

The Parliament of the  
Commonwealth of Australia

DEPARTMENT OF THE SENATE  
PAPER No. 4019  
DATE  
PRESENTED

17 OCT 1991

*Many thanks*

Joint Committee  
on  
Foreign Affairs, Defence and Trade

## AUSTRALIA'S CURRENT ACCOUNT DEFICIT

AND

## OVERSEAS DEBT

October 1991



Canberra

OVERSEAS DEBT  
AND  
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*Monty Egan*

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**TERMS OF REFERENCE**

Causes of the Australian current account deficit, the consequent growth of overseas debt and measures for reducing the deficit.

JOINT COMMITTEE ON FOREIGN AFFAIRS,  
DEFENCE AND TRADE

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## GLOSSARY AND ABBREVIATIONS

### Glossary

**ASEAN -**

The Association of South East Asian Nations whose members include Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand.

**Assets -**

Future economic benefits or ability to generate cash inflows as a result of a past transaction.

**Balance on Current Account -**

The net sum of credit and debit entries in the current account section of the balance of payments. A current account deficit means that total debits exceed total credits, while a current account surplus means the reverse.

**Balance on Merchandise Trade -**

The difference between the total 'free on board' value of exports and that of imports. If the value of Australia's imports exceeds the value of its exports, Australia has a balance of trade deficit. If the reverse is true, Australia has a balance of trade surplus.

**Balance of Payments -**

A record of all transactions between one particular country and all foreign countries. It is made up of two accounts - the current account and capital account.

**Balance of Trade Deficit (or Surplus) -**

See 'Balance on Merchandise Trade'.

**Balancing Item -**

That item which brings about equality between the sum of the credit and debit entries in the balance of payments. Since, by definition, the balance of payments on the current and capital accounts must always be in balance, the balancing item thus reflects the net impact of transactions that have not been measured accurately (errors) or have not been measured at all (omissions).

**Capital Account -**

The record of transactions resulting in claims on the rest of the world (assets) and obligations (liabilities) to the rest of the world. Capital movements occur because of international loans, their repayment and direct investment (including reinvested earnings on investment) made by private individuals, companies and governments. The capital account measures new inflows and outflows of capital over a period of time.

**Current Account -**

The record of transactions in goods, services, income and unrequited transfers between one particular country and the rest of the world. Items which represent incoming money flows are registered as credits, those representing outgoing flows as debits.

**Current Account Deficit (or Surplus) -**

See 'Balance on Current Account'.

**Direct Investment -**

Capital invested in an enterprise by an investor having a significant influence - currently defined as at least 10 per cent equity - over the key policies of the enterprise.

**Equity -**

Another name for ownership.

**European Community -**

The EC is comprised of Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain and the United Kingdom.

**Exchange Rate Variations -**

A change in the value of a claim liability between two points in time arising from a change in the exchange rate between the Australian dollar and other currencies.

**Financial Enterprises -**

Business enterprises that are mainly engaged in incurring liabilities and acquiring financial assets such as banks, finance companies and merchant banks, irrespective of whether they are privately or publicly owned and/or controlled.

**Foreign Equity -**

The accumulated stock of all equity investment in Australia by foreign residents involving equity in Australian assets. Together with foreign or overseas debt, this makes up Australia's foreign liabilities.

**Foreign Liabilities -**

Obligations to make payments or render service in the future as a result of a past transaction. Australia's foreign liabilities are the sum of foreign equity and foreign debt.

**Foreign Residents -**

All government institutions, individuals and households and financial and trading enterprises that are not residents.

**General Government -**

Commonwealth, State/Territory and local government organisations and statutory bodies other than those classified as public business trading or financial enterprises. State government central borrowing authorities such as the New South Wales State Treasury and the South Australian Finance Authority are included in this sector.

**Gross Foreign Debt -**

Gross foreign debt is the accumulated stock of all previous borrowings from foreigners by Australian residents that has yet to be repaid.

**Merchandise Trade -**

Movable goods (with a few exceptions) that change ownership from residents to non-residents (exports) and from non-residents to residents (imports).

**Net Foreign Debt -**

The accumulated stock of foreign borrowings by Australian residents less the sum of Australia's reserve assets and the stock of lending abroad.

**Net Income -**

The difference between income earned by Australian residents from non-residents and by non-residents from residents. It consists of investment income (eg dividends and interest), other property income (eg royalties) and labour income (eg wages and salaries).

**Net Services -**

The difference between services rendered by Australian residents to non-residents and by non-residents to residents. It consists of freight and insurance charges, the amount Australians spend abroad net of what foreigners spend here and the cost of international passenger fares.

**Non-Official Sector -**

The non-official sector which comprises banks (apart from the Reserve Bank), non-bank financial enterprises and trading enterprises and households. This means all private and public sector trading and financial business enterprises are included in the non-official sector.

**OECD -**

The Organisation for Economic Cooperation and Development whose members include Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States of America.

**Official Sector -**

The official sector comprises general government institutions and the Reserve Bank. This means the capital transactions of the Commonwealth Government, the Reserve Bank, State and Territory Governments and those provided to local government through the Commonwealth and State/Territory governments are included in the official sector.

**Portfolio and Other Investment -**

All foreign investment activity not classified as 'direct investment' or 'reserve assets'.

**Private Sector Enterprises -**

All trading and financial business enterprises which are not public sector enterprises.

**Public Sector Enterprises -**

Trading and financial business enterprises which are publicly owned and/or controlled. The Australian Industry Development Corporation, Qantas, the Australian Wheat Board, Telecom and the Commonwealth Bank are examples of Commonwealth public trading or financial business enterprises. The State Bank of South Australia and the New South Wales Electricity Commission are examples of State public trading or financial business enterprises.

**Reserve Assets -**

Foreign financial assets that are effectively controlled and available for use by the central authorities for meeting balance of payments needs. The category comprises the Reserve Bank series 'official reserve assets' which includes monetary gold, Special Drawing Rights in the International Monetary Fund (IMF), reserve position in the IMF and foreign exchange.

**Reserve Bank -**

Australia's central bank - the Reserve Bank of Australia (RBA).

**Residents of Australia -**

Residents of Australia consists of general government institutions, individuals and households and financial and trading enterprises that are located in the territories of Australia, or that have a closer association with Australia than any other nation.

**Trading Business Enterprises -**

Enterprises that are mainly engaged in the production of goods and services for sale in the market, whether publicly or privately owned and/or controlled.

**Unrequited Transfers -**

One-sided transactions where resources are provided, without something of economic value being received in return, by non-residents to Australian residents and by residents to non-residents. Examples are foreign aid, migrants' transfers, gifts, donations, pensions and taxes.

#### **Abbreviations**

<b>ABARE</b>	Australian Bureau of Agricultural and Resource Economics
<b>ABS</b>	Australian Bureau of Statistics
<b>ACC</b>	Australian Chamber of Commerce
<b>ACM</b>	Australian Chamber of Manufactures
<b>ACTU</b>	Australian Council of Trade Unions
<b>ADFs</b>	Approved Deposit Funds
<b>AIDAB</b>	Australian International Development Assistance Bureau
<b>AIDC</b>	Australian Industries Development Corporation
<b>AMC</b>	Australian Manufacturing Council
<b>APEC</b>	Asia-Pacific Economic Cooperation
<b>ASEAN</b>	Association of South East Asian Nations
<b>AUSTRADE</b>	Australian Trade Commission
<b>BCA</b>	Business Council of Australia
<b>BIE</b>	Bureau of Industry Economics
<b>CAP</b>	Common Agricultural Policy
<b>CEP</b>	Company Export Planning
<b>CER</b>	Closer Economic Relations (with New Zealand)
<b>DIFF</b>	Development Import Finance Facility
<b>DITAC</b>	Department of Industry, Technology and Commerce
<b>EC</b>	European Community

EFIC	Export Finance and Insurance Corporation
EMDGS	Export Market Development Grants Scheme
EPAC	Economic Policy Advisory Council
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GIRD	Grants for Industry Research and Development
GNP	Gross National Product
IC	Industry Commission
IMF	International Monetary Fund
IPP	Investment Promotion Program
ITES	International Trade Enhancement Scheme
MEP	Market Entry Program
MTIA	Metal Trades Industry Association
NIES	National Industry Extension Service
OECD	Organisation for Economic Cooperation and Development
PMLF	Project Marketing Loans Facility
RBA	Reserve Bank of Australia
TESSAs	Tax Exempt Special Savings Accounts
TOP	Trade Opportunities Program
TPC	Trade Practices Commission

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## SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

EX-PORTS, AS A PERCENTAGE OF GROSS DOMESTIC PRODUCT, AND THE CURRENT ACCOUNT DEFICIT AS A PERCENTAGE OF GROSS DOMESTIC PRODUCT

Australia's current account deficit grew markedly over the 1980s from less than 4 per cent of Gross Domestic Product (GDP) at the beginning of the decade to 6 per cent of GDP by the end of the 1980s.

The composition of the current account deficit also changed considerably over the 1980s. Australia began the decade with a current account deficit that was equally made up of a trade deficit (where our consumption of imports was not matched by our exports) and net income payments overseas (which are dividend payments and debt servicing payments to overseas lenders and investors). By the end of the decade the much higher current account deficit was dominated by income payments overseas, particularly to meet Australia's overseas debt servicing obligations.

During the past year the current account deficit has fallen by some 31 per cent over the previous year to just over \$15 billion or some 4 per cent of GDP. The improvement in Australia's export performance, particularly in relation to the growth in manufactures exports, is heartening. However, the decline in imports has been marginal and the situation concerning our debt servicing obligations and other income payments overseas has improved to an even smaller degree despite the severity of the current recession.

The Committee is concerned that the current account deficit will again return to high and growing levels as Australia comes out of the recession, with increases in imports and foreign investment in Australia being likely to return to pre-recession levels, unless concerted action is taken to address the underlying causes of Australia's high current account deficit.

There is a considerable risk that Australia could become complacent about the current account deficit because of the reduction in its size over the past year. It must be remembered, however, that it has taken a very severe recession to halt the growth in imports and further declines in imports cannot be expected once the recession eases.

Australia's overseas debt grew sharply during the 1980s, increasing more than tenfold to over \$145 billion by 1989. Australia's overseas debt has increased even further in the early 1990s and currently stands at over \$165 billion, representing almost 44 per cent of GDP.

The Committee reached the conclusion that while Australia's foreign debt has not yet reached the crisis proportions evident in some countries, it would certainly do so by the end of the 1990s, if Australia's debt accumulation were to continue unabated at the inordinately high rate we have experienced, particularly in the mid-eighties.

Such is the growing concern in the community about Australia's current account deficit and overseas debt problems that some submissions to the Committee argued for a return to the protectionist and regulatory policies of the past as the basis for addressing these problems.

The Committee rejects these propositions. A return to protectionist policies and regulatory controls can only serve to reduce Australia's ability to adjust to changing global circumstances. A failure to make necessary adjustments would ultimately reduce the living standards of Australians.

At the other end of the spectrum the view was put by many that the growing current account deficit and overseas debt level is no longer a problem requiring government action because the growing debt has largely been incurred by the private sector, which is responsible for its repayment.

While it is acknowledged that those who have incurred debt are individually responsible for its servicing and repayment, there can be no question that Australia's vulnerability to global economic changes will be greater if debt accumulation continues unabated. Moreover, a debt crisis which could compromise Australia's economic sovereignty may result if the overseas debt growth of the 1980s were to be replicated in the 1990s. These are issues which affect all Australians and not just those who directly incur foreign debt.

The Committee has recommended a package of proposals designed to comprehensively address Australia's current account and overseas debt problems. These revolve around three items:

- improvements to Australia's international trading performance through further reductions in tariff and other universal protectionist measures, while at the same time implementing a comprehensive package of positive measures designed to assist the development of Australia's export and import replacement industries, particularly value-added exports;
- a range of measures designed to increase domestic savings and reduce Australia's reliance on overseas borrowings to finance investment; and
- a set of appropriate macroeconomic policy settings and necessary microeconomic reforms that are consistent with lowering the current account deficit and level of overseas debt - a situation that has not always been the case in the past.

The following are the Committee's recommendations:

**Recommendation 1.** The Committee considers that in addition to the fundamental objectives of Australia's economic policy - full employment, low inflation and improved living standards - policy must take explicit account of the objective of reducing the current account deficit and the level of overseas debt.

**Recommendation 2.** The Committee recommends that, against a backdrop of appropriate macroeconomic policy and necessary microeconomic reforms, government needs to adopt further comprehensive policies aimed at a sustained reduction in Australia's current account deficit and level of overseas debt that include:

- a set of positive assistance measures designed to improve Australia's international trade situation through investment to enhance our export and import replacement performance (noting that such assistance is essential so long as the international climate in favour of trade subsidies persists); and
- a set of measures specifically designed to reduce Australia's heavy reliance on overseas borrowings and hence our overseas debt, as the predominant source of investment funds.

**Recommendation 3.** The Committee recommends that, in order to facilitate a substantial and sustained improvement in Australia's international trading performance, Australia's policy approach for the remainder of the 1990s should focus on:

- a continuation of the phasing out of tariff and other universal protection measures, provided these reductions are tied to a package of positive assistance measures;
- a continuation of active and strong promotion of free trade as the basis of Australia's multilateral, bilateral and regional trade strategies; and
- an enhanced and comprehensive package of positive assistance measures that are directed not only towards assistance to increase the export markets of existing industries, but also to facilitate the development of new export industries, particularly value-added exports and to the development of import replacement industries.

**Recommendation 4.** The Committee recommends that, for each industry, government should facilitate the development of an Industry and Trade Development Strategy Statement on a tripartite basis involving the relevant business and union groups in each industry and the relevant government departments or agencies that cover each industry. These plans should enhance all existing industry plans and export marketing strategies. The statements should spell out a strategic vision for each industry for the remainder of the decade. For each industry the statement should identify:

- the objectives and priorities for industry development over the remainder of the 1990s;
- export strategies for existing products to enhance market share in existing markets and to enter new markets;
- strategies for the development of new products or services for export with particular emphasis on the development of value-added products and elaborately transformed manufactures;
- strategies for the development of import replacement products;
- areas where microeconomic reforms and new public infrastructure are required as essential prerequisites or complements to industry and trade development;
- gaps in the skills needed for industry and trade development and priorities for new or enhanced education and training programs and courses that could redress any skills shortfalls;
- an industry research and development strategy; and
- likely environmental issues and concerns and feasible strategies to address any such concerns.

**Recommendation 5.** The Committee recommends that government give Australia's export industries a firm commitment to continue targeted export assistance measures for the remainder of the 1990s, recognising that such measures have a valid and continuing role to play in any long-term policies designed to enhance Australia's export performance. In particular government should:

- continue with the current range of AUSTRADE services to exporters for the remainder of the 1990s, continue with the reorientation of AUSTRADE efforts towards the Asia-Pacific region and hasten the process of reorientation to export markets in developing countries in other regions of the world;

· continue with the Export Market Development Grants Scheme (EMDGS) for the remainder of the 1990s;

· continue the International Trade Enhancement Scheme (ITES) for the remainder of the 1990s and considerably expand the funding for this scheme, as a concession loans scheme is preferred over a grants program for export promotion, with particular priority on assisting small to medium firms to enter export markets;

· continue with the Development Import Finance Facility (DIF) for the remainder of the 1990s and double the funding available under the program, by way of an overall increase to Australia's overseas aid budget, to encourage the rapid expansion of Australia's exports to developing countries; and

· continue and enhance the operations of the Export Finance and Insurance Corporation (EFIC).

**Recommendation 6.** The Committee considers a more strategic approach to the use of export assistance measures by industry is needed to maximise the effectiveness of such assistance. The tripartite industry groups - the relevant business, union and government bodies - should, in developing an Industry and Trade Development Strategy Statement for each industry, include a strategy for the coordinated use of export assistance measures that is consistent with the other elements of the statement. Government should also reorganise the administration of all targeted export assistance measures so that they can be used in a more strategic way in line with each industry's Industry and Trade Development Strategy Statement.

**Recommendation 7.** The Committee considers it is essential to recognise that there must be a substantial increase in investment in plant, equipment and infrastructure in order to achieve a sustained and substantial improvement in Australia's international trading performance - an increase of an order which could be in excess of \$10 billion in capital each year if the current account deficit were to be completely eliminated. The Committee recommends that each Industry and Trade Development Strategy Statement include, as an integral element, the joint identification by the relevant government, industry and union participants of investment priorities for the development of new international trading opportunities. In particular the strategy statements should identify, where appropriate, strategies for:

- the investment needed for the development of value-added exports and elaborately transformed manufactures in each industry;

- the investment needed to develop new import replacement opportunities in each industry;
- the investment that is needed in each industry to enable smaller to medium sized firms to develop new products for export and import replacement and/or to enter new export markets;
- the investment that is needed in each industry to develop new products for export or import replacement where long time frames are involved before break-even returns will be realised and where difficulties are currently being experienced in securing adequate investment capital to embark on such ventures; and
- the investment that is needed to provide essential underlying public infrastructure in situations where the microeconomic reform of public utilities is an essential prerequisite to industry and trade development and where current public infrastructure investment is inadequate.

