

THE INDUSTRY GROUP

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11 September 2014

The Secretary
Financial System Inquiry
GPO Box 89
Sydney, NSW 2001

Dear Mr/Ms Secretary,

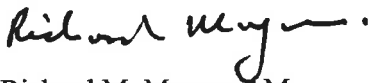
It is most encouraging that the Abbott Government is clearly committed firmly to the improvement of the international competitiveness of Australia's manufacturing sector. The establishment of the Prime Minister's Business Advisory Council and, more recently, the Industry Advisory Group to the Minister for Trade and the Australian Productivity Commission will provide fresh insight into the impediments to the competitiveness of the manufacturing and export focused sectors of the Australian economy.

Many of the impediments are widely recognised and are now under detailed review. However, there are other critical impediments which are not so widely recognised and whose impact is not at the forefront of Government and community concern.

In the attached Paper, a group with a keen interest in the Australian economy and long experience in industry, trade and government have attempted to highlight these often overlooked but critically important issues. Their significance has been emphasised over the past year or two by the rapid closure of mineral and metal manufacturing operations – alumina and primary aluminium are major examples – food and primary products processing, and the closure of oil refining and cement manufacturing facilities, all of which were world competitive a decade or so in the past.

The Paper has been sent to all of the three mentioned above and it has been suggested to the Group that the Paper may also be of interest to the Financial System Inquiry.

Yours sincerely,
For and on behalf of
The Industry Group



Richard M. Morgan AM
Convenor

NB: This Paper is available electronically or in an A5 booklet which can be requested by emailing bpchpl@bigpond.com.

**Growing the Trade Exposed Industries
- Manufacturing and Mineral and
Food Processing**

By The Industry Group

**Richard Morgan AM, Peter Jonson,
Mark Rayner, Colin Teese**

July 2014

Contents

	Page
Introduction	3
Significant Industry Impediments	4
Realities of Competing in a Global Economy	5
Review with Recommendations	6
1. Operating Costs	6
1.1 Sea Transport	6
1.2 Power and Energy	6
2. Productivity	7
2.1 Capital Improvements for Productivity	7
2.2 Management Input for Productivity	7
3. Innovation and Commercial Development	8
4. A\$/US\$ Exchange Rate	9
5. Current Account Deficit and Trade	11
6. Competition Policy	12
Conclusion	12
Addendum – Incitec General Meeting Report	13
The Authors	13

Growing the Trade Exposed Industries - Manufacturing and Mineral and Food Processing

Ludwig Erhard, the Former Vice Chancellor of Germany, writing about “Prosperity through Competition” said “Efforts will only be successful so long as competition is not hindered or eliminated through artificial or legal manipulations.”

Introduction

The Australian Government has made very clear its resolve to advance fiscal and structural reforms to strengthen the Australian economy. They include the policy areas of infrastructure, taxation and financial regulation. Improvements to labour flexibility and reducing energy and regulatory costs are also seen as critically important.

This paper makes recommendations arising out of the current economic environment, including areas that are not so evident, but require urgent attention to ensure the trade exposed industries of the Australian economy can have a sound future.

Governments, Regulators, Industry and Unions have often failed to recognise, understand, or give consideration to the less obvious and often longer term consequences of their decisions and actions, and their impact on Australia’s competitive position.

This is particularly significant when such decisions, as outlined in this paper, lead to long-term operating and capital cost penalties and market constraints, some of which may be difficult to reverse. It is the collective impact of these factors which has been so detrimental for the Australian trade exposed industries. It is clear what Ludwig Erhard had to say about the threat to competitive free markets is as relevant today as it was in his time.

Inevitably, it becomes necessary to replace or radically upgrade or expand ageing production facilities to improve productivity and restore a world competitive position. Increasingly however, the logical economics-based response by business in current circumstances will be a decision not to undertake such major capital expenditure. An adequate return would be unlikely because there appears no realistic prospect that international competitiveness can be restored.

Recent examples of these consequences are the progressive closure of our oil refineries around the coast, rather than their replacement with one or two world-scale facilities, and the closure of alumina refining, aluminium smelting and aluminium rolling capacity. These plants which a decade or so back were at the low end of the world cost curve could survive periods of global production exceeding demand. With these plant closures there is also a decline in demand for a range of supporting services.

