Australia In The World Economy

Australia is quite a rich economy in terms of Gross Domestic Product (GDP) per head of population, ranking 17th in the world. However, this has dropped from a ranking of fourth in 1950, and ninth in 1970. This could be seen as a sign of poor economic performance, however other factors that contribute towards a high standard of living, such as environmental considerations, need to be taken into account.

For much of the period up to the 1960s most of Australia’s exports were in wool, food and other commodities. Since the mid 1970s iron ore and other ores have been a significant export. Heavy dependence on overseas markets and inflows of capital and people meant that when the world economy turned down, we were severely hit. In the mid 1970s, early 1980s and early 1990s we were hit by slowdowns in world trade and industrial growth in the major economies. Up until the 1960s the United Kingdom was our most important customer and provider of imports. Since then, Asia has increased in importance as a customer and provider of manufactured goods. In recent years, we have also seen growth in exports from the services sector – for example, tourism and foreign students paying to study in Australia.

It is apparent from research by the Australian Bureau of Statistics that the make up of Australia’s export commodities has changed significantly from the traditional dominance of rural products. Three main changes stand out. Firstly, the decline in the relative importance of our rural exports. In 1950 textile fibers made up 65 per cent of the value of our merchandise exports, and in 1997 it only accounted for 10 per cent. Secondly, the strong growth in exports of minerals and fuels. And lastly, the growth in the export of services. This is largely the product of expansion in the tourist industry and the development of education and health and financial services exports.

The destination of Australian exports has also changed significantly since 1950. The United Kingdom then accounted for 39 per cent of our exports, and in 1997 it only accounted for 7 per cent. Conversely, in 1950 Japan received only 4 per cent of our merchandise exports, and it now receives 23 per cent, while other Asian destinations receive 16 per cent .

A similar pattern shows in our imports. In 1950 the United Kingdom supplied 53 per cent of imported goods to Australia, in 1997 this was only 6.5 per cent. The United States now supplies approximately 25 per cent of our imported goods, while in 1950 this was 10 per cent.

The types of goods that Australia is importing has also changed, although not quite as significantly. Capital goods and industrial supplies make up about 60 per cent of imports, similar to the 1950s. Perhaps the most significant changes in categories of imports have been in that of basic materials (19 per cent in 1950, compared to 2 per cent in 1997) and in machinery (16 per cent in 1950, increased to 31 per cent now).

There are a number of reasons for the changes in Australia’s import and export patterns. Some of these are the high levels of tariff protection previously given to Australian manufacturers, large increases in demand for mineral exports, and the decreasing demand from Britain for Australian products after they joined the EU in the 1960s.

However, the largest share of exports are still from the mining and agricultural sectors. This is because Australia has a comparative advantage in these areas . Comparative advantage of one country over another in the production of a particular good , relative to other goods it can produce, is said to occur if it produces that good less inefficiently compared with the other country.

Comparative advantage relies on the theory that a country will best produce those goods and services that are produced with factors that a country has in relative abundance. This explains why Australia has a comparative advantage in areas that utilize our abundance of land, energy and mineral products, and why we have not been so successful in the manufacturing sector, which relies on an abundance of inexpensive, low-skilled labor .

In a recent speech to the ABARE Outlook 2001 Conference , the Reserve Bank of Australia (RBA) said that short to medium term prospects looked good for the Australian economy, and that one important driver of this is our increasing exposure to international trade. Trade strengthens competitive pressures that push producers towards best practice, and allows producers to gain economies of scale by operating in larger markets. Interestingly, they say that manufacturing has been the fastest growing component of Australia's exports during the past decade – a trend that occurred at the same time as reduction in tariff protection for the industry. The ongoing shift in the direction of our trade is also an important factor of Australia's increased openness to trade. Exports to the Asia region are still growing strongly, and have recovered ground lost during the Asian crisis.

The RBA believe that the Australian economy is well placed to weather a storm in international conditions, however it would be difficult to remain unaffected in the event of a sharp slowdown in the global economy.

DOES THE CONTINUANCE OF A CURRENT ACCOUNT DEFICIT PRESENT ANY FUNDAMENTAL ECONOMIC PROBLEMS FOR AUSTRALIA?

The balance of payments is a balance sheet of a country's position which can be compared to the rest of the world. The balance of payments is divided into two main sections: the capital account and the current account.

The capital account provides all the data on capital flow in and out of Australia. It is the capital inflows from foreign investment and foreign borrowings that fund any current account deficit.