**Recommendation 8.** The Committee recommends that government, as a matter of urgency, implement a range of reforms to Australia's anti-dumping and countervailing duties system to ensure that Australian industries are fully protected from unfair import competition resulting from the practice of dumping. These reforms should be aimed at reducing the costs and time faced by industry in lodging an application for consideration that dumping is occurring. These reforms ought also to eliminate any onerous elements of current arrangements that are not absolutely essential under the requirements of the General Agreement on Tariffs and Trade (GATT) Anti-Dumping Code.

**Recommendation 9.** The Committee considers an essential element to breaking the cycle of higher current account deficits and higher levels of overseas debt rests with raising the level of domestic savings, as an alternative to the heavy reliance on overseas borrowings to finance investment. The Committee recommends that government implement a package of measures designed to increase domestic, business and household savings as the fundamental basis of policies designed to lower the current account deficit and the level of overseas debt.

**Recommendation 10.** The Committee considers that superannuation funds in Australia must recognise that they have a vital role to play, through their investment decisions, in ensuring that Australia's inordinately heavy reliance on overseas borrowings to finance new investment is reduced. The Committee recommends that government establish a formal but voluntary process of dialogue with all major superannuation funds and Approved Deposit Funds (ADFs) over:

- the best ways in which the shortfalls evident in existing patterns of investment might be jointly identified; and
- developing agreed broad investment strategies that might be voluntarily introduced which are consistent with the investment priorities identified in each industry's Industry and Trade Development Strategy.

**Recommendation 11.** The Committee recommends that government establish an Industry and Trade Development Fund, whereby all superannuation funds and Approved Deposit Funds (ADFs) are required to lodge one per cent of all new assets from 1 January 1992 in the Fund. This Fund should be used to provide loans, including on concessional terms (where appropriate), to ventures that are identified as having a high priority and good prospects for long-term viability in each industry's Industry and Trade Development Strategy where adequate investment funds cannot be found from domestic sources.

**Recommendation 12.** The Committee recommends that government consider various options for raising additional resources for public infrastructure investment that is identified as being essential in each industry's Industry and Trade Development Strategy.

**Recommendation 13.** The Committee recommends that government introduce tax exemptions on the interest earned on savings up to a certain level of savings, in order to reduce the distortions in current taxation arrangements which favour debt over savings. Government should introduce tax exemptions on interest to increase domestic savings in Australia as an essential part of a package designed to reduce our reliance on overseas debt and to lower the current account deficit. If a model along the lines of the recently introduced Tax Exempt Special Savings Accounts (TESSAs) of the United Kingdom were to be adopted in Australia, then private savings up to around \$20,000 could earn interest without attracting any income tax.

**Recommendation 14.** The Committee recommends that government adopt a further reform to taxation arrangements by way of an accelerated depreciation allowance which permits the complete write-off over four years of new investment in value-added export and import replacement ventures. These reforms would further encourage investment in Australia's productive capacity. Accelerated depreciation allowances should not be available to primary commodity exporters. Consideration is also needed of options to ensure equity in arrangements whereby immediate taxation incentives are also available to projects where the investment is not expected to yield a return in the short term, noting that current arrangements for the claiming of depreciation allowances are distorted in favour of investments yielding immediate returns.

**Recommendation 15.** The Committee recommends that the reimposition of controls on the volume of capital inflows to Australia should not be contemplated as an appropriate policy approach to reducing the current account deficit and the level of overseas debt at this stage. Government should, however, overhaul Australia's 10 per cent flat rate withholding tax on interest paid to non-residents. This tax is inflexible and inadequate. Government should introduce a flexible withholding tax, the rate of which could be varied according to Australia's differing requirements for overseas capital at different times. The overhauled withholding tax ought to include provision for levying a rate of up to 25 per cent but limiting it to 15 per cent in case of nations with which Australia has a taxation treaty.

**Recommendation 16.** The Committee recommends that government establish a capital inflow tax, with a rate that can be varied according to changing circumstances. The capital inflow tax should be a measure of last resort that is applied at times when an investment boom threatens to cause significant inflationary pressures.

**Recommendation 17.** The Committee recommends that the Investment Promotion Program (IPP), which promotes Australia as a destination for foreign investment, be abolished. Australia must reduce its reliance on overseas investment if the current account deficit and overseas debt levels are to be reduced.

**Recommendation 18.** The Committee recommends that economic policy settings in Australia, for the remainder of the 1990s, be aimed at lowering the current account deficit and the level of overseas debt in a substantial and sustained way, as well as reducing unemployment and inflation. The general policy settings that are required at present are:

- an easing of monetary policy to create the conditions for a lower exchange rate;
- the adoption of alternatives to high interest rates as the vehicles for demand management of the economy;
- a continuation of prudent fiscal policy;
- an incomes policy based on continuing restraint not only in wages growth but in the growth of incomes generally; and
- major microeconomic reforms that are aimed not only at improved productivity through realising savings but also at ensuring that Australia has the underlying infrastructure, research and development strategies and workforce skills that

are necessary for achieving improvements in Australia's international competitiveness.

**Recommendation 19.** The Committee considers that government should recognise that a lower value of the Australian dollar is fundamental to underpinning lower current account deficit and to discouraging overseas borrowing. A lower Australian dollar would encourage Australia's exports, make imports relatively more expensive and would discourage further reliance on overseas debt. The Committee recommends that government economic policy settings be consistent with creating the conditions for a lower exchange rate, particularly by maintaining persistently lower interest rates.

**Recommendation 20.** The Committee considers that governments must recognise that high interest rates, although having been justified traditionally in terms of reducing the demand for imports, are an inappropriate vehicle for lowering the current account deficit and overseas debt levels. The Committee recommends an easing of monetary policy through lower real interest rates in order to realise sustained reductions in the current account deficit and overseas debt levels.

**Recommendation 21.** The Committee recommends that government explore mechanisms for demand management of the economy that are alternatives to high taxes or tight monetary policy through high interest rates, if it is also to achieve low inflationary outcomes without creating pressures which add to the current account deficit and overseas debt level. Government seriously needs to consider mechanisms that force individuals and enterprises to forgo current consumption in favour of compulsory savings at times when excess demand in the economy is thought to pose considerable problems. Options for this include the introduction of a superannuation surcharge (or bond) which could be levied so as to require higher superannuation contributions by employees at times when government wishes to curtail consumption demand and the introduction of a requirement on business for the purchase of an "investment bond" which could later be drawn upon to stimulate investment in periods of economic downturn.

**Recommendation 22.** The Committee recommends that government continue to pursue fiscal moderation directed at minimising its borrowings as a proportion of Gross Domestic Product as part of a long-term strategy to ensure that borrowings are not contributing to a high current account deficit and a high level of overseas borrowings. Nevertheless this policy should not be pursued at the expense of enhanced outlays that are necessary to improve Australia's long-term international trading performance and domestic savings and investment situation.

Recommendation 23. The Committee considers that in order to maintain downward pressure on inflation, government needs to ensure that a policy of continuing income restraint is pursued. The Committee recommends that such a policy must ensure restraint in all incomes and not just those of wage earners, to ensure equity across all sectors of the community.

**Recommendation 24.** The Committee considers that a policy of continuing microeconomic reforms is essential to underpin the efficiency and productivity gains that are needed to improve Australia's international trading performance. The Committee recommends that the microeconomic reform process encompass investment in new public infrastructure, in addition to restructuring to reduce industry input costs.

**Recommendation 25.** The Committee recommends that real outlays on research and development and education and training should be increased so that strategies identified in each industry's Industry and Trade Development Strategy can be implemented to improve Australia's international trading performance.

A Minority Report is located at pages 141-153.

# CHAPTER 1

## BACKGROUND TO THE INQUIRY

### The Seriousness of the Current Account Deficit

1.1 Australia's economy has run current account deficits over most of its history. Australia has always relied heavily on overseas borrowing, with its inherent debt servicing obligations, placing deficit pressures on the current account. An inability to achieve a consistent or frequent surplus in Australia's international trade balances has been a critical factor underlying Australia's current account deficits.

**1.2** Despite this history there is growing concern about the present size of Australia's current account deficit. The current account deficit grew markedly from less than 4 per cent of Gross Domestic Product (GDP) at the beginning of the 1980s to around 6 per cent of GDP by the end of the decade. Notwithstanding that the current account deficit has since fallen in 1990-91 to 4 per cent of GDP. Its growth over the 1980s is significant in that the current account deficits averaged around 2 per cent of GDP in the three decades prior to the 1980s.

1.3 The apparent structural increase in the current account deficit is a significant economic event in Australia that distinguishes the 1980s from earlier decades. Not since the 1920s has Australia experienced persistent current account deficits of the relative magnitude of those experienced in the 1980s.

1.4 Adding to the concerns generated by the marked increase in the relative size of the current account deficit over the 1980s is the fact that Australia's current account deficit is now very high by international standards. Australia's current account deficit as a proportion of GDP is amongst the highest of any Organisation for Economic Cooperation and Development (OECD) country (see Chapter 2).

1.5 The current account deficit has been used as a major justification for most of the main economic policy settings over the past decade. This is particularly so for the rationale for policies of fiscal surpluses and high interest rates. Despite these policies the current account deficit deteriorated over the 1980s.

1.6 The widening current account deficit over the 1980s coincided with major changes to Australia's approach to macroeconomic policy. Financial deregulation and the floating of the exchange rate, combined with further reductions in industry protection, led to heightened anxieties in some parts of the Australian community about the ability of government to take sufficient corrective action to address current account deficit problems. Interest rates have now become the major remaining instrument of monetary policy. The impact of high interest rates on the current account is ambiguous and the deficit may well have been higher than it otherwise would have been if interest rates had been lower.

#### The Burgeoning Level of Australia's Overseas Debt

1.7 The other major economic phenomenon that distinguished the 1980s from earlier decades was the rapid accumulation of foreign debt to unprecedented levels.

1.8 Australia's indebtedness to foreigners increased more than tenfold, in nominal terms, over the 1980s to over \$145 billion by the end of the decade. This stock of gross overseas debt rose from around 11 per cent of GDP at the beginning of the 1980s to nearly 43 per cent of GDP by the end of the decade. The level of overseas debt has since further increased to reach some \$165 billion by June 1991 - which is almost 44 per cent of GDP.

1.9 These trends have caused considerable concern. Fears have been expressed that Australia is sliding into a "debt trap" of the kind found in some Third World economies. Under such a scenario it is felt that if the sharp rises in Australia's level of overseas debt continue unchecked, Australia's ability to service such levels of debt may falter and harsh "corrective action" may be imposed by our overseas creditors. Certainly most of the submissions to this inquiry have pointed to the level of overseas debt as an area of grave concern.

1.10 Australia's level of overseas debt is, perhaps surprisingly, not inordinately high by some overseas standards. Many countries have far higher ratios of foreign debt to GDP than Australia. Australia's ratio of overseas debt to GDP is comparable with that of smaller OECD economies such as Canada and Sweden and is, for instance, much lower than that of other Scandinavian countries and most South East Asian countries. On the other hand, Australia's overseas debt ratio is considerably higher than that of larger OECD economies such as the United States, Japan, the United Kingdom, France and Germany (see Chapter 3).

1.11 The key feature is that Australia's overseas debt has grown so rapidly in recent years and that this growth rate has not been widely replicated in other economies.

#### Establishment of the Inquiry

1.12 It is against this backdrop of a persistently high current account deficit and the burgeoning level of Australia's overseas debt that this inquiry was established.

1.13 Following the March 1990 Federal election the reference on Australia's foreign debt and current account problems was re-referred, on 18 June 1990, to the Joint Committee on Foreign Affairs, Defence and Trade by the Minister for Foreign Affairs and Trade, Senator the Honourable Gareth Evans, QC. In the previous Parliament (35th) the Committee had been conducting an inquiry into the international trade and financial situation, including debt and Australia's balance of trade on goods and services. The Committee reported on the international aspects of the reference - Third World debt. In picking up the national aspect of the original reference the Committee in the current Parliament (36th) was asked to inquire and report on Australia's foreign debt and current account problems with the following terms of reference:

Causes of the Australian current account deficit, the consequent growth of overseas debt and measures for reducing the deficit.

1.14 The Trade Sub-Committee of the Joint Committee on Foreign Affairs, Defence and Trade, chaired by Mr John Langmore, MP, conducted the inquiry.

1.15 Amongst issues which the Committee addressed in the inquiry process were the need to expand trade beyond the traditional commodity base, to achieve increased value-added for those exports and greater import substitution, and the impact of movements of capital on the current account deficit.

1.16 The reference was advertised in the national and capital city daily newspapers in late June 1990. In all, 72 submissions and 24 exhibits were received by the Committee. The Committee began public hearings on 27 September 1990 in Sydney. The final public hearings were held on 21 and 22 March 1991 in Canberra. See Appendix 2 for the list of public hearings and witnesses; see Appendix 3 for the list of submissions and Appendix 4 for the list of Committee exhibits. Appendix 1 shows historical data on the current account and the level of overseas debt.

## CHAPTER 2

### TRENDS IN THE CURRENT ACCOUNT

#### Long-Term Trends in the Current Account Balance

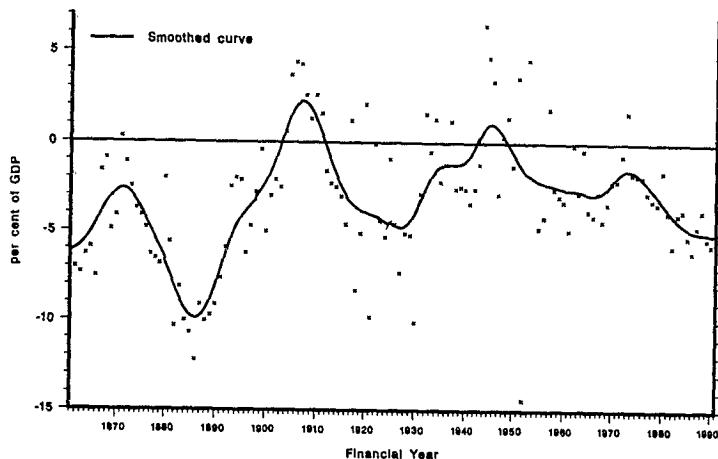
2.1 Substantial deficits in the current account are not new in Australia. Australia has always relied heavily on imported manufactures and technology and has always had significant overseas debt servicing obligations. The highest recorded relative deficits on the current account were experienced over 100 years ago. During the 1860s the current account deficit averaged 5 per cent of Gross Domestic Product (GDP) and in the 1880s massive deficits averaging almost 9 per cent of GDP were recorded. Deficits averaging in excess of 5 per cent of GDP were also experienced during the 1920s.

2.2 The 1980s are the fourth highest decade on record for current account deficits. The current account deficit as a proportion of GDP averaged 4.9 per cent during the 1980s. This level was extremely high in comparison with the deficits experienced in the period since the Second World War.

2.3 Surpluses on the current account in Australia are quite rare. There have been only 23 surpluses over the past 130 years, the last being in 1972-73.

2.4 These trends are depicted in Figure 2.1.

Figure 2.1 The Current Account Balance as a Proportion of GDP, 1860 to 1990



Source: Derived from statistics published by the Australian Bureau of Statistics.

#### The Current Account Over the Last Decade

2.5 In nominal terms the current account deficit increased markedly over the past decade - from just under \$5.5 billion in 1980-81 to just over \$22 billion in 1989-90. This represents a rise from just under 4 per cent of GDP at the beginning of the decade to 6 per cent of GDP by 1989-90. The current account deficit has since fallen to 4 per cent of GDP in 1990-91.

2.6 Fluctuations in the current account deficit as a proportion of GDP over the decade have also been quite sharp, as shown in Table 2.1.

Table 2.1 Current Account Deficit, 1980-81 to 1990-91

Year	Value of current account deficit (\$ million)	Proportion of GDP (per cent)
1980-81	-5,465	-3.9
1981-82	-9,097	-5.8
1982-83	-6,794	-4.0
1983-84	-7,365	-3.8
1984-85	-11,34	-5.3
1985-86	-14,613	-6.1
1986-87	-12,346	-4.7
1987-88	-11,279	-3.8
1988-89	-18,540	-5.5
1989-90	-22,280	-6.0
1990-91	-15,309	-4.0

Source: Australian Bureau of Statistics, Balance of Payments, Australia, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

2.7 It is important to note that Australia's current account deficit is comparatively very high by international standards. Amongst the countries shown in Table 2.2, Australia had the fourth highest proportional current account deficit by 1990. Australia's relative position will have improved over the past year given that our current account deficit fell to 4 per cent of GDP in 1990-91.

