Professor Gruen is in the Department of Economics at the Research School of Social Sciences at the ANU and is also with the Department of the Prime Minister and Cabinet.

The 25% Tariff Cut; was it a mistake?

By F. H. Gruen

Introduction

At the time, the 25% tariff cut was widely applauded. Perhaps no other economic measure taken by the Labor Government was greeted with such acclaim by the Australian press.[1]

Within the last 9 to 12 months the tariff decision has come under increasing attack and there is now a fairly general view that the cut was an unwise one. For instance the recent Liberal-Country Party National Economic Programme 1975 talked about the "ill conceived" 25% across the board tariff cut which caused the "destruction" of labour-intensive industries. Nor is this belief confined to one side of politics; there are plenty of Government backbenchers who share the view that the across the board tariff cut was ill conceived and largely responsible for our present unemployment problems.

I propose to discuss first the economic background to the decision to cut tariffs by 25% and to evaluate the arguments raised against the decision at the time within Government. Then I propose to discuss the effects of the tariff cuts on prices, imports and employment—in so far as these can be ascertained. Finally I want to answer the question whether in retrospect one should regard the tariff cut decision as a mistake.

The 25% Tariff Cut — The Background

Post-war Australian tariff policy has been the subject of controversy at least since the resignation of Sir Leslie Melville as Chairman of the Tariff Board 12 years ago. Originally led by Dr Max Corden, Australian academic economists have generally been critical both of the basic economic rationale for the high levels of protection in Australia and the "made to measure" nature of the Australian tariff system.

Under the Chairmanship of Mr G. A. Rattigan, the Tariff Board in its 1967-68 Annual Report proposed a threefold classification of industries according to their levels of effective protection. It also recommended the review of industries with effective rates of protection of 50% or more. The purpose of this review was to examine more critically the level of protection afforded for those economic activities which require most financial assistance (from consumers) to enable them to compete with overseas suppliers. The review was approved by the Liberal-Country Party Government in 1971 and is scheduled to be completed by 1978.

The lengthy industry-by-industry examination is an important and worthwhile exercise. However, it is unlikely to be entirely successful—if only because a period of seven years is likely to contain a number of periods when it would be politically difficult to reduce tariffs—either because of the existence of unemployment or because of balance of payments problems. For these reasons a number of economists have felt that it is really only when there is full employment and the external situation is favourable that any substantial reduction in tariffs is a genuine possibility.

As Max Corden put it in 1966,

> Normally in these circumstances we allow inflationary pressure to develop and wages and other costs to rise, so eliminating the balance of payments surplus. But if we accept that a move towards free trade were desirable, we might try to prevent some of the increase in costs and take the opportunity to reduce tariffs. Of course the tariff reduction would only be feasible politically and desirable economically (if costs of change are to be minimized) in a context of high employment. It follows that our freedom of action on the general level of the tariff is limited by the way the balance of payments evolves. It is limited by factors which have nothing to do with the usual arguments for or against protection. Only a period of external surplus gives us the opportunity to choose.[2]

Externally the opportunity first arose in 1971 when Australian Official Reserve Assets started their spectacular climb from around $1,500 million in December 1970 to a peak of over $4,750 million in December 1972. During this period some academic economists did indeed informally raise the possibility of a general tariff cut with senior public servants in economic advisory positions. However these notions did not get very far in official Canberra at that time. Administrative difficulties were one reason advanced; another was that there is a very wide range of "fat" in the amount of protection which different industries possessed and that an across the board tariff cut would therefore affect industries differentially. Whatever the reason, the proposal for some overall tariff reduction was never seriously entertained either by those senior public servants who had the ear of ministers, or by the Government itself.

During the early months of the Labor Government it became obvious that there would be great and growing demands on the productive capacity of the Australian economy. Apart from private demands, the Government had very ambitious social objectives (for instance the Karmel Report on Education was tabled in Parliament in May 1973). In these circumstances the greater the proportion of total community expenditure spent on imports, the easier—or at least the less difficult—it was likely to be for Government to fulfil its social objectives. In this situation, imports had the virtue that they added to the supply of things to buy in Australia without creating additional incomes from production and thus extra demands.

