to ignite a fuse under business. On the other hand, there is an arrogance around Canberra that they know it all. Compared to MITI bureaucrats who spend staggering amounts of time with their business counterparts, Australia's bureaucracy is remote. I have my own personal example of this. Our report, *The Global Challenge*, was generally regarded as a serious and novel contribution to the national debate. But since its publication in mid-1990, now two years ago, neither I nor my colleagues have received even *one* contact or question from *any* of the policy making parties in Canberra—Treasury, Finance, Industry Commission, DITAC.<sup>8</sup> Not even a question about the source, or the meaning of a number. Not a request that a view be debated. Just silence.

Finally, if one approaches the Australian industry policy debate in early 1992, viewing it from the perspectives described in this essay, what are the types of initiatives one would like to see pursued? The recommendations in Table 7 illustrate the approach. The main difference between these recommendations and existing policy is that *exporting* and *firms* are emphasised and supported, selective use of incentives is accepted and that a sense of national priorities is established. The most important feature in common with current policy is a desire for a less protected, more externally oriented and specialised economy.

The fundamental departure this essay argues for is the acceptance of positive incentives to build strong export firms. In *The Global Challenge* we portrayed the required approach in three interlocking circles (see Figure 2). This strategy is quite unlike the old inward looking protection of the past. Current Australian policy argues for the first two circles, but the more successful economies add a third. This too is the preferred approach for Australia as it approaches the next century.

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8. Except a visit from a former colleague in November 1991 who has recently been appointed to a position in the bureaucracy.

**Table 7****Important Initiatives**

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- Maintain pressure through the Uruguay Round for lessening of European and U.S. agricultural subsidies. (Notwithstanding the relatively poor prospects for commodities, they are the basis for Australia's comparative advantage and a most important part of our future.)
  - Continue tariff phase down to levels as proceeding since May 1988, but link any further reduction to progress in micro-economic reform. Do not necessarily aim for zero tariffs, an extraordinary position shared only by Hong Kong, Singapore and Malta. (Remember that Singapore uses positive incentives.)
  - Promote the development of competitive firms in value-added traded sector businesses, particularly those that tap our natural resources.
    - Allow accelerated depreciation for tax purposes (with franking claw-forward) for large (\$20 million plus) capital intensive value-added export projects.
    - Set macro-economic reform priorities in ways that tackle direct impediments to export first.
    - Maintain anti-dumping provisions (although ensure that this is not used as covert protectionism).
  - Develop best practice processes for environmental assessment and decision making with regard to industrial development projects.
  - Develop "best practice" programme to stimulate business' and unions' understanding of "benchmarking".
  - Vigorously pursue competition policy in domestic industries but develop modified approach to deal with traded sector firms.
  - Develop the export facilitation/partnership approach in the global scale industries to encourage integration and participation into the global system (that is, in autos, computers, aerospace, telecommunications).
  - Provide incentives for private sector development of specified areas of infrastructure.
  - Articulate and debate an economic vision for the country, indicating likely growth/contracting sectors.
  - Articulate the export vision. Include an "employment" plan.
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## Figure 2

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