Table 2.2 International Comparisons of Current Account Balances

Country and year	Current account as a proportion of GDP (per cent)	Country and year	Current account as a proportion of GDP (per cent)
Venezuela (1988)	-7.8	Israel (1988)	-1.5
Greece (1990)	-5.3	Italy (1990)	-1.3
Finland (1990)	-4.9	People's Republic of China (1988)	-1.2
Australia (1990)	-4.8	Chile (1988)	-0.8
Papua New Guinea (1988)	-4.5	France (1990)	-0.7
Pakistan (1988)	-3.8	Brazil (1987)	-0.5
Argentina (1988)	-3.6	Malaysia (1989)	-0.4
Peru (1988)	-3.3	Poland (1988)	-0.2
Philippines (1989)	-3.3	Portugal (1990)	-0.1
Spain (1989)	-3.3	Austria (1990)	0
Iceland (1990)	-3.1	Uruguay (1988)	0.4
Thailand (1988)	-2.9	Denmark (1990)	1.2
New Zealand (1990)	-2.6	Japan (1990) <sup>(d)</sup>	1.2
Sweden (1990)	-2.5	Belgium-Luxembourg (1990)	2.2
Canada (1990)	-2.4	Mexico (1987)	2.8
Turkey (1990) <sup>(a)</sup>	-2.4	Ireland (1990) <sup>(a)</sup>	3.0
United Kingdom (1990)	-2.4	Germany (1990) <sup>(a)(b)</sup>	3.2
Hungary (1989)	-2.0	Norway (1990)	3.6
India (1987)	-2.0	Netherlands (1990)	3.8
United States of America (1990) <sup>(a)</sup>	-1.8	Switzerland (1990)	4.3
Indonesia (1988)	-1.7	Singapore (1988)	6.8
		South Korea (1988)	8.1

(a) Proportion of Gross National Product (GNP).

(b) The data for Germany refer to West Germany, ie the Federal Republic of Germany before the reunification of East and West Germany.

Source: International Monetary Fund (IMF), International Financial Statistics Yearbook 1990, Washington, 1990; and Organisation for Economic Cooperation and Development (OECD), OECD Economic Outlook, 49, July 1991, Paris, 1991.

2.8 The composition of the current account in 1989-90 and 1990-91 is given in Table 2.3. Australia's imports of goods from overseas exceeded exports to overseas markets by \$3.2 billion in 1989-90. By 1990-91, however, Australia had a positive balance on merchandise trade of over \$2.5 billion.

Table 2.3 The Current Account, 1989-90 and 1990-91

Current transactions	1989-90	1990-91	Change between 1989-90 and 1990-91 (\$ million)
<b>Goods and services -</b>			
Merchandise -			
Exports	47,815	51,793	+8.3
Imports	-50,991	-49,250	-3.4
Balance on merchandise trade	-3,176	2,543	+180.1
Services -			
Credits	11,799	13,268	+12.5
Debits	-16,212	-16,723	-3.2
Services balance	-4,413	-3,455	+21.7
Balance on goods and services	-7,589	-912	+88.0
Income -			
Credits	4,921	5,038	+2.4
Debits	-21,958	-21,917	+0.2
Income balance	-17,037	-16,879	+0.9
<b>Unrequited transfers -</b>			
Credits	4,518	4,711	+4.3
Debits	-2,172	-2,229	-2.6
Net unrequited transfers	2,346	2,482	+5.6
Balance on current account	-22,280	-15,309	+31.3

Source: Australian Bureau of Statistics, Balance of Payments, Australia, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

2.9 The services balance consists of the travel, freight and insurance payable to Australia, and the amounts spent by foreign tourists in Australia less travel, freight and insurance payable overseas and the amounts spent by Australian tourists abroad. Australia's negative services balance amounted to \$4.4 billion in 1989-90 and \$3.5 billion in 1990-91.

2.10 The income balance consists of interest, dividends and royalties paid overseas less what is received from overseas. The income deficit was over \$17 billion in value in 1989-90 and it fell to \$16.9 billion in 1990-91. This is by far the largest component of the current account deficit, even though it is the trade deficit which receives the most attention.

2.11 Net unrequited transfers reflect the balance between incomings and outgoings of other transfers such as the money migrants bring with them to Australia, the money people send to Australia, the money migrants send to family or others in overseas countries, the money Australia pays out in foreign aid, pensions paid to Australians living overseas and tax revenues received from foreigners. Australia's net balance on this item was a surplus of \$2.3 billion in 1989-90 and a surplus of \$2.5 billion in 1990-91.

2.12 The current account balance is the sum of the balance on merchandise trade, the services balance, the income balance and net unrequited transfers. In 1989-90 a deficit of \$22.3 billion was recorded. The current account deficit fell in 1990-91 to \$15.3 billion.

#### The Composition of Merchandise Exports

2.13 Australia's share of world exports fell from around 1.7 per cent in 1960 to 1.1 per cent of the total value of global exports by the late 1980s. Canada, the United States and the United Kingdom also saw their shares of global exports fall over the same period. In contrast the share of global exports of France, Germany, Japan and the emerging North Asian economies grew over the period.

2.14 Even though the nominal value of Australia's exports more than doubled over the 1980s to reach nearly \$48 billion by 1989-90, as shown in Table 2.4, the value of Australia's exports as a proportion of GDP changed very little over the 1980s. Indeed there has been little change in this ratio since the late 1950s. During 1990-91, however, there was a useful growth in the value of exports as a proportion of GDP.

Table 2.4 Trends in Merchandise Exports, 1980-81 to 1990-91

Year	Value of exports (\$ million)	Proportion of GDP (per cent)
1980-81	18,718	13.4
1981-82	19,080	12.1
1982-83	20,656	12.0
1983-84	23,682	12.2
1984-85	29,212	13.5
1985-86	32,208	13.4
1986-87	35,423	13.3
1987-88	40,541	13.5
1988-89	43,073	12.7
1989-90	47,815	12.9
1990-91	51,793	13.7

SOURCE: Australian Bureau of Statistics, *Balance of Payments, Australia*, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

2.15 There has been considerably more change in the importance of different industries in contributing to Australia's exports. These changes are depicted in Table 2.5.

Table 2.5 The Composition of Merchandise Exports, 1980-81 and 1990-91

Sector	Value of exports		Proportion of exports	
	1980-81 (\$ million)	1990-91	1980-81 (per cent)	1990-91
<b>Rural exports -</b>				
Meat & meat preparations	1,592	3,176	8.5	5.1
Cereal grains & cereal preparations	2,339	2,400	12.5	4.6
Sugar, sugar preparations & honey	1,198	876	6.4	1.7
Wool & sheepskins	1,920	2,797	10.3	5.4
Other rural	1,636	4,621	8.7	9.0
Total rural	8,685	13,870	46.4	26.8
<b>Non-rural exports -</b>				
Metal ores & minerals	3,410	8,051	18.2	15.6
Coal, coke & briquettes	1,981	6,486	10.6	12.5
Other mineral fuels	517	3,561	2.7	6.9
Metals & metal manufactures	1,686	8,653	9.0	16.7
Machinery and transport equipment	912	4,992	4.9	9.6
Manufactures nec & other non-rural	1,527	6,180	8.2	11.9
Total non-rural	10,033	37,923	53.6	73.2
<b>Total exports</b>	<b>18,718</b>	<b>51,793</b>	<b>100.0</b>	<b>100.0</b>

nec not elsewhere included

Source: Australian Bureau of Statistics, *Balance of Payments, Australia*, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

2.16 The importance of agriculture declined markedly over the past decade. Rural exports made up 46 per cent of the total value of exports in 1980-81, but they accounted for only just over one-quarter of the total value of exports by 1990-91. Relative falls were evident in all major traditional agricultural export commodities, with large relative declines in the export of cereals, sugar and wool.

2.17 Non-rural exports grew over the 1980s from just over half of the total value of Australia's exports when the decade began to almost three-quarters of the total value of merchandise exports by 1990-91.

2.18 All major categories of non-rural exports increased in relative importance over the decade, with the exception of metal ores and minerals exports, as shown in Table 2.5. Significant growth occurred in the relative importance of exports of metals and metal manufactures, other mineral fuels, machinery and transport equipment and in the export of other manufactures.

2.19 Nevertheless manufactured exports still make up only just over one-third of Australia's merchandise exports, the bulk of which are not "elaborately transformed manufactures". Australia continues to rely very heavily on the export of basic agricultural and rural commodities and on non-transformed mining exports, even though there were some improvements in this situation over the 1980s.

2.20 This situation can perhaps be best summarised by the estimates made by the Pappas Carter Evans & Koop (PCEK)/Telesis study on Australian manufacturing, as shown in Table 2.6. According to their estimates, in 1987 almost half of Australia's exports were unprocessed primary products. Some 14 per cent were processed minerals and fuel, almost all of which was gold, alumina and refined petroleum. Processed food exports made up some 12 per cent of the total, of which almost three-quarters were exports of frozen and chilled meat, bulk raw sugar and dairy products. "Simply transformed manufactures" (mostly aluminium and other non-ferrous metals, chemicals and skins and tops) made up just over 11 per cent of total exports, while "elaborately transformed manufactures" accounted for only 11 per cent of exports.

Table 2.6 Estimates of Export Composition, 1987

Category	Value of exports (\$ billion)	Proportion of total exports (per cent)
Unprocessed primary products	19.7	48.2
Processed minerals and fuel	5.9	14.4
Processed food	4.9	12.0
Simply transformed manufactures	4.6	11.2
Elaborately transformed manufactures	4.5	11.0
Balancing item	1.3	3.2
<b>Total exports</b>	<b>40.9</b>	<b>100.0</b>

Source: Pappas Carter Evans & Koop (PCEK)/Telesis study (1990), *The Global Challenge: Australian Manufacturing in the 1990s*, Australian Manufacturing Council, Sydney.

**2.21** These patterns are reinforced by a change in the ratio of prices received by the tradeable goods as compared with the non-tradeable sector. The tradeable sector refers to industries which traditionally export or compete against imports and encompasses agriculture, mining and some manufacturing. Estimates of the Australian Bureau of Agricultural and Resource Economics (ABARE), as shown in Table 2.7, clearly indicate that, in terms of the prices received by each sector, the trend against tradeable industries was striking over the 1980s. Some of the implications of these figures are mentioned later (see paragraphs 6.15 and 6.16).

**Table 2.7 Average Price Movements in Non-tradeable Items as a Ratio of Prices of Tradeable Goods, 1980-81 to 1990-91**

Year	Index of Relative Prices (1980 = 100)
1980-81	102.3
1981-82	110.7
1982-83	113.4
1983-84	120.1
1984-85	113.0
1985-86	104.2
1986-87	107.1
1987-88	117.6
1988-89	139.5
1989-90	145.2
1990-91 (September quarter)	154.1
(December quarter)	147.8

Source: Australian Bureau of Agricultural and Resource Economics.

**2.22** In contrast to the changes in the importance of different export industries to Australia over the 1980s, there was surprisingly little change in the relative importance of different export markets. This situation is depicted in Table 2.8. Japan remains by far Australia's largest export market accounting for over one-quarter of Australia's total exports, followed by the European Community (EC) and the North American countries at less than 15 per cent each. The importance of the Association of South East Asian Nations (ASEAN) increased slightly over the 1980s, with ASEAN countries purchasing over 10 per cent of Australia's exports by 1989-90.

**Table 2.8 Australia's Merchandise Export Markets, 1980-81 and 1989-90<sup>(a)</sup>**

Buyers of Australia's exports	Value of exports		Proportion of total exports	
	1980-81 (\$ million)	1989-90 (\$ million)	1980-81 (per cent)	1989-90 (per cent)
<b>North American countries</b>				
United States of America	2,090	5,361	11.2	11.2
Canada	436	714	2.3	1.5
<b>European Community</b>				
United Kingdom	696	1,726	3.7	3.6
Germany <sup>(b)</sup>	462	1,028	2.5	2.2
Other EC countries	1,154	3,576	6.2	7.5
<b>Other OECD countries</b>				
Japan	5,240	12,774	28.0	26.7
New Zealand	881	2,601	4.7	5.4
Remainder of OECD	247	1,112	1.3	2.3
<b>Other countries</b>				
ASEAN	1,539	4,944	8.2	10.3
Papua New Guinea	411	839	2.2	1.8
Other nations/ unallocated	5,562	13,140	29.7	27.5
<b>Total</b>	<b>18,718</b>	<b>47,815</b>	<b>100.0</b>	<b>100.0</b>

(a) 1989-90 data are the latest available data showing different regions and countries.

(b) The data for Germany refer to West Germany, ie the Federal Republic of Germany before the reunification of East and West Germany.

Source: Australian Bureau of Statistics, *Balance of Payments, Australia*, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

#### Trends in Merchandise Imports

**2.23** Australia's share of the total value of global imports has fallen quite dramatically over the past 30 years, from 2.1 per cent in 1960 to 1.2 per cent by the late 1980s. Canada and the United Kingdom also experienced relative declines in their shares of global imports since 1960, whereas the United States, Japan, Germany, France and the emerging North Asian economies experienced growing shares of global imports.

**2.24** Over the 1980s in Australia the nominal value of merchandise imports increased from less than \$20 billion to just under \$51 billion, as shown in Table 2.9. In 1990-91 the value of imports to Australia fell to \$49.3 billion. However, there was relatively little change in the value of imports as a proportion of GDP in Australia over the past decade. By the end of the 1980s, the value of merchandise imports as a proportion of GDP was just under 14 per cent. Moreover, the ratio of imports as a proportion of GDP has been in the range of more than 12 per cent and less than 14 per cent in all but four of the past 30 years.

**Table 2.9 Trends in Merchandise Imports, 1980-81 to 1990-91**

Year	Value of imports (\$ million)	Proportion of GDP (per cent)
1980-81	19,177	13.7
1981-82	22,368	14.2
1982-83	21,705	12.7
1983-84	23,497	12.1
1984-85	30,093	13.9
1985-86	35,676	14.9
1986-87	37,159	14.0
1987-88	40,386	13.5
1988-89	47,032	13.8
1989-90	50,991	13.7
1990-91	49,250	13.0

Source: Australian Bureau of Statistics, Balance of Payments, Australia, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

**2.25** Generally there have been only minor changes in the relative importance of different broad categories of imports over the last decade. The exceptions are imports of fuels and of machinery and transport equipment, as shown in Table 2.10.

**2.26** There was a substantial relative decline in Australia's reliance on fuel imports over the past decade. Australia's reliance on fuel imports may, however, become comparatively greater over the 1990s with the expected relative decline in the value of domestic crude oil production. ABARE has projected that the deficit between Australia's exports and imports of petroleum products will grow from \$611 million in 1991 to \$3,734 million by the year 2000.

**Table 2.10 The Composition of Merchandise Imports, 1980-81 and 1990-91**

Category	Value of imports		Proportion of imports	
	1980-81 (\$ million)	1990-91 (\$ million)	1980-81 (per cent)	1990-91 (per cent)
Food, beverages and tobacco	818	2,322	4.3	4.7
Fuels	2,713	3,146	14.1	6.4
Chemicals (including plastics)	1,563	5,128	8.1	10.4
Textiles, fabrics, etc	978	1,829	5.1	3.7
Metals and metal manufactures	1,052	2,484	5.5	5.1
Machinery and transport equipment	7,568	21,908	39.5	44.5
Manufactures nec, basic materials & other imports	4,485	12,433	23.4	25.2
<b>Total imports</b>	<b>19,177</b>	<b>49,250</b>	<b>100.0</b>	<b>100.0</b>

nec not elsewhere included

Source: Australian Bureau of Statistics, Balance of Payments, Australia, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

**2.27** There was a rise in the importance of machinery and transport equipment imports over the 1980s to a level where they now make up some 45 per cent of the total of imports. This increase was largely due to increases in the machinery, road transport and civil aircraft imports during the 1980s. Machinery imports now make up almost two-thirds of the total of machinery and transport imports. Road transport imports make up over 20 per cent of the total machinery and transport imports, while civil aircraft imports make up almost 7 per cent of the total. Over 3 per cent of machinery and transport equipment imports are expenditure on the imports of defence capital equipment. Moreover, weapons imports now represent over 10 per cent of transport equipment imports.

**2.28** The United States and Japan are the source of over 40 per cent of imports to Australia. This situation has changed very little over the past decade, as shown in Table 2.11.