It was in this setting that the Prime Minister and Dr Cairns on June 27, 1973, set up a committee, under the chairmanship of Mr Rattigan, to report on possible action to increase imports. The committee reported on July 15, 1973, in favour of a 25% reduction of all tariffs. The Government accepted the report three days later. Its acceptance may have been helped by the release of the June quarter of the Consumer Price Index on the preceding day, showing a then record increase of 3.3% for the preceding quarter. This probably made Cabinet more willing to adopt a relatively painless anti-inflationary measure. However, the main stress in the report was not on dampening price rises but on the possibility of increasing imports and thus making more supplies available locally. This is indeed clear from the heading of the report of the Rattigan Commission.

The Treasury Critique

As mentioned in the Liberal-Country Party's National Economic Programme for 1975, the Treasury had some reservations about the proposal and, as the Government's principal economic source of advice, raised a number of issues for consideration.[3] Treasury doubts were not directed at the objective of increasing imports but only at the means employed—namely the across-the-board reduction in tariffs. There were basically three objections raised in the Treasury notes on the subject.[4] First and perhaps most important, it was argued that a tariff cut would prejudice the possibility of a further revaluation. The Treasury regarded revaluasion as a superior instrument for easing the pressure on resources. Second, they believed tariff making to be an area in which justice not only should be done but should be seen to be done. A broad tariff cut was regarded as incompatible with the long-term industry examination. Thirdly, the real effects on employment and on industry were uncertain; in addition there could be significant, adverse, psychological effects from the announcement which in turn might lead to very sharp dislocations in the areas principally affected.

These are significant issues—issues on which some comment seems desirable here because they have also been raised in different forms outside Government.

Tariff Cuts Versus Appreciation

The July tariff cuts did not prevent a further appreciation of 5% on 9 September, 1973. To this extent the Treasury fears were groundless.

However, there is obviously a limit to the extent to which one can revalue and cut tariffs—a limit given, in the ultimate, by available foreign exchange reserves.[5] It is of interest then to consider the relative virtues of the two methods of increasing supplies on the local market.[6] The appreciation of the exchange rate directly affects the price and quantity of both exportables and importables available within the economy. Furthermore appreciation reduces the price of those imports (e.g. raw materials and capital goods) which come into the country free of duty. An across-the-board tariff cut will affect only those import-competing industries receiving protection.

Exchange rate changes therefore operate directly over a wider area of the economy than tariff changes. How much wider? This will depend in part on the measure used. One possible and relevant measure uses the proportion of value added affected by the two measures. Some 66% of domestic value added in the Australian economy originates in the non-traded sector of the economy.[7] That area will not be affected directly by either measure. Appreciation will directly affect the remaining 34%. However, about a third of the traded sector is not protected by tariffs. Hence changing the overall level of protection affects directly only 22½% of the economy (on a value added basis).[8] This would be one way of looking at the widths of the relative effects of tariff cuts and exchange rate changes. It shows that both measures affect sizeable sections of the economy, with appreciation affecting a sector approximately 50% larger than all-round tariff reductions.[9]

In terms of their aggregate effect on gross operating surplus, a 25% tariff cut has about the same depressing effect as a revaluation of about 4%. If we compare the effects of these two measures on individual industries, we find that for 58% of traded value added, a tariff cut will have a greater depressing effect. For the remainder—i.e. 42%—the exchange rate change will have a greater depressive effect. Thirty-five per cent of value added—i.e. most of this 42%—would be in industries which actually benefit from a tariff cut.