Other current examples of this substantial hollowing out of Australian manufacturing industry are the reductions in cement and steel manufacture and closure of a number of food processing operations.

Also, some companies have chosen to relocate overseas or have preferred to build new plants overseas. See Addendum to this paper, for the reasons given at their General Meeting for Incitec to build an ammonia plant in the US rather than Australia.

Industrial development in Australia in the Post World War II years focused on the supply of domestic demand behind tariff protection. Later, countries in the region led by Japan and then South Korea focused on the economic benefits of larger plants to supply not only domestic demand but exports. They were assisted by tariffs and other forms of protection for their local markets, some of which remain in place.

Unfortunately Australia has missed out on a second stage of industrial development, with world-class plants with improved productivity, as a result of the continuing impact of past policies. The failure to gain the benefit of plants with improved productivity is of particular concern. In the report by the Productivity

Commission, the Chairman Peter Harris said, "Our (productivity) performance has been significantly worse than that of most other developed economies for more than a decade."

Decisions against major renewal investment in more productive equipment are made ever more likely when the cost impediments are compounded by low rates of tax-deductible depreciation and the absence of accelerated write-off to match overseas competitors. This has led to minimum capital expenditure and a focus on immediately tax-deductible maintenance to preserve the status quo as long as possible before the inevitable final plant closure.

Free markets have been accepted by policy makers as central for economic growth. Nevertheless sovereign states, despite statements supporting free markets, are intervening with measures which hinder competition in favour of their national interests and these activities have significance for Australian industry and agriculture.

The trade exposed industries are now operating in a global economy. Markets no longer have a national or regional emphasis but have a global perspective. Specialisation provides gains in productivity but it is the size of markets which enables these gains to create national wealth with opportunities to generate jobs, economies of scale, resources for research and innovation and an increase to the national tax base.

For Australia however, there have been a number of impediments for industry, which have seriously constrained market opportunities and competitiveness.

Significant Industry Impediments

- Cabotage raising the cost of coastal shipping compared to foreign flag vessels used for imports.
- Regulatory impacts on power and energy costs.
- Decisions by majority foreign shareholders restricting local manufacturers' access to overseas markets.
- Subsidised production in competing countries, for example, Chinese aluminium and solar panel production.
- Infrastructure constraints.
- Management attitudes and capabilities.
- Constraints on labour and capital productivity improvements.
- Unilateral reduction of tariffs compared to our competitors.
- Competition for investment in industries where other countries offer access to "set aside" gas at below world prices.
- States competing in the past with incentives for operating units, leading to fragmentation of industries into sub-scale units.
- Resistance, in the name of maintaining domestic competition, to mergers in unprotected industries which might otherwise have redressed earlier fragmentation to create units able to compete in the global economy.
- Overvalued A\$/US\$ exchange rate.
- Competitors manipulating their currency exchange rate for trade advantage.
- Lax anti-dumping policy.

- Non tariff barriers and import taxes. Research has revealed “The imposition of more than 1,500 non tariff restrictions since the Global Financial Crisis.” *The Australian July 16 2014*

The Realities of Competing in a Global Economy

Over two hundred years ago, the father of economics, Adam Smith identified fundamental economic principles in ‘An Inquiry into the Nature and Causes of The Wealth of Nations’ that emphasised the importance of market size for the creation of national wealth. He said:

“As it is the power of exchanging that gives occasion to the division of labour, so the extent of this division must always be limited by the extent of that power, or, in other words, by the extent of the market.”

He explained the advantage of cheap transport to increase the size of markets had been a significant factor in determining the rise in the wealth of nations. For example, he noted the advantage the Egyptian civilisation had with cheap water transport on the Nile.

What Smith had to say about the advantage of specialisation with free markets has been accepted for policy formation, whereas there has been scant attention to what he said about the extent of markets being relevant for wealth creation. It is the combination of the Australian market and export markets that provide the opportunity to create wealth. Policies which adversely affect the size of markets have a negative impact on scale, productivity, wealth creation and jobs.