Table 2.11 Source of Merchandise Imports to Australia, 1980-81 and 1989-90<sup>(a)</sup>

Source of imports to Australia	Value of imports		Proportion of imports	
	1980-81 (\$ million)	1989-90	1980-81 (per cent)	1989-90 (per cent)
<b>North American countries</b>				
United States of America	4,558	12,253	23.8	24.0
Canada	494	1,220	2.6	2.4
<b>European Community</b>				
United Kingdom	1,560	3,332	8.1	6.5
Germany <sup>(b)</sup>	1,058	3,406	5.5	6.7
Other EC countries	1,198	4,509	6.2	8.9
<b>Other OECD countries</b>				
Japan	3,674	9,858	19.2	19.3
New Zealand	629	2,160	3.3	4.2
Remainder of OECD	736	2,192	3.8	4.3
<b>Other countries</b>				
ASEAN	1,255	2,949	6.5	5.8
Papua New Guinea	73	234	0.4	0.5
Other nations/ unallocated	3,942	8,878	20.6	17.4
<b>Total imports</b>	<b>19,177</b>	<b>50,991</b>	<b>100.0</b>	<b>100.0</b>

(a) 1989-90 data are the latest available data showing different regions and countries.

(b) The data for Germany refer to West Germany, i.e. the Federal Republic of Germany before the reunification of East and West Germany.

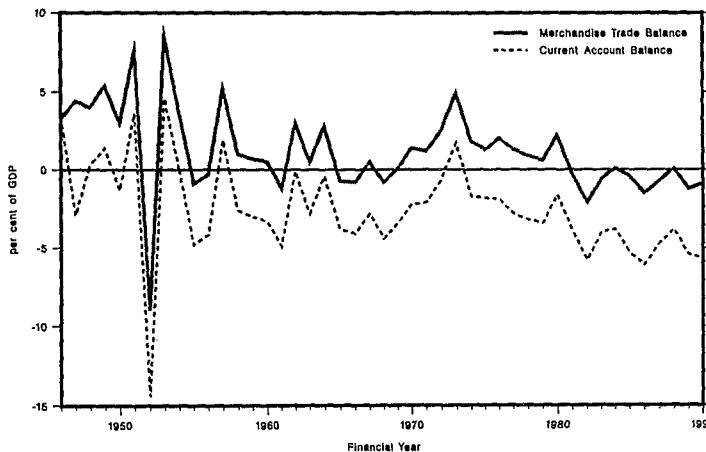
Source: Australian Bureau of Statistics, *Balance of Payments, Australia*, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

**2.29** The major shift in the source of imports to Australia over the past decade has been an increase in the value of imports from EC countries. This is despite the fact that Australia's purchase of imports from the United Kingdom has continued to decline.

#### The Merchandise Trade Balance

**2.30** The merchandise trade balance, being the difference between exports and imports of goods, is a critical component of the current account. Trends in the merchandise trade balance and the current account balance are depicted for the period since the Second World War in Figure 2.2.

Figure 2.2 The Merchandise Trade Balance and the Current Account Deficit as a Proportion of GDP, 1946 to 1990



Source: Derived from statistics published by the Australian Bureau of Statistics.

**2.31** Apart from the early to mid-1950s, merchandise trade has been fairly close to a balance over most of the period since the Second World War. Up until the 1980s the merchandise trade balance was in surplus more often than in deficit.

**2.32** Although the merchandise trade balance is empirically a relatively small component of the current account deficit, its importance in "driving" the current account deficit is starkly depicted in Figure 2.2. Trends in the merchandise trade balance mirror very closely those in the current account balance. This is hardly surprising when it is remembered that, while the merchandise trade balance itself may be a relatively small surplus or deficit each year, exports and imports of goods are by far the largest items in the current account.

**2.33** Surpluses in the merchandise trade balance have only been recorded in two years since 1980-81, as shown in Table 2.12. The first in 1983-84 was associated with recession and the second in 1987-88 was associated with a substantial improvement in commodity prices. Of the merchandise trade deficits recorded over the past decade most have been relatively small. Merchandise trade deficits exceeding 1 per cent of GDP were recorded in only three years over the period - 1981-82, 1985-86 and 1988-89. Each of these was associated with periods of rapid economic growth. A significant merchandise trade surplus was recorded in 1990-91.

Table 2.12 The Merchandise Trade Balance, 1980-81 to 1990-91

Year	Value of trade balance (\$ million)	Proportion of GDP (per cent)
1980-81	-459	-0.3
1981-82	-3,288	-2.1
1982-83	-1,049	-0.6
1983-84	185	0.1
1984-85	-881	-0.4
1985-86	-3,468	-1.4
1986-87	-1,736	-0.7
1987-88	155	0.1
1988-89	-3,959	-1.2
1989-90	-3,176	-0.9
1990-91	2,543	0.7

Source: Australian Bureau of Statistics, Balance of Payments, Australia, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

**2.34** Overall patterns in Australia's merchandise trade with the rest of the world are depicted in Table 2.13.

Table 2.13 Australia's Merchandise Trade With Different Regions of the World, 1980-81 and 1989-90<sup>(a)</sup>

Region	Trade surplus/ deficit		Proportion of GDP	
	1980-81 (\$ million)	1989-90	1980-81 (per cent)	1989-90 (per cent)
<b>North American countries</b>				
United States of America	-2,468	-6,892	-1.8	-1.9
Canada	-58	-506	-	-0.1
<b>European Community</b>				
United Kingdom	-864	-1,606	-0.6	-0.4
Germany <sup>(b)</sup>	-596	-2,378	-0.4	-0.6
Other EC countries	-44	-933	-	-0.3
<b>Other OECD countries</b>				
Japan	1,566	2,916	1.1	0.8
New Zealand	252	441	0.2	0.1
Remainder of OECD	-489	-1,080	-0.4	-0.3
<b>Other countries</b>				
ASEAN	284	1,995	0.2	0.5
Papua New Guinea	338	605	0.2	0.2
Other nations/ unallocated	1,620	4,262	1.2	1.1
<b>Balance of merchandise trade</b>	<b>-459</b>	<b>-3,176</b>	<b>-0.3</b>	<b>-0.9</b>

(a) 1989-90 data are the latest available showing different regions and countries.

(b) The data for Germany refer to Western Germany, ie the Federal Republic of Germany before the reunification of East and West Germany.

Source: Australian Bureau of Statistics, Balance of Payments, Australia, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

**2.35** Australia has a large merchandise trade deficit with the United States and the European Community. The relative size of the deficit with the United States was stable over the 1980s. The deficit with the United Kingdom as a proportion of GDP fell over the 1980s. Australia's deficit in merchandise import and export trade with the rest of the EC has widened over the last decade.

**2.36** Australia's merchandise trade surplus with Japan represents almost 1 per cent of GDP, although it has fallen since the beginning of the 1980s. Our trade surplus with ASEAN countries increased in relative importance over the 1980s, whereas our trade surplus with New Zealand declined during the decade.

**2.37** An indication of Australia's merchandise trade performance over the past two decades, relative to that of some other OECD countries, is given in Table 2.14. Australia's manufactures trade balance is by far the largest relative deficit of any country shown in Table 2.14. Moreover, its relative size grew in the 1980s. Thus Australia relies more heavily on imports for its manufactures than any of the countries shown. Australia's trade surplus in commodities was higher than for any other country shown, indicating the comparative extent of our reliance on commodity exports. In contrast Canada (the only other net commodity exporter shown in Table 2.14) has managed to rapidly reduce its manufactures trade deficit. This suggests that it is possible for Australia to do likewise. However, in the Canadian case integration with the United States market is the major factor contributing to this outcome and Australian exporters do not have proximity to such a market.

**Table 2.14 International Comparisons of Merchandise Trade Performance**

Country	Average annual manufactures trade balance as a proportion of GDP		Average annual commodities trade balance as a proportion of GDP	
	1970s	1980s	1970s	1980s
	(per cent)		(per cent)	
Australia	-5.8	-8.0	7.4	7.5
Canada	-4.7	-2.9	6.2	6.0
Sweden	3.2	4.3	-1.9	-2.9
United Kingdom	3.2	-0.6	2.9	-0.1
Germany <sup>(a)</sup>	8.7	9.5	-5.1	-5.0
United States of America	0.4	-1.5	-1.1	-0.9
Japan	8.1	9.0	-7.5	-5.6

(a) The data for Germany refer to West Germany, i.e. the Federal Republic of Germany before the reunification of East and West Germany.

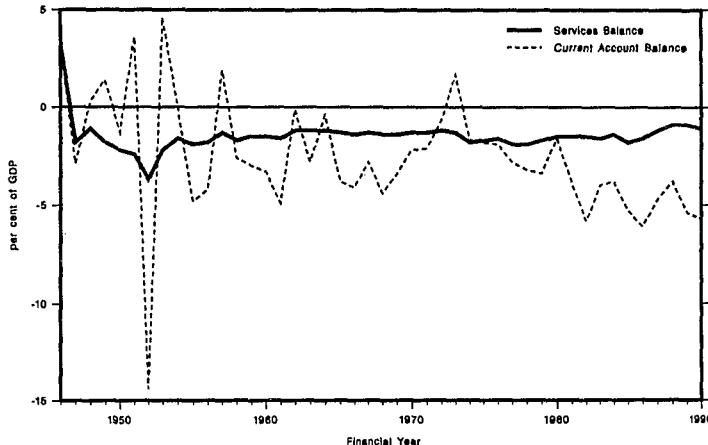
Source: International Monetary Fund (IMF), *International Financial Statistics Yearbook 1989*, Washington, 1989; and International Monetary Fund (IMF), *Supplement on Trade Statistics*, Washington, 1988.

#### The Services Trade Balance

**2.38** Long-term trends in the difference between Australia's imports and exports of services are depicted in Figure 2.3. Since the Second World War, Australia has consistently recorded a deficit on trade in services. This has been a fairly stable 1 per cent to 2 per cent of GDP since the mid-1950s.

**2.39** It is clear from reference to Figure 2.3 that trends in Australia's exports and imports of freight, wharfage, travel, tourist expenditure, insurance and other services are not closely linked to fluctuations in the current account balance.

**Figure 2.3 The Services Balance and the Current Account Deficit as a Proportion of GDP, 1946 to 1990**



Source: Derived from statistics published by the Australian Bureau of Statistics.

**2.40** The nominal value of the deficit in services trade doubled over the 1980s to more than \$4 billion by the end of the decade. There was some improvement in the relative size of the services trade balance over the past decade, as shown in Table 2.15. The services balance has since fallen in the early 1990s to around \$3.5 billion in 1990-91.

Table 2.15 The Services Balance, 1980-81 to 1990-91

Year	Value of service services balance (\$ million)	Proportion of GDP (per cent)
1980-81	-2,107	-1.5
1981-82	-2,409	-1.5
1982-83	-2,762	-1.6
1983-84	-2,782	-1.4
1984-85	-3,869	-1.8
1985-86	-3,926	-1.6
1986-87	-3,133	-1.2
1987-88	-2,596	-0.9
1988-89	-3,160	-0.9
1989-90	-4,413	-1.2
1990-91	-3,455	-0.9

Source: Australian Bureau of Statistics, *Balance of Payments, Australia*, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

2.41 An indication of changes in the composition of Australia's trade in services over the 1980s is given in Table 2.16.

2.42 "Shipment" refers to the freight and insurance payments associated with the shipment of the imports and exports of merchandise to and from Australia. Australia's relative net deficit on shipment has decreased since the beginning of the 1980s.

Table 2.16 The Composition of the Services Balance, 1980-81 and 1990-91

Category	Value of services		Proportion of GDP	
	1980-81 (\$ million)	1990-91 (\$ million)	1980-81 (per cent)	1990-91 (per cent)
<b>Credits</b>				
Shipment	402	605	0.3	0.2
Other transportation	1,498	3,986	1.1	1.0
Travel	983	4,954	0.7	1.3
Other services	904	3,723	0.6	1.0
Total services credits	3,787	13,268	2.7	3.5
<b>Debits</b>				
Shipment	-1,728	-3,048	-1.2	-0.8
Other transportation	-1,494	-3,481	-1.1	-0.9
Travel	-1,530	-5,250	-1.1	-1.4
Other services	-1,142	-4,944	-0.8	-1.3
Total services debits	-5,894	-16,723	-4.2	-4.4
<b>Net Services Balance</b>				
Shipment	-1,326	-2,443	-0.9	-0.6
Other transportation	4	505	-	0.1
Travel	-547	-296	-0.4	-0.1
Other services	-238	-1,221	-0.2	-0.3
balance	-2,107	-3,455	-1.5	-0.9

Source: Australian Bureau of Statistics, *Balance of Payments, Australia*, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

2.43 The "other transportation" category consists of passenger services and port services. Passenger services are international passenger services provided to foreigners by Australian transport operators (credits), and of those provided to Australians by foreign transport operators (debits). Port services refers to goods and services procured in Australian ports by foreign transport operators (credits) and vice versa (debits), goods and services purchased by foreign civilian crews while in Australia (credits) and vice versa (debits), and to charter transport services provided by Australians to foreigners (credits) and vice versa (debits). There is a very small surplus in Australia's favour on this item in the net services balance.

2.44 The "travel" item refers to the acquisition of goods and services in Australia by foreign travellers including tourists, business persons and students (credits), and to those goods and services provided to Australians whilst abroad (debits). Australia's relative travel deficit declined significantly over the past decade, largely due to a major increase in overseas tourists coming to Australia during the 1980s.

2.45 "Other services" refers to the provision of services to foreigners by Australians not elsewhere included, such as defence services, aid services and financial services (credits) and vice versa (debits). Australia runs a small deficit on these services, the relative size of which has increased over the past 10 years.

2.46 An indication is given in Table 2.17 of Australia's major trading relationships with respect to the imports of services from and exports of services to different parts of the world. The major changes over the 1980s were falls in Australia's net services trade deficits with the United Kingdom and ASEAN countries, a rise in our services deficit with the United States and a turnaround in a small services deficit with Japan at the beginning of the 1980s to a small but significant surplus by the end of the decade.

Table 2.17 Australia's Trade Services Balance With Different Regions of the World, 1980-81 and 1989-90<sup>(a)</sup>

Region	Net services balance		Proportion of GDP	
	1980-81 <sup>(b)</sup>	1989-90	1980-81	1989-90
	(\$ million)		(per cent)	
<b>North American countries</b>				
United States of America	-457	-1,480	-0.3	-0.4
Canada	-4	-19	-	-
<b>European Community</b>				
United Kingdom	-600	-1,266	-0.4	-0.3
Germany <sup>(c)</sup>	-74	-236	-	-0.1
Other EC countries	-261	-731	-0.2	-0.2
<b>Other OECD countries</b>				
Japan	-111	786	-0.1	0.2
New Zealand	56	64	-	-
Remainder of OECD	-135	-256	-0.1	-0.1
<b>Other countries</b>				
ASEAN	-272	-426	-0.2	-0.1
Papua New Guinea	44	119	-	-
Other nations/ unallocated	-432	-968	-0.3	-0.2
<b>Net services balance</b>	<b>-2,246</b>	<b>-4,413</b>	<b>-1.6</b>	<b>-1.2</b>

(a) 1989-90 data are the latest available data showing different regions and countries.

(b) Unrevised figures. The total net services balance (unrevised) for 1980-81 is -\$2,246 million, which differs from the total net services balance (revised) for 1980-81 of -\$2,107 million which is used in Tables 2.15 and 2.16. Revised figures by region are not available for 1980-81.

(c) The data for Germany refer to West Germany, ie the Federal Republic of Germany before the reunification of East and West Germany.

Source: Australian Bureau of Statistics, Balance of Payments, Australia, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

2.47 Australia's net services deficit is higher than the other countries shown in Table 2.18. However, the differences between the countries shown are not large.

Table 2.18 International Comparisons of Services Trade Merchandise

Country	Average annual services trade balance as a proportion of GDP	
	1970s	1980s
	(per cent)	
Australia	-1.6	-1.5
Canada	-1.3	-1.2
Sweden	-0.7	0.1
United Kingdom	-0.7	0.1
Germany <sup>(a)</sup>	-1.2	0.9
United States of America	-0.2	-0.1
Japan	-0.8	-0.8

(a) The data for Germany refer to West Germany, ie the Federal Republic of Germany before the reunification of East and West Germany.

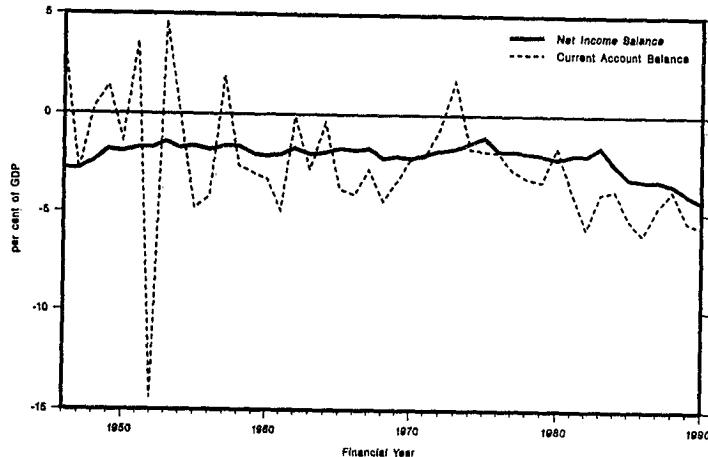
Source: International Monetary Fund (IMF), International Financial Statistics Yearbook 1989, Washington 1989; and International Monetary Fund (IMF), Supplement on Trade Statistics, Washington, 1988.