Furthermore, appreciation and tariff cuts may have different effects on consumer prices. Since some exportables (e.g. meat) figure prominently in the consumer price index, the two measures of affecting supplies may have differential effects on consumer prices. According to Klijn, the effect of appreciation on consumer prices is relatively twice as great as a tariff cut which has the same effect on the current account.[10]

The two relative advantages of appreciation—i.e. the wider coverage and the greater effect on consumer prices—of course account for Treasury's espousal of it. However there are the longer term issues of resources allocation mentioned earlier. It is not unreasonable to pay some consideration to these longer term issues and to take action to increase local supplies in such a way as to affect particularly those activities requiring especially high rates of protection. This is, of course, one differential effect of tariff cuts as compared with appreciation. It would be difficult to argue that the Government has lent too heavily in the direction of reducing tariffs as opposed to changing the exchange rate. The successive appreciations of the effective exchange rate exceeded 20 per cent in the aggregate. This compares with an effective up valuation of perhaps 4 to 5 per cent in the form of the across-the-board tariff cut. Appreciations have been a much more important influence on the total volume of imports and even on the profitability of the highly protected industries than the 25% tariff cut. This is a matter which will be discussed in more detail in the next section.

Tariff Making – Justice Needs to be Seen to be Done

The Rattigan Committee felt that the across-the-board tariff cut had certain similarities to an appreciation. Exchange rate changes do of course change the terms on which domestic manufacturers compete with imports equally arbitrarily as a general tariff cut.

Since it has been suggested in some quarters that there are swings and roundabouts and gains and losses from appreciation for manufacturing industry, it is of interest to look at these "swings and roundabouts" in more detail. Import competing industries practically always lose from appreciation. Even if the prices of their inputs are reduced, their output prices are going to be affected in most cases by a larger percentage (since some inputs are not imported). Table 1 gives an estimate of the revaluation equivalent of the 25% tariff cut. Equivalent in this context means in terms of the direct effect of both types of action on the operating surplus or profitability of industry. Table 1 is restricted to eleven industries which have been regarded as particularly seriously affected by the tariff cut. It will be seen that even for this group of highly protected industries, the revaluation equivalent is surprisingly modest and between one third and half the cumulative revaluations of the Australian dollar between December 1972 and September 1974.

In other words, the twenty per cent plus revaluation of the Australian dollar between December 1972 and September 1974 has typically had three times as much effect on the profitability of the major tariff-affected industries as the 25% tariff cut. If government is not supposed to affect industry profitability through across-the-board tariff reductions why should it be allowed to affect it much more severely in an equally arbitrary fashion through changes in the exchange rate?

The wage explosion of the last 18 months has of course had an even more drastic effect on industry profitability than either revaluation or tariff cuts. One of the subsidiary aims of both appreciation and tariff cuts was to make it less profitable for industry to grant such large wage increases. Of course both measures in this respect failed dismally—for reasons which are referred to again in the concluding comments.

Table 1:
Estimated Revaluation and Wage Change Equivalents
of the 25% Tariff Cut*

Industry	Revaluation Equivalent †	Wage Change ‡ Lower Limit	Wage Change ‡ Upper Limit
	%	%	%
Knitting Mills	6.5	6.2	12.8
Clothing	7.5	6.9	13.4
Footwear	8.4	9.5	17.4
Wooden Furniture	7.7	7.4	14.8
Pulp, Paper & Board	6.7	10.7	22.9
Glass & Products	3.4	4.4	8.2
Motor Vehicles & Parts	7.0	9.6	15.9
T.V., Radios, etc.	10.0	11.7	16.9
Household Appliances	6.3	5.4	10.6
Electrical Cable, Machinery, etc.	6.5	5.3	11.4
Rubber Products	5.5	4.9	8.2

* Equivalent in terms of their direct effect on the operating surplus or profitability of the respective industry. The estimates were made with the use of the 1967-68 Input-Output Table prepared by Mr N. Klijn.

† The estimate of the Revaluation equivalent of the tariff cut assumes that prices of traded goods change by the full extent of the revaluation (including those which are inputs) and that the operating surplus in the non-traded sector of the economy remains unchanged.