Our recommendations in no way challenge the case for the economic advantage that can be provided by properly operating free markets. They address those matters which have prevented free markets being the vehicle for Australian companies to extend the market for their products and create wealth and jobs.

Whilst past mercantilist policies to build foreign reserves have been discredited, governments today are intervening in markets in pursuit of the new political imperative of job creation. These interventions may not comply with WTO rules. For example, the ban in China on export of rare earths and the US “set aside” program for natural gas at prices to support industry, and the stringent terms for anti dumping proposed by the US, are contrary to WTO rules.

A further example of unfair trade is the complaint by EU officials that since Iran trade sanctions US exports have climbed 35% since 2011, compared with a 77% drop for the EU.

To illustrate the importance now placed on job creation, the Chinese Premier is quoted in his recent speech to Congress as saying, “Employment is the basis of peoples’ wellbeing. We will steadfastly implement the strategy of giving top priority to employment.”

The floating of the Australian dollar assumed a competitive commercial environment. On two counts this assumption has not been fulfilled. Firstly, an uncompetitive cost structure and other matters listed earlier which have constrained market opportunities, and secondly, the impact of foreign government intervention, including exchange rate adjustments for trade advantage, affecting free markets. These developments have constrained markets for Australian producers.

Australia’s vision of being a “food bowl” for Asia is at risk. The international rural financier, Rabobank, in its Focus Report for 2014 states, “The rising cost and regulation of critical inputs, and the stronger productivity growth of competing suppliers, are eroding Australia and New Zealand’s on-farm cost competitiveness. Sustained investment in scale, new technologies, and research and development can enhance local production systems and reignite on-farm productivity growth.”

It is clear that as well as fiscal repair which is receiving priority attention, there is now an urgent need to give more emphasis to addressing those factors restraining the trade exposed industries of the Australian economy.

It will take some time for policies pursued by the Government to come into effect. Meanwhile, interim measures may be required to ensure that industries which have longer term potential, when constraints outside their control are removed, are not lost prematurely.

In these circumstances, policies to address impediments cannot be labelled as either rent seeking by business, or corporate welfare, but are measures to restore competitive free markets.

The evidence does not support the view expressed in the past that free markets alone will resolve the difficulties outlined in this paper. For more than a decade productivity has declined and there has been a steady erosion of Australia's industrial base and increased unemployment. At the same time, Australia's current account deficit and overseas debt have become a cause for concern.

Review with Recommendations

1. Operating Costs

1.1 Sea Transport

Australia is a large country with a relatively small population concentrated in a limited number of centres spread around a long coastline and with its natural resources widely dispersed across the continent. To achieve internationally competitive manufacturing industries it needs world-scale operations, likely only one or two in each industry, and low cost transport of their output to the various population concentrations – for which coastal shipping is the logical best option. Oil refining, steel products and cement manufacture are obvious examples.

Unfortunately, however, Australian coastal shipping costs are amongst the highest in the world due to our long-established cabotage system and its inefficient labour practices which fosters and protects a coastal fleet which has reduced from 55 vessels in 1995 to an estimated 18 currently. It now costs much less to move oil products from Singapore to any Australian capital city than from one to another around the coast. Similarly, cement can be shipped at lower cost from Asia than between capitals. This disadvantage is a significant factor in recent plant closure decisions.

The impact of the unavoidable coastal shipping costs for raw materials, for example bauxite, alumina, iron ore, cement/clinker and gypsum, is again a significant contributor to the declining competitiveness of the Australian aluminium industry (emphasised by the recent closures of two local smelters) and steel, cement and plaster board manufacturers.

Resource processing, for example alumina refining, aluminium smelting, steel production and non-ferrous metals, are all major industries contributing to current account earnings either through exports or competing with imports, and depend on economic coastal shipping to move raw materials from one part of the country to another at minimum cost.

There has been extensive and detailed review of coastal shipping recently, which has resulted in calls to reverse changes to cabotage rules introduced since 2009, and particularly in 2012. However, this will only reduce the level of the cost penalty to a relatively small degree.

Recommendation:

It is recommended that immediate action be taken to reverse cabotage rules introduced since 2009, and phase out as rapidly as possible the entire cabotage system and its unique work practices regime. This would allow coastal shipments of products and raw materials to be transported at internationally competitive rates.