#### Net Income Payments Overseas

2.48 Income payments within the current account consist principally of interest and dividend receipts to Australia and interest and dividend payments to overseas residents and businesses.

2.49 Trends in Australia's net income position since the Second World War are depicted in Figure 2.4. Australia has consistently run a deficit on the net income balance. The net income deficit was around 2 per cent of GDP from the 1950s to the early 1980s. Certainly up until the 1980s fluctuations in the current account deficit were largely unrelated to changes in the deficit on net income.

Figure 2.4 The Net Income Balance and the Current Account Deficit as a Proportion of GDP, 1946 to 1990



Source: Derived from statistics published by the Australian Bureau of Statistics.

2.50 The deficit in net income increased substantially during the 1980s to in excess of 4 per cent of GDP by the end of the decade. As shown in Table 2.19, Australia's net income deficit reached over \$17 billion by 1989-90, remaining almost constant at \$16.9 billion by 1990-91. The net income deficit is by far the largest component of the current account deficit.

Table 2.19 The Net Income Balance, 1980-81 to 1990-91

Year	Value of net income balance (\$ million)	Proportion of GDP (per cent)
1980-81	-2,759	-2.0
1981-82	-3,208	-2.0
1982-83	-2,788	-1.6
1983-84	-4,883	-2.5
1984-85	-6,792	-3.1
1985-86	-7,928	-3.3
1986-87	-8,690	-3.3
1987-88	-10,502	-3.5
1988-89	-13,619	-4.0
1989-90	-17,037	-4.6
1990-91	-16,879	-4.5

Source: Australian Bureau of Statistics, Balance of Payments, Australia, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

2.51 Income transactions are comprised of property and investment income and labour and other income. The composition of income credit and debit transactions at the beginning and the end of the 1980s is shown in Table 2.20.

Table 2.20 The Composition of the Net Income Balance, 1980-81 and 1990-91

Category	Value of income transactions		Proportion of GDP	
	1980-81 (\$ million)	1990-91 (\$ million)	1980-81 (per cent)	1990-91 (per cent)
<b>Credits</b>				
Property and investment income	763	4,392	0.5	1.1
Labour and other income	119	646	0.1	0.2
<b>Total income credits</b>	<b>882</b>	<b>5,038</b>	<b>0.6</b>	<b>1.3</b>
<b>Debits</b>				
Property and investment income	-3,531	-21,406	-2.5	-5.7
Labour and other income	-110	-511	-0.1	-0.1
<b>Total income debits</b>	<b>-3,641</b>	<b>-21,917</b>	<b>-2.6</b>	<b>-5.8</b>
<b>Net Income Balance</b>				
Property and investment income	-2,768	-17,014	-2.0	-4.6
Labour and other income	9	135	-	0.1
<b>Net income balance</b>	<b>-2,759</b>	<b>-16,879</b>	<b>-2.0</b>	<b>-4.5</b>

Source: Australian Bureau of Statistics, Balance of Payments, Australia, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

2.52 "Property and investment income" refers to the earnings of Australian residents from the ownership of foreign assets (credits) and the earnings derived by foreigners from the ownership of Australian assets (debits). Property and investment income is comprised of investment income (which is mainly interest and dividends) and other property income (which is mainly royalties).

2.53 Since the beginning of the 1980s the gap between property and investment credits and debits has increased considerably from 2 per cent of GDP in 1980-81 to 4.5 per cent of GDP by 1990-91. This means that some 4.5 per cent of GDP is now required annually to meet Australia's net interest, dividend, royalty and similar income payments overseas.

2.54 "Labour and other income" refers to wages and salaries paid in Australia to foreigners and vice versa and to insurance transfers to and from Australia. This item generally records a small surplus.

**2.55** Australia's net income balance with different countries and regions is depicted in Table 2.21. Australia's largest deficits are with the United States, the United Kingdom and Japan. Australia's net income deficit with Japan has increased strikingly since the beginning of the 1980s.

**Table 2.21 Australia's Net Income Balance With Different Regions of the World, 1980-81 and 1989-90<sup>(a)</sup>**

Region	Net income balance		Proportion of GDP	
	1980-81 <sup>(b)</sup> (\$ million)	1989-90	1980-81	1989-90 (per cent)
<b>North American countries</b>				
United States of America	-1,461	-3,041	-1.0	-0.8
Canada	-69	-229	-	-0.1
<b>European Community</b>				
United Kingdom	-852	-3,817	-0.6	-1.0
Germany <sup>(c)</sup>	-138	-452	-0.1	-0.1
Other EC countries	-107	-1,044	-0.1	-0.3
<b>Other OECD countries</b>				
Japan	-227	-3,799	-0.2	-1.0
New Zealand	67	1,141	-	0.3
Remainder of OECD	-41	-834	-	-0.2
<b>Other countries</b>				
ASEAN	41	-386	-	-0.2
Papua New Guinea	62	-8	-	-
Other nations/ unallocated	-96	-4,568	-0.1	-1.2
<b>Net income balance</b>	<b>-2,821</b>	<b>-17,037</b>	<b>-2.0</b>	<b>-4.6</b>

(a) 1989-90 data are the latest available showing different regions and countries.

(b) Unrevised figures. The total net income balance (unrevised) for 1980-81 is -\$2,821 million, which differs from the total net income balance (revised) for 1980-81 of \$2,759 million which is used in Tables 2.19 and 2.20. Revised figures by region are not available for 1980-81.

(c) The data for Germany refer to West Germany, ie the Federal Republic of Germany before the reunification of East and West Germany.

Source: Australian Bureau of Statistics, Balance of Payments, Australia, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

#### Unrequited Transfers

**2.56** The final component of the current account is unrequited transfers. The principal transactions that are counted as unrequited transfers to and from Australia are foreign aid, social security payments, taxes, fines and fees payable to governments and gifts and sustenance payments to organisations and individuals between Australia and overseas. The most significant element is migrant transfers covering all cash transfers of migrants to Australia.

**2.57** As shown in Table 2.22, the net unrequited transfers balance grew from a small deficit at the beginning of the 1980s to a surplus exceeding \$2 billion by the end of the decade. The surplus has since grown further in the early 1990s to almost \$2.5 billion by 1990-91. The major factors leading to this situation are net revenue from withholding taxes and migrants transfers into Australia, including through the Business Migration Program.

**Table 2.22 Unrequited Transfers Balance, 1980-81 to 1990-91**

Year	Value of net unrequited transfers balance (\$ million)	Proportion of GDP (per cent)
1980-81	-140	-0.1
1981-82	-192	-0.1
1982-83	-195	-0.1
1983-84	115	0.1
1984-85	198	0.1
1985-86	709	0.3
1986-87	1,213	0.5
1987-88	1,664	0.6
1988-89	2,198	0.7
1989-90	2,346	0.6
1990-91	2,482	0.7

Source: Australian Bureau of Statistics, Balance of Payments, Australia, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

**2.58** Australia records surpluses in unrequited transfers with the United States, the United Kingdom, Japan, Germany and New Zealand, as shown in Table 2.23. Deficits are recorded with Papua New Guinea, Canada, ASEAN countries and other EC countries.

Table 2.23 Australia's Net Unrequited Transfer Balance With Different Regions of the World, 1980-81 and 1989-90<sup>(a)</sup>

Region	Net unrequited transfers balance		Proportion of GDP	
	1980-81 <sup>(b)</sup> (\$ million)	1989-90	1980-81	1989-90 (per cent)
<b>North American countries</b>				
United States of America	120	235	0.1	0.1
Canada	-1	-5	-	-
<b>European Community</b>				
United Kingdom	265	300	0.2	0.1
Germany <sup>(c)</sup>	36	11	-	-
Other EC countries	-28	-35	-	-
<b>Other OECD countries</b>				
Japan	18	99	-	-
New Zealand	40	22	-	-
Remainder of OECD	11	21	-	-
<b>Other countries</b>				
ASEAN	-67	-186	-	-0.1
Papua New Guinea	-230	-343	-0.2	-0.1
Other nations/ unallocated	-244	-2,227	-0.2	0.6
<b>Net unrequited transfers balance</b>	<b>-80</b>	<b>-2,346</b>	<b>-0.1</b>	<b>0.6</b>

(a) 1989-90 data are the latest available showing different regions and countries.

(b) Unrevised figures. The total net unrequited transfers balance (unrevised) for 1980-81 is \$80 million, which differs from the total net unrequited transfers balance (revised) for 1980-81 of -\$140 million which is used in Table 2.22. Revised figures by region are not available for 1980-81.

(c) The data for Germany refer to West Germany, i.e. the Federal Republic of Germany before the reunification of East and West Germany.

Source: Australian Bureau of Statistics, Balance of Payments, Australia, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

#### The Changing Nature of Australia's Current Account Deficit

2.59 The current account deficit grew rapidly over the 1980s from less than 4 per cent of GDP in 1980-81 to 6 per cent of GDP by 1989-90. The deficit has since fallen in the last year to 4 per cent of GDP.

2.60 There has been a radical change in the nature of the current account deficit over the past decade. When the decade began the current account deficit largely reflected two things. First, the degree to which Australia's consumption of imported goods and services was not matched by our exports. Second, it equally reflected our relatively low foreign debt service obligations and other income payments to foreigners. By the end of the 1980s the much larger current account deficit was dominated by our foreign debt servicing obligations.

2.61 Over the past year the current account deficit has fallen by some 31 per cent. This is largely due to a substantial growth in exports, even though the value of agricultural exports continued to decline. Imports also fell but only by a relatively small margin. These developments mean that the current account deficit today is overwhelmingly dominated by our foreign debt servicing obligations and other income payments overseas.

## CHAPTER 3

### THE CAPITAL ACCOUNT AND OVERSEAS DEBT

#### **The Capital Account Balance Over the Past Decade**

3.1 The capital account records capital inflows to Australia from overseas and capital outflows from Australia to the rest of the world. It is a record of transactions resulting in claims on the rest of the world (assets) and obligations to the rest of the world (liabilities). Capital movements occur because of international loans, their repayment and direct investment made by persons, companies and governments.

3.2 Trends in Australia's capital account over the past decade are shown in Table 3.1. Australia has traditionally experienced a capital account balance which reflects capital inflows to Australia from overseas outweighing capital outflows from Australia by a considerable margin. This overall situation was no different in the 1980s from most earlier periods.

3.3 There was rapid growth in Australia's capital account balance (ie net capital inflows) in the period between the early 1980s to the mid-1980s, from around 3 per cent of GDP in 1980-81 to some 6 per cent of GDP by 1985-86. Subsequently net capital inflows to Australia fell in relative size to around 4 per cent of GDP by the end of the decade. They fell further to 3.5 per cent of GDP in 1990-91.

3.4 As can be seen by reference to Table 3.1, net overseas borrowings and foreign investment in the non-official sector dominated the capital account balance in Australia over the past decade. The non-official sector refers to both private and public business enterprises. The exception was a couple of years in the mid-1980s where it was net capital inflows to the government sector (ie official sector) that contributed to around half of Australia's net capital inflows. At all other times during the past decade government sector borrowings have been relatively small. In five of the years over the period, net government sector repayments of capital occurred.

Table 3.1 The Capital Account Balance<sup>(a)</sup>, 1980-81 to 1990-91

Year	Value of net capital transactions			Proportion of GDP		
	Official	Non-official	Balance on capital account	Official	Non-official	Balance on capital account
	(\$ million)			(per cent)		
1980-81	-1,187	5,685	4,498	-0.9	4.1	3.2
1981-82	-896	9,277	8,331	-0.6	5.9	5.3
1982-83	-1,614	7,940	6,326	-0.9	4.6	3.7
1983-84	-1,048	6,770	5,722	-0.5	3.5	3.0
1984-85	5,253	6,679	11,932	2.4	3.1	5.5
1985-86	7,750	7,382	15,132	3.2	3.1	6.3
1986-87	2,490	7,245	9,735	1.0	2.7	3.7
1987-88	770	10,480	11,250	0.3	3.5	3.8
1988-89	1,801	15,757	18,558	0.5	4.9	5.4
1989-90	442	14,093	14,535	0.1	3.8	3.9
1990-91	-3,297	16,623	13,326	-0.9	4.4	3.5

(a) Balance on capital account excluding the balancing item.

Source: Australian Bureau of Statistics, *Balance of Payments, Australia*, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

3.5 A more detailed picture of the recent composition of the capital account is given in Table 3.2. In 1989-90 net capital inflows to Australia, as depicted by Australia's capital account balance, were around \$14.5 billion or almost 4 per cent of GDP. In 1990-91 net capital inflows fell to \$13.3 billion or 3.5 per cent of GDP.

3.6 In relation to capital transactions between Australia's government sector and the rest of the world in 1989-90, general government borrowings from overseas were more than matched by outflows of foreign reserve assets held by the Reserve Bank of Australia (RBA). In 1990-91 a net repayment of government borrowings of around \$1.8 billion occurred. Australia's foreign reserves held by the Reserve Bank amounted to nearly \$1.5 billion in 1990-91. These reserves were made up entirely of official holdings of foreign currencies.

Table 3.2 The Composition of the Capital Account, 1989-90 and 1990-91

Net capital transactions	Value of capital inflows and outflows		Proportion of GDP	
	1989-90 (\$ million)	1990-91 (\$ million)	1989-90 (per cent)	1990-91 (per cent)
<b>OFFICIAL</b>				
<i>General government -</i>				
Foreign investment in Australia -				
Borrowing	2,734	-1,837	0.7	-0.5
Other	-74	-5	-	-
Total	2,660	-1,842	0.7	-0.5
Australian investment abroad -				
-86	13	-	-	-
Total general government	2,574	-1,829	0.7	-0.5
<i>Reserve Bank -</i>				
Foreign investment in Australia -	24	22	-	-
Australian investment abroad -				
Reserve assets	-2,156	-1,446	-0.6	-0.4
Other	-	-	-	-
Total	-2,156	-1,446	-0.6	-0.4
Total Reserve Bank	-2,132	-1,468	-0.6	-0.4
<b>TOTAL OFFICIAL</b>	<b>442</b>	<b>-3,297</b>	<b>0.1</b>	<b>-0.9</b>
<b>NON-OFFICIAL</b>				
<i>Foreign investment in Australia -</i>				
Direct investment -				
Reinvestment of earnings	1,536	1,420	0.4	0.4
Other	5,144	7,178	1.4	1.9
Portfolio and other investment	11,116	9,511	3.0	2.5
Total foreign investment in Australia	17,796	18,109	4.8	4.8

Table 3.2 (continued)

Net capital transactions	Value of capital inflows and outflows		Proportion of GDP	
	1989-90 (\$ million)	1990-91	1989-90 (per cent)	1990-91
<b>Australian investment abroad -</b>				
Direct investment -				
Reinvestment earnings	-1,591	-1,472	-0.4	-0.4
Other	-1,220	904	-0.3	0.2
Portfolio and other investment	-892	-918	-0.2	-0.2
Total Australian investment abroad	-3,703	-1,486	-1.0	-0.4
TOTAL NON-OFFICIAL	14,093	16,623	3.8	4.4
BALANCE ON CAPITAL ACCOUNT <sup>(a)</sup>	14,535	13,326	3.9	3.5

(a) Balance on capital account excluding balancing item.

Source: Australian Bureau of Statistics, *Balance of Payments, Australia*, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

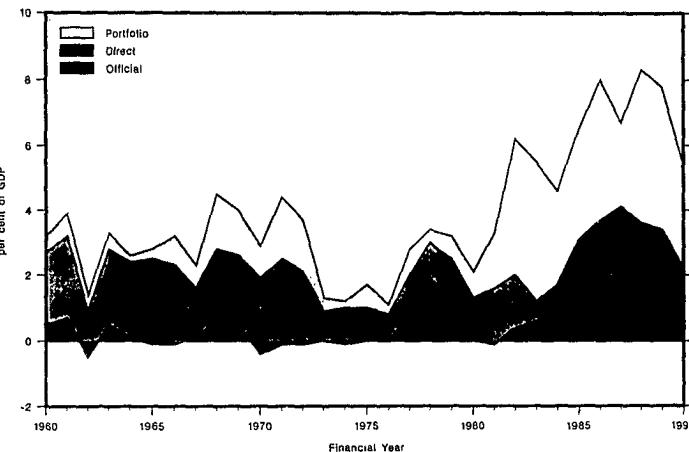
3.7 In 1989-90 inflows of foreign capital to Australia exceeded \$20 billion with around one-third being direct investment. During 1990-91 these inflows were lower being just over \$18 billion and the proportion of direct investment was over 47 per cent of the total. Direct investment refers to capital inflows to Australian residents and companies operating in Australia that involved equity of at least 10 per cent in the assets in Australia being held by the foreign investor. The remaining inflows of foreign capital were portfolio and other investments which comprise all other foreign investment in Australia (this means all other foreign investment in Australia where a 10 per cent or greater equity relationship is not involved, including overseas borrowings).