‡ The lower estimates for wage changes assume that wage increases occur not only in the industry concerned, but also in all industries supplying inputs to that industry. The higher estimate assumes no wage (or price) increases in supplying industries.

If we are not going to allow governments to change exchange rates when it is economically sensible, world inflationary and deflationary trends will have even more impact on the local economy than they have now. In fact, in a world where other currencies fluctuate, it is just about impossible to finely tune the degree of import competition for each and every local import competing industry. For instance, since September 25, 1974, the effective exchange rate of the Australian dollar has been maintained at a steady level. However this has not prevented the Australian dollar from appreciating by some 4.4% against the US dollar during the next 5 months. For those industries which are affected primarily by competition from the US this movement over a 5-month period—a period during which our effective exchange rate was constant—could be equivalent to a 15 to 20% tariff cut.

The point I am trying to make is that complete maintenance of the status quo (which is what the demand for justice often means) is just not possible in a changing world. Governments need to cushion individuals and firms occasionally when they cannot cope unaided with economic change; however government cannot provide industry with complete guarantees against import competition and, in the interests of managing the economy, will from time to time need to change the *overall* degree of import competition to which industry is exposed.

The Effects of the 25% Tariff Cut

(a) *Psychological effects*

The psychological effects of the tariff cut were probably very minor, if the Stock Exchange reaction is any sort of guide. The day after the tariff cuts were announced the Clothing and Textile section of the Sydney Stock Exchange Index fell by 8%; the shares of other import competing industries were affected to a lesser extent. After the first day or so, prices of tariff-affected stocks stabilised. If we compare the All-Ordinaries Index with the various tariff-affected sections of the index a month or two after the tariff-cut there was no longer any difference in the price changes. The All-Ordinaries declined by some 15% in the two months after the tariff cut; such tariff-affected sections as Textiles and Clothing, electrical sales and manufacturing declined by a smaller percentage and chemicals, paper, glass, rubber by the same percentage.

What other evidence can one offer regarding the psychological effect of tariff cuts? Further differential changes in share prices might have taken place subsequently—but they could have taken place for other reasons. Manufacturers certainly complain loudly about the tariff cuts—more loudly than they have complained about revaluations or wage increases. Since we have shown above that the latter have directly affected manufacturers' profitability more severely than tariff cuts, what does this additional volume of complaint mean? Does it mean any more than that manufacturers feel they have a better chance to affect the government's tariff policy than its exchange rate or its wages policies respectively?

(b) *The effect on imports*

The effect of the tariff cuts on the volume of imports has recently been estimated by Gregory and Martin.[11] A detailed consideration of this paper would be beyond the scope of this talk. However some of the main conclusions are worth giving here. If we compare the twelve months ended September 30 1974 with the previous 12 months, we find that the volume of imports increased by some 30%. About half of this increase was the result of the price changes produced by revaluations and tariff cuts. In round figures, of an increase in imports (constant 1966-67 dollars) of $1,500 million in the year ended 30 September 1974, the 25% tariff cut is estimated to have contributed about $160 million or 11 per cent, whilst changes in the exchange rate are estimated to have contributed about $600 million of 40% of the increase in imports. About half of the increase in imports was the result of other factors—in particular of the boom conditions in 1973-74.

The increase of imports resulting from tariff cuts took some time to get under way. According to Gregory and Martin increases were very small (less than $30 million) until the June quarter of 1974. This is probably the result of the world-wide shortage of many products during 1973-74. Conditions in the second half of 1974 were somewhat similar to those at the end of the post-war boom in 1952—when supplies suddenly "catch up" in wide areas and stocks ordered on the basis of both boom period demand and of previous shortages suddenly start to accumulate. The excess stocks accumulated as a result of over-ordering during the boom were probably a major factor in the subsequent low level of economic activity.