1.2 Power and Energy

It is now widely recognised that within the past decade, Australia has moved from enjoying a major competitive advantage as a low power and energy cost environment to become one of the world's high cost energy countries.

The Government has recognised that the Carbon Tax has been one element of this adverse change, and one which will greatly increase in its impact in future as the transitional compensation arrangements expire, and it is intent on its repeal.

Less commonly recognised or acknowledged, but at least as damaging now and more damaging in the future, is the impact of the Renewable Energy Target (RET), particularly its wind and solar power elements (given that hydro power potential is largely already being exploited).

The Australian Aluminium Council has determined that the aluminium sector has paid more than A\$300 million extra as a result of the RET since it was introduced and "this is not sustainable".

Recommendations:

1. It is recommended a thorough and broad-ranging public review of the impact of the RET schemes at Federal and State level proceed urgently. Full account must be taken of the total cost impact, including utilisation/actual output versus nameplate capacity, cost and nature of running back-up capacity to handle load fluctuation, total cost impact of the extra transmission grid requirements, capital and operating cost subsidies, tariff subsidies and tax concessions.
2. High efficiency super-critical coal fired power generation must become again the major base for a return to Australia's power and energy cost advantage. Whilst latest nuclear power technology is clean and worthy of serious consideration elsewhere, its higher capital cost and total cost per unit cannot be justified in the face of our coal resources.
3. From a broader energy perspective, it is imperative that Australia's natural, coal-seam and shale bed gas resources be developed as rapidly as possible to keep down domestic gas costs.

2. Productivity

2.1 Capital Improvements for Productivity

Ten and fifteen year depreciation rates for capital equipment have favoured renovation of old equipment because costs can be written off against current income for tax purposes. With technology rapidly improving the productivity of manufacturing plant, it is important there be encouragement to purchase new plant rather than refurbish old equipment.

It is relevant to note in the 1970's BHP conducted a major refurbishment of the Newcastle Steelworks. An employee of the German company involved remarked at the time, that in Germany the equivalent plant would have been replaced with modern more productive equipment and written off over three years.

Today the Newcastle Steelworks has closed, whereas Germany's plants still prosper and steelworkers receive an hourly wage above Australian rates, but the labour cost per unit is lower because of higher productivity.

A boost to manufacturing investment would not only improve productivity but offset the decline in mining investment and in the short term create jobs.

Recommendation:

It is recommended that company tax reform provides for the write-off of new manufacturing equipment to match overseas competitors.

2.2 Management Input for Productivity

Statements which put the onus on labour for productivity address only part of the problem.

A common feature of a successful business is that managers provide leadership, so that labour and staff recognise a common interest to achieve productivity improvements for the success of the operation and co-operate effectively. Capable management working closely with all employees is critical.

It is interesting to note in a recent Bloomberg Business Weekly article that Volkswagen workers in the US voted against the United Automobile Workers for their representation. The decision is said to be "an opportunity for labour and management to show the auto industry, and in particular corporate America in general, that they can work more productively together."

Recommendations:

1. It is recommended that Government urgently remove regulatory impediments to management and labour flexibility, to allow work practices and conditions of employment to be tailored to the specific needs of each individual business, removing "one size fits all" award restraints. This must be done in the context of emphasising the importance of increasing employment flexibility and thus opportunities for productivity improvement.
2. It is recommended Government and employer organisations support the message of how important employee and management cooperation is for success in the highly competitive Australian market. The contribution by management is particularly important.

3. Innovation and Commercial Development

In a study called *The Mystery of Economic Growth*, Israeli economist Elhanan Helpman reviewed all the available research on the sources of above average economic growth, especially growth of productivity. He found that the only single clear reason for higher productivity growth was corporate and Government spending on Research and Development (R&D) as a share of GDP. Singapore and Israel feature near the top of any list of nations that have commercialised inventions.

Australia's total spending on R&D is not especially high on lists of international spenders and as the budgetary situation allows needs to be increased. The long established Cooperative Research Centre (CRC) conducted a review by Allen Consulting Group in 2014. This review reported that, relative to the funds committed to the CRC program by the Australian Government, the CRC program has generated a net economic benefit to the community, which has exceeded its costs by a factor of 3 to 1.