3.8 In 1989-90, Australian non-official sector investment overseas amounted to over \$3.7 billion, most of which was direct investment by Australians in overseas economies leading to Australian equity in overseas assets and enterprises. This investment abroad has fallen away with the recession, totalling less than \$1.5 billion in 1990-91.

#### Foreign Investment Inflows to Australia and New Overseas Borrowing

3.9 Trends in foreign investment inflows to Australia since 1960 are depicted in Figure 3.1. Foreign investment in Australia reached unprecedented levels during the 1980s. This was mainly due to the very high levels of new portfolio investment (ie investments not involving equity of at least 10 per cent foreign ownership in Australian assets). The most important element has been very high levels of overseas borrowings in the period coinciding with the deregulation of Australia's financial system which included the abolition of exchange control.

Figure 3.1 Foreign Investment in Australia, 1960 to 1990



Source: Derived from statistics published by the Australian Bureau of Statistics.

3.10 Direct investment from overseas involving foreign equity of at least 10 per cent in Australian assets has followed a far more stable pattern. Government borrowing from overseas has been a relatively small component over the past 30 years with the exception of the late 1970s and the mid-1980s, where State government borrowings were relatively prominent.

3.11 The relative importance of foreign investment and overseas borrowings in the Australian economy grew significantly over the past decade. As shown in Table 3.3, foreign investment and overseas borrowings each year in the non-official sector grew from 4.4 per cent of GDP in 1980-81 to a peak of 8.3 per cent of GDP in 1988-89. The ratio has since fallen to 4.8 per cent of GDP in 1990-91. The significant new foreign borrowings each year for the past decade have been for use in private and public business enterprises.

Table 3.3 Foreign Investment in Australia and Overseas Borrowings, 1980-81 to 1990-91

Year	Value of inflows of foreign investment/overseas borrowings			Proportion of GDP		
	Official	Non-official	Total	Official	Non-official	Total
	(\$ million)				(per cent)	
1980-81	-131	6,195	6,064	-0.1	4.4	4.3
1981-82	646	9,956	10,602	0.4	6.3	6.7
1982-83	1,059	9,390	10,449	0.6	5.5	6.1
1983-84	1,291	8,875	10,166	0.7	4.5	5.2
1984-85	4,074	11,041	15,088	1.9	5.1	7.0
1985-86	5,823	14,171	19,994	2.4	5.9	8.3
1986-87	6,458	16,383	22,841	2.4	6.2	8.6
1987-88	4,279	23,473	27,752	1.4	7.9	9.3
1988-89	3,033	28,174	31,207	0.9	8.3	9.2
1989-90	2,684	17,796	20,480	0.7	4.8	5.5
1990-91	-1,864	18,109	16,245	-0.5	4.8	4.3

Source: Australian Bureau of Statistics, Balance of Payments, Australia, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

3.12 General government sector inflows, which were mainly borrowings from overseas, grew from a low base to a level of 2.4 per cent of GDP during the middle period of the 1980s. These inflows then fell to 0.7 per cent of GDP by the end of the decade. In 1990-91 a net outflow of 0.5 per cent of GDP was recorded.

3.13 An indication of the sources of overseas funds for foreign investment in and lending to Australia is given in Table 3.4. In terms of individual countries, Japan and the United States were the major overseas investors in and lenders to Australia by the end of the 1980s.

Table 3.4 Sources of Foreign Investment and Overseas Borrowings in Australia, 1989-90<sup>(a)</sup>

Sources of foreign investment/overseas borrowings	Value of inflows of foreign investment/overseas borrowings (\$ million)	Proportion of GDP (per cent)
<b>North American countries</b>		
United States of America	1,837	0.5
Canada	12	-
<b>European Community</b>		
United Kingdom	69	-
Germany <sup>(b)</sup>	109	-
Other EC countries	649	0.2
<b>Other OECD countries</b>		
Japan	6,133	1.6
New Zealand	-309	-0.1
Remainder of OECD	709	0.2
<b>Other countries</b>		
ASEAN	587	-0.2
Papua New Guinea	-8	-
Other nations/unallocated	10,668	2.9
<b>Total inflow of investment/borrowings</b>	<b>20,456<sup>(c)</sup></b>	<b>5.5</b>

(a) 1989-90 are the latest year for which data are available by country and region.

(b) The data for Germany refer to West Germany, ie the Federal Republic of Germany before the reunification of East and West Germany.

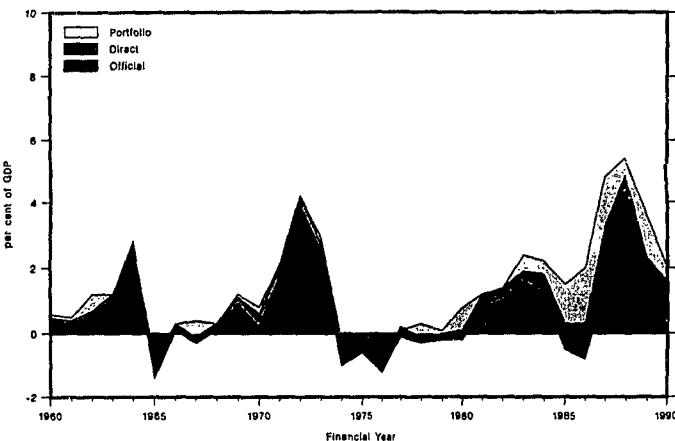
(c) The total value of inflows of \$20,456 million differs from the total shown in Table 3.3 of \$20,480 million because this table excludes inflows to the Reserve Bank of Australia which totalled \$24 million in 1989-90. This was not available by country and region.

Source: Australian Bureau of Statistics, Balance of Payments, Australia, 1989-90, Cat. No. 5303.0, Canberra, various issues.

### Australian Investment Overseas

3.14 Trends in Australian investment overseas are depicted in Figure 3.2. By 1987-88 Australian investment abroad peaked at over 5 per cent of GDP. This level of overseas investment by Australians is not only historically very high, but it differs markedly from peaks in the early to mid-1960s and 1970s when Australian investment abroad was dominated by the government sector. This earlier investment was largely made up of official reserve assets of gold, foreign currencies and other foreign reserves held by the RBA.

Figure 3.2 Australian Investment Abroad, 1960 to 1990



Source: Derived from statistics published by the Australian Bureau of Statistics.

3.15 During the 1980s and in particular during the mid to late 1980s, it was non-official sector investment abroad which boomed. For instance in 1988-89 some 90 per cent of Australia's investment abroad was by private and public business enterprises. Australia's official foreign reserves were a relatively small proportion of total investment abroad during this period. Australian investment abroad has fallen sharply since, so that by 1990-91 this investment was only around one-quarter of that of the peak of 1987-88.

3.16 This trend is indicated in Table 3.5. Since 1986-87 private and public business enterprise investment abroad has contributed to around three-quarters of total Australian investment overseas. This situation is unprecedented. The period since deregulation has not only seen historically high levels of investment abroad, but it also has produced a shift where the vast majority of such capital transactions were non-official sector investment and lending overseas by the end of the 1980s. It is, however, important to note that non-official investment overseas has fallen away with the onset of the recession.

Table 3.5 Australian Investment Overseas, 1980-81 to 1990-91

Year	Value of outflows			Proportion of GDP		
	Official (\$ million)	Non- official	Total	Official (per cent)	Non- official (per cent)	Total (per cent)
1980-81	-1,057	-510	-1,567	-0.8	-0.4	-1.2
1981-82	-1,542	-729	-2,271	-0.9	-0.5	-1.4
1982-83	-2,673	-1,450	-4,123	-1.6	-0.8	-2.4
1983-84	-2,339	-2,105	-4,444	-1.2	-1.1	-2.3
1984-85	1,179	-4,335	-3,156	0.5	-2.0	-1.5
1985-86	1,927	-6,789	-4,862	0.8	-2.8	-2.0
1986-87	-3,968	-9,138	-13,106	-1.5	-3.5	-5.0
1987-88	-3,509	-12,993	-16,502	-1.2	-4.3	-5.5
1988-89	-1,232	-11,417	-12,649	-0.4	-3.3	-3.7
1989-90	-2,218	-3,703	-5,921	-0.6	-1.0	-1.6
1990-91	-1,455	-1,486	-2,941	-0.4	-0.4	-0.8

Source: Australian Bureau of Statistics, *Balance of Payments, Australia*, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

**3.17** The impact of increased Australian investment on the current account deficit is both positive and negative. On the one hand it has produced credits on the income balance as overseas residents, organisations and companies service these investments by way of interest and dividend payments to Australia. On the other hand this higher level of Australian investment overseas in the late 1980s meant that a higher level of foreign investment in Australia was needed to finance the current account deficit.

**3.18** Australia's investment overseas is dominated by investments in the United States, New Zealand and the United Kingdom. Japan and the ASEAN countries are also important destinations for Australian investment abroad, as shown in Table 3.6.

**Table 3.6 Destinations of Australian Investment Overseas, 1989-90<sup>(a)</sup>**

Destination of overseas investment	Value of outflows of overseas investment (\$ million)	Proportion of GDP (per cent)
<b>North American countries</b>		
United States of America	-2,589	-0.7
Canada	123	-
<b>European Community</b>		
United Kingdom	-1,418	-0.4
Germany <sup>(b)</sup>	147	-
Other EC countries	-48	-
<b>Other OECD countries</b>		
Japan	-752	-0.2
New Zealand	-2,655	-0.7
Remainder of OECD	-388	-0.1
<b>Other countries</b>		
ASEAN	-732	-0.2
Papua New Guinea	-85	-
Other nations/ unallocated	2,476	0.7
<b>Total overseas investment</b>	<b>-5,921</b>	<b>-1.6</b>

(a) 1989-90 is the latest year for which data are available by country and region.

(b) The data for Germany refer to West Germany, ie the Federal Republic of Germany before the reunification of East and West Germany.

Source: Australian Bureau of Statistics, Balance of Payments, Australia, Cat. No. 5303.0, Canberra, various issues.

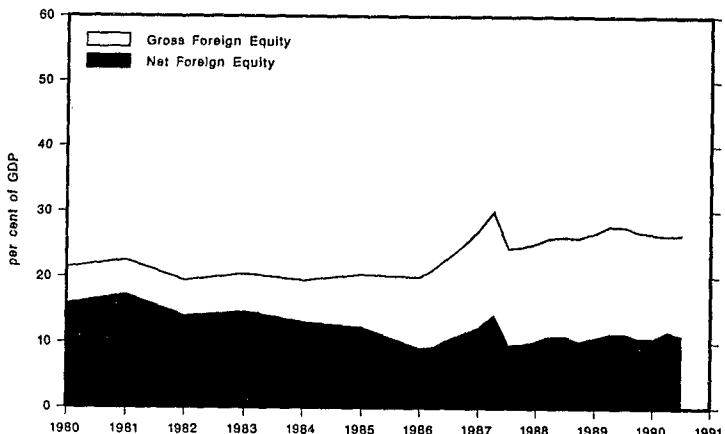
#### Australia's Foreign Liabilities and the Level of Overseas Debt

**3.19** Persistent surpluses on the capital account reflect net capital inflows each year to Australia which give rise to financial obligations in the future. The total stock of these obligations or the total stock of foreign investment in Australia constitutes the level of Australia's foreign liabilities.

**3.20** Australia's foreign liabilities are comprised of two elements - foreign equity and foreign debt.

**3.21** Foreign equity takes the form of subsidiaries, branch offices, ownership of shares and ownership by foreign residents, corporations and organisations of any other assets which give rise to profits and dividends. Foreign equity is a measure of the foreign ownership of Australia's assets. Trends in the level of foreign equity in Australia over the past decade are shown in Figure 3.3.

**Figure 3.3 Level of Foreign Equity, 1980 to 1990**



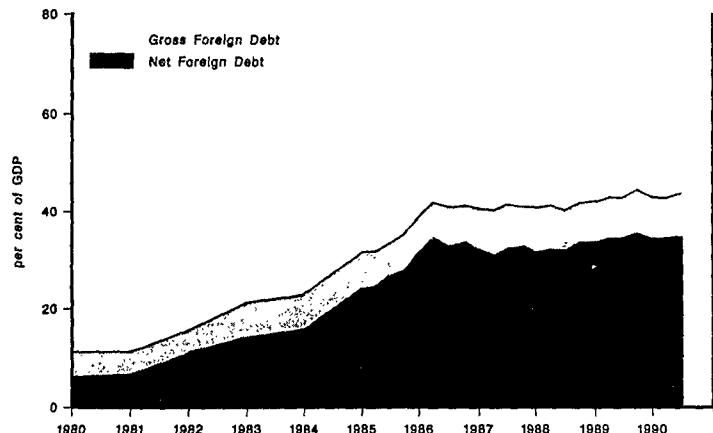
Source: Derived from statistics published by the Australian Bureau of Statistics.

**3.22** Gross foreign equity as a percentage of GDP only rose very modestly over the 1980s, from just under 22 per cent at the beginning of the decade to around 27 per cent by the end of the decade. Net foreign equity, which is gross foreign equity net of the stock of Australian equity investment abroad, has declined slightly over the decade.

**3.23** The second element of Australia's foreign liabilities is foreign or overseas debt. The stock of overseas debt is the accumulation of past Australian borrowing from foreigners. Current account deficits add to foreign debt when they are financed by borrowing.

**3.24** The rapid increases in Australia's foreign liabilities over the 1980s were very much due to the sharp rises in the level of Australia's overseas debt. Trends in Australia's foreign debt over the past decade are shown in Figure 3.4.

**Figure 3.4 Level of Foreign Debt, 1980 to 1990**



Source: Derived from statistics published by the Australian Bureau of Statistics.

**3.25** Gross foreign debt increased rapidly, particularly in the period of the mid to late 1980s. Net foreign debt, which is gross foreign debt net of Australian lending abroad, shows a similar pattern to gross foreign debt. This is because Australian lending abroad is relatively small in comparison with foreign borrowing, even though the stock of Australian lending abroad rose from about 5 per cent of GDP to about 9 per cent of GDP over the 1980s.

**3.26** Australia's foreign liabilities situation is summarised in Table 3.7. Foreign debt increased more than tenfold over the decade from \$13.5 billion in 1980 to over \$145 billion in 1989. This represented a massive increase in foreign debt as a proportion of GDP from 11 per cent in 1980 to nearly 43 per cent by 1989. The accumulated total of gross foreign debt has further increased in the early 1990s reaching a level of over \$165 billion by June 1991 - which is almost 44 per cent of GDP. This increase in foreign debt includes funds for the financing of investment that is beneficial to Australia's future, in addition to funds which have financed speculative investments.

**Table 3.7 Levels of Australia's Foreign Liabilities and Overseas Debt, 1980 to 1991**

Year 30 June	Level of Australia's foreign liabilities			Proportion of GDP		
	Gross foreign debt (\$ million)	Equity & other investment	Total gross	Gross foreign debt (\$ million)	Equity & other investment	Total gross
			(per cent)			(per cent)
1980	13,498	26,383	39,881	11.0	21.5	32.5
1981	15,219	31,567	46,786	10.9	22.5	33.4
1982	24,350	30,745	55,095	15.4	19.4	34.8
1983	35,891	35,044	70,935	20.9	20.4	41.3
1984	44,101	37,772	81,873	22.7	19.4	42.1
1985	67,473	43,845	111,318	31.2	20.3	51.5
1986	92,050	47,387	139,437	38.3	19.8	58.1
1987	105,702	71,606	177,308	39.9	27.1	67.0
1988	122,802	76,690	199,492	41.0	25.6	66.6
1989	145,370	92,059	237,429	42.8	27.1	69.9
1990	157,317	99,399	256,716	42.3	26.7	69.0
1991	165,704	106,604	272,308	43.6	28.1	71.7

Source: Australian Bureau of Statistics, *Foreign Investment, Australia*, Cat. Nos. 5305.0, 5306.0 and 5307.0, Canberra, various issues.

**3.27** The increase in gross foreign equity over the decade rose from around \$26 billion in 1980 to almost \$107 billion in 1991. In contrast to the growth in foreign debt, this growth in foreign equity translates to a much more modest rise in the ratio of foreign equity to GDP from just under 22 per cent in 1980 to 28 per cent by 1991.

**3.28** These patterns have seen the predominant type of foreign investment in Australia shift from equity to debt over the 1980s.