(c) *The effects on prices*

What was the effect of the tariff cut on prices? The only available empirical estimate of the increased volume of imports resulting from tariff cuts and revaluations was given in the preceding section. The extra supplies of goods available provided more competition for local suppliers and reduced the extent of some of the shortages experienced during the first half of 1974. As pointed out in the reports from the Joint Parliamentary Committee on Prices the tariff cut and the revaluations have had a cumulative effect on landed costs of imports and it is not possible, in practice, to separate the price effects of the one from the other. In the aggregate, prices rises within Australia were probably reduced by somewhere between 4 and 8% as a direct result of the revaluations and tariff cuts.

There is a popular notion afoot that the benefits of tariff changes and revaluations either did not reach Australia (i.e. were pocketed by foreigners who put up their Australian prices) or, if the benefit did reach Australia, it was absorbed by importers and other distributors. This is the result of a number of highly publicised accusations of overchanging, profiteering and—to quote Mr Don Chipp, MP—"king-sized rip-offs". There were at least five occasions during 1974 when such accusations were made in the Federal Parliament. The only two specific accusations of overcharging which I have seen, have been rebutted by the major retailers who were accused.

This does not mean that there were no cases of overcharging. It is, after all, difficult for outsiders to get specific evidence of overcharging. Again, one would expect that some importers or retailers who succeeded in obtaining imported supplies very quickly after a revaluation or a tariff cut would charge what the market would bear and obtain unusually high profits—until such time as their competitors had obtained similar supplies. It is therefore not surprising if examples of astute purchasing and excessive mark ups could be substantiated.[12]

However, the important point is not whether it is possible to discover occasional examples of excessive mark ups but whether this has been the typical response to lower overseas prices and/or tariff reductions. The Joint Parliamentary Committee on Prices has probably conducted the most detailed investigations of these matters and published three Reports on the subject.[13] Table 3 in Report No. 3 summarises a good deal of their investigations. It is reproduced below. The Committee looked at 35 commodity groups—commodity groups which accounted for some 60% of all commodity imports in 1972-73. We are therefore confronted with an investigation into a very large segment of Australia's imports. If we classify the response according to the general result of the up valuations and tariff reductions we find:

1. In cases accounting for 36.3 per cent of the value of imports given by the Committee, landed costs were reduced and this reduction was typically passed on to the consumer.
2. In cases accounting for 56.1 per cent of the value of imports landed costs were not reduced—either because overseas prices and inward freight rates were increasing too rapidly or because Australia had not appreciated against the currencies of the supplying countries (e.g. the German mark, the Japanese yen and the Swiss franc). Since world wholesale prices were rising by some 20 per cent during the twelve months ended March 1974, it is not surprising that the dominant effect of appreciation and tariff cuts has been one of restraining price increases rather than actually lowering prices.
3. In the remaining cases—accounting for some 7.6 per cent of imports investigated by the Joint Committee, market power overseas prevented the local economy from benefitting—at least in the short run—from revaluations and tariff cuts.[14]

In other words, in the overwhelming majority of cases Australian purchasers benefitted from revaluations and tariff cuts—even though there are some cases where foreigners benefitted and there may be some truth in some of the highly publicised cases that some retailers and/or importers may have secured substantial benefits. When man bites dog it is news, when dog bites man it is not. So it is with the benefits of revaluations and tariff cuts—except that the general public knows that dogs bite men more often than vice versa. On the other hand, with tariff cuts the public has been given the impression that everyone got the benefits except the general public. The careful study of the Joint Parliamentary Committee suggests that such cases were very much the exception.

The general conclusion of this study has had very little publicity. As long as there was no reliable information, the idle speculation or malicious information of interested parties was given a good deal of prominence in the media. When information is painstakingly researched and assembled but it is of a nature which does not provide for a nice juicy scandal, it is barely noticed.

(d) *The effect on employment*

The effect of tariff cuts on employment has probably been minor. The Rattigan Committee estimated that the extra imports brought in as a result of the 25% tariff cut would amount to $400 million on an annual basis and that they could reduce employment by 33,000. The actual imports attributable to the tariff cut in the year ended September 1974 were estimated at $200 million (current prices) by Gregory and Martin, with, presumably, a proportionate reduction in the estimate of the number of employees displaced.