We must stress, however, that it is not just R&D that matters. 'Innovation' requires successful commercialisation of R&D. By contrast to our average performance with R&D in the international league tables, Australia often ranks lowest in tables comparing successful implementation of the results of R&D. (See John Bell, 'Innovation policy linked to productivity boost', *ATSE Focus*, April 2014.)

Australian Venture Capital Association Ltd (AVCAL) has pointed out that the flaw in Australia's current policy prioritisation is that it does not invest enough in bringing its innovation to market. AVCAL quoted a recent PricewaterhouseCoopers study that flagged venture capital as being one of the potential 'game changers' in contributing to Australia's innovation system: a position that has been echoed in many forums in recent years. It also highlighted the fact that the US spends over four times (per capita) what Australia spends through venture capital investment.

The 300 page Strategic Review of Health and Medical Research report referred to what it called the "valley of death" being the hiatus between discovery and successful commercialisation.

The evidence suggests that two key factors involved, firstly the availability of risk capital for commercialisation, and secondly the transfer of development to staff sufficiently trained and with the business skills required.

Another generic issue concerns the early sale of successful new Australian ventures to large foreign companies. The causes of this perhaps includes cultural obstacles and also lack of explicit tax

benefits for investors, to compensate for the higher risk attaching to early stage innovation and development.

There is a further uncertainty with foreign owned companies as to the question of retaining the benefits of Government supported innovations and commercialisation within the Australian economy. It may be necessary to focus assistance to smaller Australian companies. Larger global companies in the main have their own resources. For example, the German company Bosch, has 38,000 staff worldwide working in innovation and development and on average registers 14 patents each day.

Business regulation and taxation arrangements can be unhelpful for commercialisation of ventures. For example, entrepreneurial people granted shares in cash strapped start-up companies immediately pay the full amount of income tax based on the theoretical value of the shares - value that may never be realised.

No comment on innovation is complete without recognition of staff in the workplace being able to recognise the opportunity for innovation with improvements to processes and products. Smith referred to the value of workers contributing to innovation. He said:

“A great part of the machines made use of in those manufacturers in which labour is most subdivided, were originally the inventions of common workmen, who, being each of them employed in some simple operation, naturally turned their thoughts to finding out easier and readier methods of performing it.”

Today his comments would apply to a wider range of employees.

Such innovations can support the management philosophy of continual improvement known in Japan as Kaizen management. Toyota benefits from a sophisticated system whereby employee ideas are given consideration and where adopted the employee gets a benefit reflecting the value of the innovation.

Recommendations:

1. It is recommended policies be put in place to raise the overall spend (Government and corporate) on R&D as a percentage of GDP, to global best practice levels. The program would need to ensure that relevant business and administrative skills and experience are available to use any Government support effectively.
2. To attract capital to this high risk area, tax concessions would be appropriate. For example, for approved projects foundation shares could be capital gains tax free and further calls up to set limits tax deductible. This could reduce the requirement for payments by Government to support innovation and commercialisation.
3. Remove the tax penalty applying to shares issued in start up companies commercialising innovations.
4. It is recommended a task force be constituted to review best practice arrangements in countries which lead the table of performance with innovation and commercialisation. The outcome be a basis to review and implement policies which would be relevant for Australia. The internal process, if available, of successful companies in this field such as Bosch, would also be relevant.
5. The Government consider claw-back of grants and/or tax concessions within, say, five years as a way to discourage too early sale to overseas interests.
6. Ensuring tax certainty and consistent long term policy settings for innovation and commercial development.

4. A\$/US\$ Exchange Rate

Recent plant closures have emphasised the high value of the Australian dollar as a heavy penalty.

There is a significant disparity between prices in Australia and USA and the exchange rate between their currencies. The price of a common basket of consumer goods and services which in Australia cost 100 currency units would only cost 72 units in the USA. (Source: OECD Jan 2014)

The high Australian dollar has been a burden for the trade exposed industries and needs to be considered in the context of past fluctuations. Since floating, against the US\$, the A\$ has ranged from A\$0.50 to A\$1.16. Contributing factors have been fluctuating foreign exchange earnings following the commodity price cycle and the impact of our trading partners' exchange rates.