The current account consists of (1) the trade in goods balance (the net effect of tangible goods imports and exports); (2) the services balance (the net effect of non-tangible imports and exports, such as freight, tourism and foreign students); (3) the net income and (4) the net transfer balance, all added to give an overall current account balance .

The net income figure consists of interest, dividends and royalties paid overseas and those received from overseas. The biggest debits here are the interest payments on foreign borrowings, but dividends paid to foreign owners of Australian shares has increased markedly in recent years, hence the net income deficit is the main portion of our current account deficit.

In mid 1997, Australia had a current account deficit (measured as a percentage of GDP) second in size in the Western world. The increase in our current account deficit is largely a product of four things:

(1) the failure of exports to grow as fast as imports in most years;

(2) declines in our terms of trade;

(3) declining competitiveness in many locally made products, and

(4) the further growth in foreign debt.

As mentioned above, the net income deficit is the main part of the current account deficit. In recent years this deficit has increased – from $2.8 billion in 198283 to $18.6 billion in 19992000.

Does a high level of foreign liability matter? The main consideration of whether or not such borrowing is a good idea depends on what we do with the borrowed funds. If they are used to finance the import of consumption items, then we can be seen as living beyond our means, because the time will come when the loan must be repaid with interest and, having added nothing to our productive capacity, the repayment will require a reduction in our current consumption levels. On the other hand, if the funds are allocated to the purchase of items that will raise our productive capacity, then the loan can be considered a proper and productive one. In this latter case, our ability to increase exports or reduce imports would be enhanced, and this would impact directly on our ability to repay the loan.

Experts are divided on the issue of whether having a foreign debt is a major problem. One view is that the current account deficit is no problem because normal economic activity requires borrowing, and that the free floating exchange rates and flexible interest rates will always even out international receipts and payments. They also argue that it is private sector borrowing which makes up the large part of our overseas debt, and that these private sector investors must bear the consequences of any mistakes they make in their obligations to overseas lenders.

The opposite view argues that all foreign borrowing imposes an exchange obligation on the Australian economy at some point. As mentioned earlier, if the borrowings are invested in activity which produces future revenue for Australia, then foreign exchange obligations are taken care of. However, if the borrowings fund consumption then the economy as a whole must service the debt at a later stage.

A related effect is that any private sector loan defaults lower a country's credit rating, increasing the cost of future borrowings. It is also argued that not all foreign debt is private sector owned, in fact the public sector have not ceased to borrow overseas, and do not use borrowings to generate foreign currency earnings.

Clark argues that increasing dependence on foreign savings exposes the economy to sudden shifts in market confidence, leads to higher borrowing costs for Australian business and makes the economy more vulnerable to external shocks. He states that overseas investors fear a depreciation in the $A, because of our large foreign debt, and consequently investors believe that any investments in Australia are at risk of falling in value in the event of a depreciation in the $A. Investors therefore demand higher rates of return on investments in Australia.

A result of the higher returns demanded by foreign investors is the direct effect on interest rates for Australians. Our interest rates on government and statutory authority bonds have to be higher than would otherwise be the case in order to attract the foreign savings we need. These costs are then passed on to Australians through higher government charges, taxes, and interest rates.

Regardless of whether continuing foreign debt is a problem for the Australian economy it is a fact that Australia's net overseas indebtedness has been growing in absolute terms, and relative to the GDP.

Stabilizing our foreign debt will be a difficult task. To achieve this the international community needs to continue to invest in Australia because it is their investment that finances our current account deficit. The time that it takes to achieve stabilization depends on a number of factors. Some of these are exchange rate movements, the level of interest rates on our foreign debt, the composition of the current account deficit (i.e. whether it is made up of borrowings or share issues) and the size of the current account deficit.

Efforts will need to be made to reduce overseas borrowings and to get Australians to save more. Clark argues that we need to:

(1) keep our wage increases, inflation and interest rates down near – and preferably lower than – the rates enjoyed by our major trading partners;
(2) encourage more investment in export-expanding and import-replacing industries;
(3) provide incentives for Australians to save more, including tax reductions…; and
(4) further improve the productivity of our workplaces, transport and shipping facilities and management, to boost exports and make imports less competitive and attractive.

Even if we do stabilize our level of foreign debt, the size of our current account deficit and level of debt that requires servicing still remains huge, leaving Australia exposed to any downturns in our trading position and at the mercy of world interest rates.

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