The total number of people who have claimed income maintenance as a result of various tariff decisions remained very low (below 6,000) until the end of September 1974—i.e. 15 months after the tariff cut. To January 1975 the numbers have increased to 23,000; since then they have declined. While the argument has been used that some employers are unwilling to give the necessary certificate to employees for them to obtain income maintenance, and therefore the number of workers displaced is underestimated, there is an offsetting bias the other way since presumably most workers who are unemployed would prefer to claim that their unemployment is the result of tariff reduction in order to qualify for the higher levels of benefit. Average payments under income maintenance amount to about $97 a week, compared to unemployment benefit of $51.50 a week for a married couple and $31 for a single person.

Under these circumstances it seems obvious that less than 10% of the current level of unemployment can be attributed to the Government's tariff decisions. Furthermore, the unemployment caused in "tariff-affected" industries has been caused because profitability in these industries has been impaired. However both revaluations and wage increases in these industries have had a much more dramatic effect on profitability than tariff cuts.

I refer again to table 1 which gives estimates for 11 important industries of estimated changes in wage rates which would have the same effect on profitability as the 25% tariff cut.

Two estimates are given. The lower one assumes that wage increases occur not only in the industry concerned, but also in all industries supplying inputs to that industry (e.g. in the case of the motor car industry the assumption is made that all their suppliers have equivalent wage rises which they pass on in increased prices to their motor car manufacturer

Table 3:
Response of Import Prices to the Upvaluations

COMMODITY	Share of imports (f.o.b.) in 1972-73	Reductions in landed costs of imports		The upvaluations restrained price increases	Response of consumer/user prices to reductions in landed costs	
		Reduced	Not reduced (a)		Responded	No/small response (b)
	%					
Agricultural machinery	1.1	x	–	–	(x)	x [7]
Excavating and levelling machinery	1.6	x	–	–	x	(x)[7]
Telecommunications equipment	1.3	x	–	–	x	(x)[7]
Non-electric machinery	5.7	x	–	–	x	–
Office machines	2.9	x	(x)[2]	(x)	x	(x)[5]
Photocopying and photographic materials and equipment	1.3	x	(x)[2]	–	x	(x)[5]
Internal combustion engines	1.8	x	–	–	x	–
Chemicals	3.5	–	x [1, 2]	x	–	x [5]
Anti-knock preparations	0.4	x	–	–	–	x [6]
Petroleum and petroleum products	4.3	–	x [1, 2]	x	–	x [5]
Plastics	2.6	–	x [2]	x	–	x [5]
Man-made fibres	0.6	–	x [2]	x	–	x [5]
Crude rubber	0.6	–	x [2]	x	–	x [5]
Paper	2.7	–	x [2, 3]	–	–	x [5, 8]
Timber	1.7	–	x [2]	x	–	x [5, 8]
Jute	0.3	x	–	–	x	–
Flat glass	0.3	(x)	x [3]	–	–	x [5, 6, 7]
Footwear	0.6	(x)	x [2]	x	–	x [5]
Textiles	7.5	–	x [2]	x	–	x [5]
Clothing	1.6	–	x [2]	x	–	x [5]
Floor coverings	0.8	(x)	x [2]	x	(x)	x [5]
Motor vehicles	7.3	–	x [2, 4]	x	–	x [5, 7]
Motor cycles	0.9	x	(x)[3, 4]	–	x	(x)[5]
Domestic appliances	0.9	–	x [2]	x	–	x [5]
Tyres and tubes	0.9	x	(x)[4]	–	x	(x)[5]
Pharmaceutical products	1.6	x	(x)[3, 4]	–	x	(x)[5]
Cutlery	0.3	–	x [1, 2]	x	–	x [5]
Ceramic tiles	0.4	–	x [2]	x	–	x [5]
Toys, games and sporting goods	0.9	x	–	–	x	–
Printed matter	1.8	x	(x)[3]	–	x	(x)[5, 7, 8]
Tea	0.5	x	–	–	x	–
Coffee	0.5	–	x [2]	x	–	x [5, 7]
Fish	0.9	(x)	x [2]	x	–	x [5]
Alcoholic beverages	0.6	x	–	–	x	–
Tobacco (unmanufactured)	0.4	x	–	–	–	x [6]
TOTAL	60.8					