Capital inflow purchasing assets and seeking higher interest yields is also contributing to the strong A\$.

For the trade exposed industries this represents a stop/start competitive environment. It is dangerous to accept industry closures when the A\$ is strong, when at other times with lower rates the same industries would be competitive. The uncertainty makes it almost impossible to justify investment in world-scale plants.

Industries which close when the dollar is strong are not available when the dollar weakens. There is a loss of technical know-how with the redundancy of highly skilled employees and premature destruction of productive capital.

Even for companies that do not close, profit margins and taxes can be severely reduced during periods with an overvalued A\$. There is a corresponding fall in the ability to raise capital for productivity improvement, expansion and new plants. Also, export markets are lost as in the case of SPC that lost 30% of their production going to exports through the higher A\$.

An overvalued dollar is equivalent to a tax on exports and a subsidy on imports. When the A\$ is strong importers have an advantage over local industry to increase their market share.

Countries which manage their exchange rate can set the level below what would be a market rate to make exports more competitive. China has been a case in point and in the process has now accumulated overseas reserves approaching US\$4 trillion. The emphasis on Chinese policy to create jobs is consistent with their setting an exchange rate for trade advantage.

Recently, a weakening of the Chinese currency has renewed concern about currency manipulation. An article in the Wall Street Journal (The Australian 17.4.14) states "The US has blasted China for its recent currency moves, calling the decline in the yuan 'unprecedented' and pressing Beijing to disclose its market intervention more regularly."

And further "US manufacturers have complained that China's artificially weak yuan gives the country advantage in trade. US politicians have backed laws targeting overseas currency manipulation and have asked the Obama administration in recent months to include currency rules in trade negotiations."

Other countries with floating exchange rates, particularly the USA, have seen their currency devalued through "quantitative easing". Through monetary stimulus or what is referred to as Abenomics, Japan has recently devalued by 20% against the US\$. These developments have contributed to the overvalued A\$/US\$ exchange rate. The fluctuations may at times be more important than tariff rates for trade protection.

Most recently, the EU has reduced interest rates to minus one-quarter percent and the ensuing lower value of the EU was sited as a benefit.

If it is correct that floating exchange rates provide a discipline upon a country's economic circumstances, then it is logical that there must be a similar adjustment internally to cost structures with a rising A\$. This places the emphasis on the importance of adjustments required to preserve industries and employment.

Recommendations:

1. The Australian currency is one of the most widely traded currencies for speculation, and if in the future fluctuations become more marked and the rate does not reflect overseas trade requirements, it may be necessary to consider intervention to prevent persistent major mispricing of Australia's exchange rate.
2. There is a major issue globally of how central banks should intervene to curb asset inflation where actual or potential bubbles threaten economic stability. A persistently overvalued exchange rate is a form of asset pricing imbalance that involves instability of industry structure and which requires fresh thinking by the Reserve Bank of Australia.
3. As stated earlier an overvalued dollar is the equivalent to a subsidy on imports. Consumers benefit. In the event an overvalued dollar threatens key industry and jobs, it may be appropriate to consider an "industry stabilisation" payment on key consumer imports to provide revenue to support those industries penalised during the period when the dollar is overvalued.

Such payments would not carry the stigma of taxpayers' dollars being referred to as "corporate welfare" payments. In effect they would be sharing the benefit of the overvalued dollar between consumers and industry to preserve industries affected and jobs.

4. To the extent that capital inflow to purchase assets, particularly shares and property contributes to an overvalued dollar a tax on those payments may also be appropriate.
5. Defence expenditure disregard the extent of short term benefits imports have over local production with an overvalued dollar.

It is recognised these recommendations might be controversial, however unless the issue is addressed in some way, manufacturing in Australia will continue to have a severe competitive disadvantage.