**3.29** As can be seen in Table 3.8, the growth in the foreign debt of Australia's governments was relatively modest over the 1980s. In the past decade it rose from just under 5 per cent to 11 per cent of GDP. However, the government or official sector's share of total foreign debt fell from over 40 per cent at the beginning of the 1980s to around one-quarter by the end of the 1980s. In the past year to June 1991 the actual level of general government sector debt also fell by over \$1 billion.

**Table 3.8 The Level of Australia's Gross Foreign Debt, 1980 to 1991**

Year 30 June	Gross foreign debt			Proportion of GDP		
	Official (\$ million)	Non- official	Total	Official (per cent)	Non- official	Total (per cent)
1980	5,687	7,811	13,498	4.6	6.4	11.0
1981	4,816	10,403	15,219	3.4	7.5	10.9
1982	5,692	18,658	24,350	3.6	11.8	15.4
1983	7,682	28,209	35,891	4.5	16.4	20.9
1984	8,874	35,227	44,101	4.6	18.1	22.7
1985	14,883	52,590	67,473	6.9	24.3	31.2
1986	23,409	68,641	92,050	9.7	28.6	38.3
1987	29,857	75,845	105,702	11.3	28.6	39.9
1988	33,536	89,266	122,802	11.2	29.8	41.0
1989	37,192	108,178	145,370	11.0	31.8	42.8
1990	38,772	118,545	157,317	10.4	31.9	42.3
1991	37,590	128,114	165,704	9.9	33.7	43.6

Source: Australian Bureau of Statistics, *Foreign Investment, Australia*, Cat. Nos. 5305.0, 5306.0 and 5307.0, Canberra, various issues.

**3.30** The level of overseas debt owed by the non-official sector is a different story. Foreign debt owed by Australia's private sector, Australia's banks and public business enterprises increased from under \$8 billion in 1980 to over \$100 billion by the end of the 1980s. Non-official overseas debt reached a level of over 30 per cent of GDP by the end of the 1980s. This debt has since risen to over \$128 billion by June 1991, and it now amounts to almost 34 per cent of Australia's GDP.

3.31 More detail about changes in the level of foreign debt in each sector over the past 10 years is given in Table 3.9. The decline in the relative share of total gross foreign debt owed by the general government sector was due to a large relative fall in Commonwealth foreign debt which was not offset by the rise in State/Territory government debt.

3.32 In the case of business enterprises shown in the non-official sector, the relative share of foreign debt owed by public business enterprises has risen over the past 10 years because of the high relative growth in the foreign debt owed by public financial trading enterprises. The overseas debt of private sector business enterprises also grew because of very high relative growth in the share of foreign debt held by private financial enterprises. It is important to note that financial sector foreign debt ends up, in large measure, as investment across all other industry sectors.

Table 3.9 The Level of Australia's Gross Foreign Debt by Institutional Sector, 1981 and 1991

Institutional sector	Level of gross foreign debt at		Proportion of gross foreign debt at 30 June	
	1981	1991	1981	1991
	(\$ million)			
<b>OFFICIAL SECTOR</b>				
Commonwealth Government and Reserve Bank	4,816	16,469	31.6	9.9
State/Territory governments	-	21,121	-	12.8
<b>TOTAL OFFICIAL SECTOR</b>	<b>4,816</b>	<b>37,590</b>	<b>31.6</b>	<b>22.7</b>
<b>NON-OFFICIAL SECTOR</b>				
Public sector enterprises -				
Financial enterprises	297	18,874	2.0	11.4
Trading enterprises	1,707	13,081	11.2	7.9
Total public sector enterprises	2,004	31,955	13.2	19.3
Private sector enterprises -				
Financial enterprises	1,558	41,647	10.2	25.1
Trading enterprises	6,841	54,512	45.0	32.9
Total private sector enterprises	8,399	96,159	55.2	58.0
<b>TOTAL NON-OFFICIAL SECTOR</b>	<b>10,403</b>	<b>128,114</b>	<b>68.4</b>	<b>77.3</b>
<b>TOTAL</b>	<b>15,219</b>	<b>165,704</b>	<b>100.0</b>	<b>100.0</b>

Source: Australian Bureau of Statistics, *Foreign Investment Australia*, Cat. Nos. 5305.0, 5306.0 and 5307.0, Canberra, various issues.

3.33 An indication in trends in Australia's overseas debt levels by industry sector is given in Table 3.10. The finance, property and business sector now has the highest level of foreign debt, a situation which has changed substantially since the early 1980s. Its proportion of the total more than doubled between 1982 and 1988. All other industry sectors, while increasing their nominal levels of overseas debt over the 1980s, reduced their proportion of the total debt over the period.

Table 3.10 The Composition of Australia's Gross Foreign Debt by Industry Sector, 1982 and 1988<sup>(a)</sup>

Category	Gross foreign debt		Proportion of total	
	1982 (\$ million)	1988 (\$ million)	1982 (per cent)	1988 (per cent)
Mining	3,673	10,386	15.2	8.9
Manufacturing	3,883	15,145	16.1	12.9
Finance, property and business	4,399	49,181	18.2	42.0
Other industries	12,223	42,307	50.6	36.2
Total	24,178	117,019	100.0	100.0

(a) Unrevised figures. The 1982 and 1988 data are unrevised figures. The unrevised totals for gross foreign debt of \$24,178 million and \$117,019 million differ from the revised totals for those years that are shown in Tables 3.7 and 3.8.

Source: Australian Bureau of Statistics, Foreign Investment, Australia, Cat. Nos. 5305.0 and 5306.0, Canberra, various issues.

3.34 The proportion of Australia's foreign debt which is denominated in foreign currencies is an important issue because changes in the exchange rate impact on the total Australian dollar value of the foreign debt. A depreciating Australian dollar increases the Australian dollar value of the debt and vice versa. It is apparent that falling exchange rates for the Australian dollar accelerated debt growth in 1985 and 1986, but have offset it subsequently.

3.35 The proportion of Australia's foreign debt denominated in Australian dollars has increased from less than 15 per cent in 1981 to 42 per cent by 1991, as shown in Table 3.11. At the beginning of the 1980s the largest part of Australia's overseas debt was expressed in United States dollars. This proportion has declined to the point where just over one-third of Australia's foreign debt is now denominated in United States dollars. The next largest component is in Japanese Yen and its share has risen over the decade to just under 10 per cent of the total debt. The increasing proportion of the foreign debt which is denominated in Australian dollars has meant the effect of changes in the value of the Australian dollar on the Australian dollar value of foreign debt has been reduced.

Table 3.11 The Composition of Australia's Gross Foreign Debt by Currency, 1981<sup>(a)</sup> and 1991<sup>(b)</sup>

Currency	Gross foreign debt		Proportion of total	
	1981 (\$ million in SA)	1991 (\$ million in SA)	1981 (per cent)	1991 (per cent)
Australian Dollars	2,198	69,440	14.5	42.0
United States Dollars	7,874	59,028	52.0	35.7
Pounds Sterling	497	3,294	3.3	2.0
Swiss Francs	973	4,394	6.4	2.6
Deutsche Marks	1,384	2,646	9.1	1.6
Japanese Yen	1,066	15,383	7.0	9.3
Other foreign currencies	1,172	11,250	7.7	6.8
Total	15,164	165,435	100.0	100.0

(a) Unrevised figures for June 1981. The 1981 data on gross foreign debt by currency total \$15,164 million. This differs from the 1981 total foreign debt revised data total of \$16,219 million which is shown in Tables 3.7, 3.8 and 3.9. Revised figures by currency are not available for 1981.

(b) The 1991 data are for March 1991 not June 1991. Therefore, the total of \$165,435 million in this table differs from the June 1991 totals of \$165,704 million shown in Tables 3.7, 3.8 and 3.9.

Source: Australian Bureau of Statistics, Foreign Investment, Australia, Cat. Nos. 5305.0, 5306.0 and 5307.0, Canberra, various issues.

3.36 Japan, the United States and the United Kingdom are by far the largest foreign creditors of Australia. As shown in Table 3.12, residents, corporations and organisations of those countries are owed almost half of Australia's overseas debt. Japan's share rose over the 1980s, whilst that of the United States and the United Kingdom fell.

Table 3.12 The Composition of Australia's Gross Foreign Debt by Creditor Country or Regions, 1981 and 1989<sup>(a)</sup>

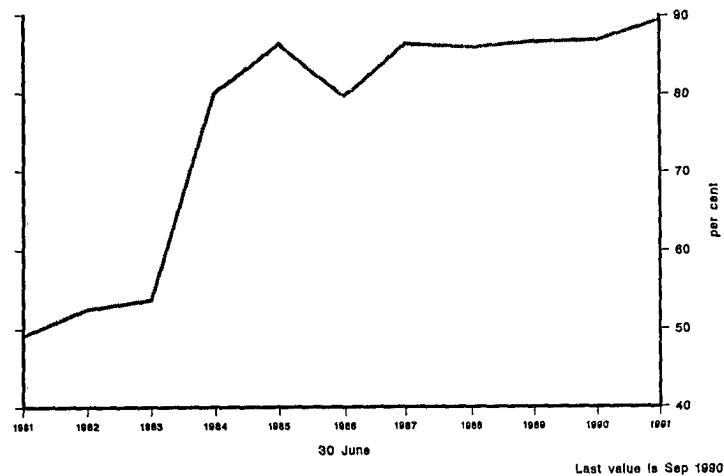
Country/region	Gross foreign debt		Proportion of total	
	1981 (\$ million)	1989	1981 (per cent)	1989
United States of America	3,027	23,938	20.0	17.2
Japan	2,220	26,721	14.6	19.2
Switzerland	999	4,507	6.6	3.2
United Kingdom	2,687	15,183	17.7	10.9
Remainder of EC	2,618	13,004	17.3	9.3
Remainder of OECD	277	1,991	1.8	1.4
ASEAN	630	5,814	4.2	4.2
Other countries/ unallocated	2,706	48,325	17.8	34.6
<b>Total</b>	<b>15,164</b>	<b>139,483</b>	<b>100.0</b>	<b>100.0</b>

(a) Unrevised figures. The 1981 and 1989 data are unrevised figures. The unrevised totals for gross foreign debt of \$15,164 million and \$139,483 million differ from the revised totals for those years that are shown in Tables 3.7, 3.8 and 3.9.

Source: Australian Bureau of Statistics, *Foreign Investment, Australia*, Cat. Nos. 5305.0 and 5306.0, Canberra, various issues.

3.37 The incidence of short-term borrowing, as defined as drawings with a term of one year or less, in Australia's total overseas debt increased markedly over the 1980s. This trend is depicted in Figure 3.5. In 1981 less than half of the overseas debt had a term of one year or less. This proportion jumped rapidly in the mid-1980s to around 85 per cent, and has been at such levels since. This means that the turnover of foreign loans is now extremely high.

Figure 3.5 Short-Term Borrowing as a Proportion of Total Foreign Debt, 1981 to 1991



Source: Derived from statistics published by the Australian Bureau of Statistics.

3.38 Some indication of the seriousness of Australia's overseas debt problem is given by comparing the relative size of our foreign debt with those of a number of other countries. Such international comparisons for the end of 1987 are given in Table 3.13.

Table 3.13 International Comparisons of Gross Foreign Debt, End-1987

Country	Proportion of GDP (per cent)	Country	Proportion of GDP (per cent)
Chile	114	Sweden	39
Ireland	96		
Israel	89	<b>Australia</b>	<b>38</b>
Philippines	85		
Argentina	82	Canada	38
Malaysia	80	United Kingdom	29
Denmark	74	South Africa	28
Mexico	74	Singapore	28
New Zealand	70	Germany <sup>(a)</sup>	16
Portugal	65	Switzerland	15
Indonesia	64	Spain	14
Norway	56	Taiwan	14
Turkey	51	Italy	13
Greece	45	United States	
Finland	44	of America	13
Belgium	41	Austria	10
South Korea	41	Netherlands	9
Thailand	41	France	8
Brazil	39	Japan	8

(a) The data for Germany refer to West Germany, ie the Federal Republic of Germany before the reunification of East and West Germany.

Source: Morgan Guaranty Trust Company, Annual Report 1987, Morgan International Data, New York, March 1988; and World Bank, World Debt Tables.

**3.39** Australia's overseas debt represents a similar proportion of GDP to the overseas debts of Brazil, Sweden and Canada. Australia was ranked 21 out of the 35 countries shown in Table 3.13.

**3.40** While Australia's foreign debt to GDP ratio is comparable with many smaller OECD countries (such as Sweden and Canada), it is certainly much higher than the major OECD economies, these being the United States of America, Japan, the United Kingdom, Germany and France. The key point is that Australia's foreign debt position deteriorated at a faster rate over the last decade than was the case in many other nations.

#### The Impact of Changes in the Capital Account on the Current Account

**3.41** In a balance of payments framework, a current account deficit means a capital account surplus by definition. A key policy issue, however, is whether or not Australia's growing current account deficit is primarily the result of growing capital inflows to Australia that have produced an increased surplus on the capital account.

**3.42** This issue is of vital importance to Australia's future and to the emphasis which is given to Australia's international trade in goods and services relative to that given to Australia's foreign investment and overseas debt situation in the debate about policies to be deployed to reduce the current account deficit.

**3.43** The *prima facie* evidence is that growing capital inflows have been associated with increased current account deficits. The massive increase in foreign investment inflows to Australia during the 1980s was principally due to large increases in overseas debt rather than to significant increases in foreign ownership of Australian assets and enterprises. In this situation the large increases in debt, particularly short-term debt, have led to greatly increased debt servicing payments overseas which of course show up in the current account as increased pressures on the deficit.

**3.44** This situation is depicted in Table 3.14, which shows the interest burden associated with the growing level of overseas debt. Interest payments rose from a base of around 1 per cent of GDP to almost 4 per cent of GDP over the past decade. By 1989-90 interest payments on the overseas debt exceeded \$14 billion.

Table 3.14 Interest on Australia's Gross Foreign Debt,  
1981-82 to 1989-90

Year	Interest on gross foreign debt (\$ million)	Proportion of GDP (per cent)	Proportion of total current account deficit (per cent)
1981-82	1,839	1.2	20.2
1982-83	2,839	1.7	41.8
1983-84	3,705	1.9	51.3
1984-85	5,297	2.5	46.7
1985-86	6,550	2.7	44.8
1986-87	7,784	2.9	63.1
1987-88	8,855	3.0	78.5
1988-89	10,801	3.2	58.3
1989-90	14,244	3.8	63.9

Source: Australian Bureau of Statistics, *Foreign Investment, Australia*, Cat. Nos. 5305.0, 5306.0 and 5307.0, Canberra, various issues; and Australian Bureau of Statistics, *Balance of Payments, Australia*, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

3.45 The interest burden in servicing the foreign debt became the dominant element of the current account deficit during the 1980s. Interest payments grew from 20 per cent of the total current account deficit at the beginning of the 1980s to reach a peak of almost 80 per cent of the current account deficit by 1987-88. In 1989-90 the current account deficit was still dominated by interest payments which made up almost two-thirds of the deficit. This provides a strong case for those who argue that the capital account is indeed driving the current account.

#### The Changing Nature of Australia's Foreign Liabilities

3.46 Australia's reliance on overseas borrowing increased markedly over the 1980s, largely due to Australia's private sector and public business enterprises turning to foreign savings as the major source of industry investment since the deregulation of finance markets.

3.47 These increased borrowings culminated in a more than tenfold increase in Australia's overseas debt during the 1980s. The overseas debt grew from 11 per cent of GDP in 1980 to over 40 per cent of GDP by the end of the decade.

3.48 This increase represents a major change in the nature of Australia's foreign liabilities. At the beginning of the decade Australia's foreign liabilities were dominated by equity investments in Australia culminating in the foreign ownership of many businesses operating in Australia and of other Australian assets. By the end of the decade, however, overseas debt represented almost two-thirds of our total foreign liabilities. Some of this overseas debt appears to have financed investments

of a speculative nature that may not have led to any productive outcomes for Australia. Part of the borrowings may also have been used to finance consumption rather than investment.

## CHAPTER 4

### THE POLICY APPROACH OVER THE 1980s TO THE PRESENT

4.1 Most major economic policies either impacted on or were directed at, amongst other things, the current account deficit over the 1980s. With the massive growth of Australia's overseas debt over the 1980s this increasingly became an issue of policy concern.

4.2 In the context of the current account deficit and foreign debt the major policy areas which have been identified are tariffs and industry protection; Australia's multilateral, bilateral and regional trade policies; export incentives and subsidies, deregulation of financial markets, the floating exchange rate policy, fiscal policy, interest rates and monetary policy, incomes policy and microeconomic reforms. Each of these areas is considered in turn.

#### A Continuation of Tariff Reforms

4.3 Over the 1980s the Government continued with the policy of dismantling tariffs and industry protection, with the avowed aim of increasing Australia's ability to compete on international markets. Such policies have, of course, also been directed towards ensuring consumers pay prices for goods and services that are not inflated by protectionist policies.