x = general result of the upvaluations; (x) = exception to general result

(a) Not reduced because of:
1 increases in inward freight
2 world shortages/overseas inflation
3 market power overseas
4 currency of major suppliers did not appreciate markedly against Australian dollar

(b) No/small response because of:
5 no reductions in landed costs
6 reductions too small
7 cost increases in Australia
8 market power in Australia

Sources: Based on the evidence and Australian Bureau of Statistics Overseas Trade Bulletin.

customers). The higher estimate assumes that there are no wage (or price) increases in supplying industries.

Irrespective of whether the upper or lower estimates are taken, it is obvious that actual wage increases in the last two years have had an impact on profitability which typically is many times greater than the effect of the tariff cuts in these 11 industries. For instance the effect of the tariff cut on the profitability of Knitting Mills is estimated to be equal to wage rises of between 6 and 13 per cent. Between December 1972 and September 1974 the actual increase in minimum wage rates in the textiles, clothing and footwear industries averaged 60% (56% for males and 73% for females).

Conclusion

What conclusions can one draw from the previous discussion?

1. The most obvious conclusion I think is that the effects of the 25% tariff cut have been exaggerated both by those, like myself, who favoured such a move and even more so, by those who opposed it. There can be no doubt that the beneficiaries of our system of protection have grossly exaggerated the damage done to their industries by the 25% tariff cut. For instance, according to the Manufacturers Bulletin of the 28th February 1975, the Associated Chambers of Manufacturers' submission to the Jackson Committee, singles out the 25% tariff cut as causing "indiscriminate damage and widespread disruption to industry". There is no recognition here of the relatively small effects of the 25% tariff cut as compared to either the revaluations which have taken place or the wage increases which industry has found it necessary to grant.

2. In the light of our present difficulties, it is fair to conclude that exchange rate changes and tariff cuts can only act as a supplement to and not as a substitute for the control of inflation through fiscal, monetary and wages policies. I don't want to suggest that this is a new conclusion—it is perhaps a dramatic confirmation of some conventional wisdom from the past.

3. In the present circumstances, with some recent reversals of the tariff cuts, it might be argued that the July 1973 decision has damaged the cause of rational tariff reform.[15]

This is an area where it is not possible to be dogmatic. My personal belief is that high levels of unemployment and unused capacity in manufacturing industry will always lead to intense pressure on democratically elected governments for additional protection (especially on governments which can be forced to hold an election every six months or so). The tariff cut is of course an additional stick with which to beat the Government. I personally doubt whether, in its absence, the pressure for extra protection would have been very different. Of course it might be argued that there would have been less unemployment without the tariff cuts.

As shown above, the quantitative effect of this argument is not great; instead there would have been greater price rises earlier, etc. etc.

4. In view of recent reversals, there is the question whether the tariff cut has really achieved anything. Reversals have taken place for clothing, textiles, footwear, household appliances and motor vehicles. These industries account for about 20% of value added under protection in Australia (and about half the value added of the industries in Table 1). Without wishing to appear too sanguine, one can note that extra protection has been granted mainly on a temporary basis and may be reduced when it comes up for review, provided the level for employment and economic activity is then more satisfactory than it is now.

In the case of the motor industry, a good deal of protection arose not directly from tariffs, but from local content plans. These have been liberalised somewhat and imports in greater volume than in any year before 1973/74 are being permitted. In spite of this, the level of effective protection for this economic activity is very high.

In a good many areas there have been increases in import competition which have not been reversed. Finally it has been shown to be administratively and possibly even politically feasible to have an across-the-board tariff cut in Australia. Economically, we are a long way from July 1973, but similar conditions might recur some day.