5. Current Account Deficit and Trade

For some observers the decline in manufacturing in favour of cheap imports is an outcome of free markets and is thus acceptable. However two points can be made. Firstly, Government policies have restricted the ability to meet import competition and grow exports. Secondly, there is the growing cost of imports of manufactured goods. This may not be of concern if there were sufficient export earnings. Australia however has a current account deficit of near \$19 billion in 2012/13 which has been financed in the main by net current account investment, borrowing, or sale of assets. These strategies are not sustainable.

It is worth noting an open border does not always deliver the cheapest goods for consumers. For example, Nike shoes costing A\$10.00 to make sell for A\$180.00 in Australia. The oligopoly in the retail industry means that cheap imports may not be passed on to consumers.

Also some cheap processed food imports have been found not to meet expensive and stringent Australian Food Safety Standards.

Manufacturing makes a significant contribution to Australia's current account balance, either through import substitution or earnings from exports. For example, metals comprise 8.2% of Australia's export earnings, compared with 8% for agriculture and 13.5% for other manufacturers (*Source: IBISWorld for 2013*). The relevance of manufacturing, totalling some 22% of Australia's exports, for the balance of payments emphasises the importance of their access to overseas markets and lower domestic costs. This will be all the more important during a downturn in prices for the mining sector.

For the three years commencing 2010-11 during the mining boom the total value of iron ore and coal exports was A\$313 billion. For the same period, the balance of payments was a deficit of A\$7 billion. This highlights the vulnerability of our current account with the fall in iron ore and coal prices already evident.

Affected industries also supply the domestic market and if they close will inevitably lead to an increase in imports to satisfy domestic needs, placing further pressure on the balance of payments. Recent closures of oil refining and cement manufacturing operations, for example, are already increasing imports with consequences for the current account balance.

Recommendations:

1. It is recommended unrestricted imports be considered not only with regard to their potential savings for consumers, but also with regard to what consumers actually pay, and also the impact on the current account deficit, particularly if dumped or subsidised imports replace local production.
2. It is also recommended immediate action be taken to make food safety testing requirements for food imports fully match Australian standards.

6. Competition Policy

Competition Policy frustrating mergers of companies in the global traded goods sector in the name of competition in the domestic market, but in the process denies a producer the extent of the market required for an operation to be internationally competitive.

The takeover of Warrambool Cheese and Butter is a case in point. The notion of reducing domestic competition if the local industry is consolidated is not relevant in the context of having an organisation able to compete locally and internationally when competing with large international groups such as Fonterra.

New Zealand "decided that trading in domestic competition for international clout through one massive exporter leader will be better for New Zealand Inc." AFR 29 Jan. 2014

"Fonterra's scale has been a plank of New Zealand's prosperity." AFR 29 Jan. 2014

A further consideration is the purchase of Australian manufacturing companies by global corporations. Such purchases mean that market development is determined to suit, and may be restricted in favour of, the interest of the parent company.

Growing international markets unrestricted by an overseas parent company has been a significant factor in the creation of wealth by global companies. For example, the Top 500 S&P American listed companies, which are in the main US owned, sold 46.59% of production overseas in 2012.

Recommendations:

1. It is recommended priority be given to mergers which favour the formation of a strong group which can compete in international markets rather than having weak fragmented entities. This will address weak links in the Australian economy as a result of past policies which favoured smaller operations no longer competitive in the global economy. The ACCC needs a strong revision in its brief from Government.
2. Recognise that foreign takeovers may hinder the development of global export markets.
3. The opportunity for Australian controlled companies to develop into global operations, or their having done so already, should be taken into account when considering foreign takeovers.

Conclusion

The theme emphasised in this paper is that the "extent of the market" available to companies is critical for the benefits of specialisation and productivity to grow national wealth and jobs. Attention is drawn to the importance of identifying and removing impediments affecting market opportunities. It is evident that urgent action is required to stop the erosion of Australia's industrial base.

Addendum

Incitec General Meeting Report

Australia behind on cost: Incitec

Incitec Pivot chief executive James Fazzino said the labour and energy benefits from building its \$US850 million ammonia plant in the United States rather than Australia are “stunning”, as the company reported a seven per cent rise in half-year profit to \$115.7m.

First production from the plant at New Orleans in Louisiana is expected in mid-2016. Construction will generate 750 jobs over three years.