In retrospect I certainly don't think that it was a mistake. It would obviously have been better if the restraining schemes and the structural adjustment schemes had worked earlier—but that is another story.

References

* I have received helpful comments on an earlier draft from Andrew Bain, John Elias, Peter Lloyd, Trevor Swan, and from some friends in Treasury and the Prime Minister's Department.

1 The 25% tariff cut was warmly praised (e.g. decisive, bold, one of the most forthright and courageous economic decisions taken by any government etc) by the **Financial Review, The Sydney Morning Herald, The West Australian,** the **Adelaide Advertiser.** It was welcomed cautiously by **The Age,** the **Sydney Telegraph** and the **Brisbane Telegraph.** It was opposed by the **Brisbane Courier Mail,** the **Australian** and the **Melbourne Herald.**

2 "Protection", by W. M. Corden, from Reviews of the Report of the Committee of Economic Enquiry, **The Economic Record,** March 1966, p. 134.

3 Since Treasury's doubts about the proposal are common knowledge, it has seemed to me desirable to summarise their argument here. I realise that this raises difficulties since the Treasury papers on the subject are not available publicly and my summary cannot be checked. However it seems more unsatisfactory for me to ignore the bare statement in the Opposition's Programme for 1975 that Treasury "opposed the tariff cuts".

4 In addition to the arguments set down on paper, some Treasury Officers argued that the tariff cut contributed to the acceptance of too expansionist a budget in 1973/74. This assumes that we would have had a less expansionist budget without the tariff cut—not necessarily a plausible assumption for the first Labor budget in 23 years.

5 But before this ultimate limit is reached, there will be other considerations—political and social—which will usually restrain the extent of either a revaluation or a tariff cut.

6 Given the context, our discussion is restricted to short-run direct effects. General effects, for instance on the prices of non-tradeables—are ignored here. This is not to deny that, in the longer run the general, less direct effects in a wide variety of ways, will be of great importance.

7 This includes the whole of the service sector plus small sections of agriculture (e.g. whole milk) and manufacturing (e.g. bricks; newspapers).

8 If we suppose that a 25% tariff reduction has little effect on industries with tariffs of 10% or less, this proportion would be reduced to 21%.

References continued

9 Another measure of the relative effects—the one used by Treasury—looks at the volume of imports coming in duty free (70%) and on that basis argues that since a reduction of tariffs can only affect a small proportion of the existing import volume, relaxation of tariffs has very concentrated effects. How concentrated the effects are should, it seems to me, be examined with reference to the size of the local industries affected rather than the proportion of imports before tariffs are changed.

10 "Revaluation and Changes in Tariff Protection—The Short Term Effects with Special Reference to Agriculture" by Nico Klijn. Paper given at the Australian Agricultural Economics Society 18th Annual Conference—Perth, 1974. Table 5.1 (revised).

11 Paper by R. G. Gregory and L. D. Martin "An analysis of Recent Relationships between Import Flows and Import Prices" as given at 46th Anzaas Congress, Canberra 1975.

12 Not that "overcharging" has any clear meaning. In such areas as retailing, wholesaling and importing, firms presumably charge what they can and competition determines the mark-up they can obtain. If that mark-up is too low, they will not re-order. "Overcharging" might be said to occur when the mark-up is "more than adequate" to ensure re-ordering. There are extra risks from importing (e.g. the extra time between order and delivery) which presumably lead to higher normal mark-ups than on local goods. At present there are many importers and retailers acutely aware of these extra risks!

13 Import Prices Inquiry—Price Effects of Currency Changes, Reports No. 1, 2 and 3 from the Joint Committee on Prices; The Government Printer 1973 and 1974.

14 These estimates were made from Table 3 using the general result of the up valuation for each commodity group and ignoring the exceptions—exceptions which would of course operate both ways (i.e. favourable and unfavourable to the view expounded above).

15 This was in fact one of the supplementary arguments used by the Treasury at the time.