In an indictment of the high cost of doing business in Australia, Mr Fazzino said the fertiliser and explosives manufacturer will spend about \$1 billion (\$US850m) building the plant in the US when it would cost \$1.4b to build it in Australia.

“It is stunning to compare the efficiency that you get on site in the US and the skill and progress that you get compared to what you get in Australia,” he said.

Mr Fazzino said labour costs are 35 per cent of the total project in the US but closer to 60pc in Australia.

This month, the Productivity Commission warned that Australia’s productivity has lagged comparable nations for more than a decade, and cautioned that resources exports could no longer support income growth.

According to OECD data, Australia’s real minimum wage of \$32,039 in 2013 is the highest in the developed world.

Another benefit in the US is the low cost of gas. Gas makes up about 80pc of the cost of producing ammonia.

In 2015, new gas contracts for Incitec Pivot’s Phosphate Hill plant in Queensland will increase the company’s cost of gas by \$50m. *Stock & Land* May 29, 2014

The Authors comprise:

Richard M. Morgan AM

Richard Morgan is Chairman of BPC Holdings Pty Limited, a private company with interests in agribusiness, New Zealand forestry and venture capital. He had a career in senior positions in industry and on company boards.

He has served as a Director and Treasurer of VECCI and was a Council Member and National Treasurer of the Australian Institute of Agriculture Science and Technology. He was made a Fellow of the Institute for his contribution to the Australian fertilizer industry as General Manager and Deputy Chairman of Queensland Phosphate. He has been National Chairman of the Australian Red Cross Society and a member of the Australian Red Cross Blood Service Board. He has degrees from the University of Melbourne in Agricultural Science and Commerce and has been a tutor of Economics at the Faculty of Business and Economics, University of Melbourne.

Richard Morgan is the author of the book *Lessons from the Financial Crisis and the Relevance of Adam Smith on Morality and Free Markets*, published in 2009, Connor Court Publishing Pty Ltd.

Peter D. Jonson

Peter Jonson has had a career as an economist. He obtained his PhD at the London School of Economics in 1975. He worked at the Reserve Bank of Australia, including Head of Research from 1981 – 1988, then in the 1990s ran two substantial financial service companies in the private sector.

Since 2000 Peter has mainly worked as a professional company director. In the entertainment, remediation and biotechnology sectors he has chaired both listed and unlisted companies. Peter served as Chair of the Federal Government’s Cooperative Research Centre (CRC) Committee from 2005 to 2010 and as chair of two other funding committees for the Federal Government.

In 1989, he was elected as a Fellow of the Academy of the Social Sciences in Australia.

Peter is the author of a book *Great Crises of Capitalism*, published in 2011, and editor and founder of HenryThornton.com.

Mark R. Rayner

Mark Rayner has had a career in the metals and mining industries in Australia and internationally.

He graduated from UNSW in 1961 with Honours in Chemical Engineering and undertook the Advanced Management Program at Harvard Business School in 1976.

He was CEO of Comalco Ltd 1978-89 and a Group Executive and Director of CRA Ltd until his retirement in 1995. Since then he has served as a Director or Chairman of a number of major listed companies in a variety of industries including banking, metals, manufacturing, health and construction.

He is a Fellow and past Vice President and Treasurer of the Academy of Technical Sciences and Engineering, a past Chairman and Honorary Life Member of the International Primary Aluminium Institute, a past President of the Australian Mining Industry Council and a past Vice President of the Australia/Japan Business Cooperation Committee.

He has served on a number of Government advisory bodies, including as a member of the Hilmer Committee on Competition Policy.

He has a grazing and wool growing operation in Western Victoria.

Colin Teese

Colin Teese worked for 30 years in the Department of Trade and was Deputy Secretary from 1978-83 and was Advisor to Prime Minister Fraser on trade policy matters.

He was leader of numerous Australian delegations in both bi-lateral and multilateral trade negotiations.

He held the position of Australian Permanent Representative to the General Agreement on Tariffs and Trade (GATT), which later morphed into the World Trade Organisation.

Colin led the Australian delegation in the final stages of the negotiations to conclude the Tokyo Round of Trade negotiations in 1981.

He has a BA from the University of Melbourne.