4.4 An indication of the progress that has been made towards reducing industry protection in Australia over the past decade is given in Table 4.1. Effective rates of assistance across Australia's manufacturing industries fell from 22 per cent in 1984-85 to some 17 per cent by 1988-89. The most notable reductions in manufacturing protection over this period were in the clothing and footwear; transport equipment; other machinery and equipment; and food, beverages and tobacco industries.

4.5 A continuation of efforts to lower tariff barriers is the cornerstone of Australia's policy to lower industry protection. The justification for such efforts has always been couched in terms of the promotion of more efficient Australian industries which are better able to compete in global markets.

Table 4.1 Manufacturing Industries Protection, 1984-85 and 1988-89

Industry	Average effective rates of assistance	
	1984-85	1988-89 (per cent)
Food, beverages & tobacco	6	3
Textiles	75	74
Clothing & footwear	250	168
Wood products & furniture	17	16
Paper and printing products	16	13
- Paper products	30	29
- Printing	12	8
Chemicals, etc	12	13
- Basic chemicals	28	20
- Other chemicals	11	16
Non-metal mineral products	12	11
Basic metal products	10	9
Fabricated metal products	22	20
Transport equipment	68	38
Other machinery & equipment	23	19
Miscellaneous manufactures	25	24
Total manufacturing	22	17

Source: Bureau of Industry Economics (BIE), *Manufacturing Trade Performance*, Attachment to the Submission of the Department of Industry, Technology and Commerce (Submission No. 67, page 1578).

4.6 The Government recently spelt out its agenda to further reduce tariffs over the coming decade. In the industry statement of 12 March 1991 (*Building a Competitive Australia, 12 March 1991*, Australian Government Publishing Service, Canberra), the Government committed itself to continuing its policy of phased reductions in tariffs. Reductions down to 5 per cent by 1 July 1996 were announced. This policy is aimed at ensuring reductions in the nominal and effective rates of assistance to the manufacturing industry to 3 per cent and 5 per cent, respectively, by the end of the decade.

4.7 To achieve these reductions the current policy is aimed at a reduction in the nominal rate of assistance to the manufacturing sector to 8 per cent by 1992 and at a reduction in the effective rate of assistance to the manufacturing sector to 12 per cent by 1992.

4.8 The current policy is also geared towards reductions in general agricultural assistance in line with the pace of tariff reforms in manufacturing. The Government announced its intention to ensure that tariffs on general agricultural products are phased down to 5 per cent by 1 July 1996.

4.9 The Government has also committed itself to a policy of phasing out or reviewing all bounties by 1995. Upon their renewal bounty rates will be set to fall in line with the fall in tariffs.

4.10 Tariff reforms in the motor vehicle and textile, clothing and footwear industries feature heavily in the Government's tariff reduction plans. These industries have been the subject of very high rates of tariff protection.

4.11 Current tariff arrangements for the motor vehicle industry will be maintained until the end of 1992. Thereafter, the Government intends to reduce such tariffs from 35 per cent in 1992 to 15 per cent by the year 2000.

4.12 Accelerated tariff reductions on textiles, clothing and footwear are planned to ensure that the maximum tariff will be no more than 25 per cent by the year 2000. In these industries quotas will be terminated by 1 March 1992 and bounties will be abolished by 1 July 1995.

4.13 The main rationale of policies of reduction and phasing out of industry protection is to improve Australia's industry competitiveness in order to improve Australia's ability to export competitively to global markets. Clearly such policies also impact on the Australian economy by opening up Australia's domestic markets to imports.

4.14 Reductions in industry protection appear to have had a relatively small impact to date on the overall size of the current account deficit. The ratios of exports and imports to GDP changed little over the 1980s, although Australia's reliance on traditional commodity exports has begun to fall and the export of manufactures is on the increase. The composition of changes in exports and imports was discussed in Chapter 2. It is, of course, unreasonable to expect that the full impact of anticipated benefits of reduced protection in improving Australia's trade performance would have been felt yet. The major benefits of the policy are more likely to be felt in the medium to long term.

4.15 The Industry Commission (IC) has estimated that the gains to the Australian economy of abolishing all tariffs, quotas and bounty assistance to Australia's rural and manufacturing industries will total some \$3.7 billion over the next decade. This of course also represents a cost in the short term to the industries that have been sheltered by protection. It should also be recognised that such policies have regional economic implications whereby some regions will suffer industry and employment losses as a result of further reducing and ultimately abolishing protection.

## Promoting a Reduction in Barriers to International Trade

4.16 The emphasis in Australia's multilateral trade policy over the 1980s was on taking an active stance against the existence of protectionist trade policies in other countries, and on promoting freer international trade. This was particularly so with respect to reducing protection of agricultural industries. This remains the policy emphasis.

4.17 The existence of distortionary trade policies, particularly with respect to agricultural commodities and products, has adversely affected Australia's trading performance. The Common Agricultural Policy (CAP) of the European Community (EC) has stimulated over-production and depressed world prices. This has adversely affected the economic welfare of the EC itself through the distortionary prices for food paid by European consumers and the policy has severely limited the trade opportunities of more efficient agricultural producers such as Australia.

4.18 Australia's trade performance has also been adversely affected by the agricultural subsidies and protectionist policies of other countries such as Japan and the United States. For instance, the Australian Bureau of Agricultural and Resource Economics (ABARE) estimates of the effects of Japanese agricultural policies on the international beef trade are that world beef prices are 7 per cent lower and the volume of world trade in beef is 27 per cent lower than it would have been if the Japanese market was open to free trade in beef.

4.19 Australia's policy stance, over the 1980s to the present, has been to consistently stress the importance of an open-rules trading system. Australia has been amongst the most active participants in efforts within the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) to revitalise and strengthen the GATT system. These endeavours cover multilateral trade policy on manufactures and services as well as trade in agricultural and basic commodities.

4.20 In this context Australia was instrumental in developing cooperation with like-minded countries in the formation of the Cairns Group. The Cairns Group brought together a range of countries from differing political and economic backgrounds in the common cause of reform to agricultural trade. Australia has also participated in a range of other similar forums such as the Rolle Group which is focussed on negotiations on trade in services.

4.21 Over the 1980s Australia also played a major role in developing new trade relationships with nations in our region. The Closer Economic Relations Agreement (CER) with New Zealand is an important example of one such policy which, through intensive development in the late 1970s and 1980s, has transformed Australia-New Zealand trade relationships.

4.22 In 1989 the Australian Government was active in initiating a process of regional economic cooperation in the Asia-Pacific region. The Asia-Pacific Economic Cooperation (APEC) initiative is a high level consultative process designed to identify and project more effectively the common interests of Asia-Pacific

countries in an open multilateral trading system. Tangible results from APEC are yet to be realised, although there has been considerable agreement over the past two years on principles of cooperation and a framework with which to improve cooperation.

4.23 Over the 1980s Australia's bilateral trade policy focussed on the Asia-Pacific region with increasing emphasis on North Asia. In total, Australia currently has bilateral trade agreements with over 30 countries. Increasing emphasis in bilateral trade agreements over the 1980s was given to promoting conditions for freer international trade. To date Australia has resisted any moves to join a trading bloc with the North American countries.

## Assistance for Expanding Australia's Exports

4.24 Australia has a policy of providing some assistance to industry in the context of promoting trade. Over the 1980s this policy was almost exclusively focussed on export development with an emphasis on export marketing and promotion. It is only in recent years that some attention has been given to import replacement, although measures to assist such developments remain sparse.

4.25 Industry assistance to expand Australia's exports is heavily focussed on the activities and programs of the Australian Trade Commission (AUSTRADE). The Committee notes that AUSTRADE has been under some scrutiny, including a review in 1990 by the consulting firm, McKinsey & Company. AUSTRADE operates to encourage the integration of Australian business into the global economy and to improve the capability of Australian industry to create and capitalise on international business opportunities, particularly in developing export markets. AUSTRADE activities fall into the following six areas - national operations, international operations, export strategies, export assistance schemes, export finance and insurance and international projects. Ministerial trade missions are also an important means of focussing on trade matters.

4.26 Within Australia AUSTRADE operates a national network that is aimed at providing information and export planning services to Australian businesses that are or wish to be involved in international trade. These services include the provision of consultative services at the company level through the Company Export Planning (CEP) process, the provision of comprehensive international trade intelligence through the AUSTRADE Trade Opportunities Program (TOP) and the organisation of trade promotion activities under the Market Entry Program (MEP).

4.27 AUSTRADE conducts its international operations through offices located in many overseas countries. The services provided by this network include implementing overseas marketing programs, collection and distribution of market information and intelligence and the provision of support to those developing trade markets in the countries of operation.

**4.28** AUSTRADE provides assistance in the development of export strategies aimed at export marketing to increase export earnings over a three to ten year time frame. Such export strategies which have recently been developed, or are currently being developed with the assistance of AUSTRADE, include textiles, tanning, carpets, fashion apparel, footwear, fruit and vegetables, processed food, railways technology, agricultural systems, automotive industries, ships and boats, coal mining systems, scientific and medical equipment, information industries, aerospace, defence equipment, education and training services, hospital and medical services, popular music, visual arts and building products. The strategies have been focussed on export promotion through market entry to new overseas markets.

**4.29** AUSTRADE has responsibility for two main export assistance schemes. The International Trade Enhancement Scheme (ITES) which began in July 1990, provides low interest loan and concessional services support to Australian individuals, firms, consortiums and industry associations to help develop their international business activities. The Scheme is directed towards activities which will result in substantial expansion of international business; activities which will result in new markets, new products and services; and joint ventures, consortiums and associations where these arrangements will permit efficiency gains, or where firms lack sufficient resources for international business. ITES will run for four years with \$15.9 million for 1990-91 and \$21.9 million in the following three years.

**4.30** AUSTRADE also operates the Export Market Development Grants Scheme (EMDGS) which has expanded in recent years to the point where in 1990-91 some \$162 million of assistance was provided to over 3,000 claimants. Expenditure of \$134 million on EMDGS is expected in 1991-92. The aim of EMDGS is to encourage Australian exporters to seek out and develop overseas markets for goods and specified services. Taxable cash grants are available to exporters covering up-front market costs such as travel expenses, promotional literature and overseas representation.

**4.31** Australia's export finance and insurance services are provided by the Export Finance and Insurance Corporation (EFIC). These insurance services and financial guarantees totalled more than \$6 billion in 1989-90. The insurance services and financial guarantees of EFIC fell to around \$4.5 billion in 1990-91 reflecting, in large part, the state of the world wheat market, events in the Gulf and the continued effects of the wool market collapse.

**4.32** AUSTRADE's international projects relate to specific assistance to Australian firms seeking to offer consultancy services or equipment to international projects such as those run by the World Bank and the Asian Development Bank. This assistance includes interest-free loans under the Project Marketing Loans Facility (PMLF). During 1990-91 loans of \$0.54 million were approved.

**4.33** Another important measure designed to promote Australian exports is the Development Import Finance Facility (DIFF). DIFF is administered by the Australian International Development Assistance Bureau (AIDAB) as part of Australia's overseas aid program. DIFF is a mixed credit financing scheme which

provides soft funding such as low interest, long-term loans to developing countries wishing to purchase Australian goods and services. DIFF provides assistance to Third World and developing countries to effectively reduce the cost of goods and services sold by Australian exporters to such countries. DIFF helps to expand Australia's trade beyond traditional export markets.

**4.34** DIFF is an expanding source of export assistance. Disbursements of some \$83.8 million were made under DIFF in 1990-91, out of a total overseas aid budget of almost \$1.3 billion. Some \$93 million worth of disbursements are planned for 1991-92 out of a total aid budget of just over \$1.3 billion.

**4.35** The Government, through initiatives administered by the Department of Industry, Technology and Commerce (DITAC) has implemented a number of other policies designed to promote the development of Australian industry with spin-offs for enhanced exports. These policies, in addition to tariff reform, include the Australian Civil Offsets Program, the National Industry Extension Service (NIES) and industry restructuring and development programs.

**4.36** The Australian Civil Offsets Program requires overseas suppliers to Commonwealth and State and Territory governments to offset a percentage of business to Australian industry through high technology export-oriented activities. Government estimates are that the program results in approximately \$350 million of activity each year, of which some \$130 million is in the aerospace sector.

**4.37** NIES aims to assist firms in the goods and services sectors to become internationally competitive by improving their internal efficiencies. NIES provides a range of programs including diagnostic assessment, business planning, advanced manufacturing technologies, human resources, product innovation, cost management, product quality and export strategies. The Commonwealth budget for NIES was \$15.5 million in 1990-91, of which \$10.5 million was paid directly to States and Territories under bilateral funding arrangements. The budget allocation for 1991-92 is \$17.3 million, of which \$10.8 million is allocated for the States and Territories.

**4.38** A number of industry restructuring and development plans are currently in place. These plans are directed at facilitating the reorientation of established industries towards global exports and specialisation, at developing value-added exports in the case of natural resource-based industries or at facilitating the development of new industries in Australia.

**4.39** The major industry plans aimed at the restructuring of established industries are the Steel Plan; the Passenger Motor Vehicle Plan; the Textiles, Clothing and Footwear Plan and the Metal-Based Engineering Program.

**4.40** The major areas of focus in the development of value-added products in Australia's natural resource-based industries are Forest Products and Printing, Processed Foods; and Minerals Processing and Chemicals.

**4.41** The focus in the area of new industries programs is with the Information Industries Strategy, the Pharmaceutical Industry Development Program, the Scientific and Medical Equipment Strategy and the Aerospace Industry Strategy.

**4.42** Another feature of Australia's policy approach to encouraging investment and production, including export industries, is a range of concessional taxation arrangements designed to assist Australian industries. These measures include exemptions from sales tax for some business inputs, overhauled depreciation provisions designed to provide taxation savings for business investment in plant and equipment, full deductibility of expenditure on environment impact studies in order to assist new business development and a 150 per cent tax concession scheme to encourage research and development.

**4.43** The latter initiative complements the Grants for Industry Research and Development (GIRD) scheme which provides grants for research and development in a range of areas to promote industry development.

#### Deregulation of Finance Markets

**4.44** Controls on overseas portfolio investments and on equity and real estate investments overseas were lifted in 1980 and 1981. The bulk of remaining exchange controls were removed in 1983. This was a significant change in Australia's economic policy framework. Prior to that time capital inflows to Australia and outflows from Australia were subject to a range of restrictions and controls.

**4.45** Controls on capital outflows were severe and restrictive, whereas controls on capital inflows tended to change according to perceptions of Australia's requirements for foreign investment. For instance, at various times before deregulation of financial markets, embargoes on foreign borrowing were introduced for specific periods of time to stem capital inflows. Other less severe restrictions were also used to discourage foreign borrowing, such as the variable deposit requirement which increased the cost of such borrowing.

**4.46** There can be little doubt that the termination of exchange controls has had a major impact on the level of Australia's overseas debt and on the current account deficit.

**4.47** The removal of exchange controls has given Australian residents, companies and governments far greater access to foreign savings. Capital inflows to Australia over the 1980s more than doubled as a proportion of GDP from inflows in previous decades. Overseas borrowings replaced equity investment as the predominant form of foreign investment in Australia over the 1980s and the level of foreign debt increased more than tenfold in nominal terms over the decade.

**4.48** The removal of exchange controls has also facilitated a rapid increase in capital outflows, largely in the form of Australian private sector equity investment abroad. Non-official capital outflows averaged 0.5 per cent of GDP in the first half of the 1980s, but rose to an average of 2.5 per cent of GDP by the second half of the decade. This unprecedented level of equity investment overseas has been largely financed by foreign borrowing. Estimates of the impact of this change alone on Australia's foreign debt are that the net foreign debt would have been some \$40 billion lower at the end of the 1980s had there not been an upsurge in Australian equity investment abroad.

**4.49** The impact of these developments on the current account deficit has also been dramatic. Interest payments overseas to service foreign debt rose from 1.2 per cent of GDP in 1981-82 to 3.8 per cent of GDP by 1989-90. Such payments contributed to only 20.2 per cent of the current account deficit in the early 1980s, whereas almost two-thirds of the current account deficit was due to overseas interest payments by the end of the 1980s.

**4.50** The objective of removing restrictions on access to foreign capital to increase investment in the Australian economy underpinned the rationale for the deregulation of financial markets. The Government also wished to remove any distortions to investment decisions imposed by restrictions to offshore investments by Australians.

**4.51** In conjunction with deregulation the Government established an Investment Promotion Program (IPP) in 1987. The IPP is designed to increase the effectiveness of Australia's efforts to encourage foreign investment in Australian industry. Australia is promoted through AUSTRADE as an attractive investment proposition to potential foreign investors. The budget for IPP was around \$6.4 million for 1990-91, with \$6.8 million being allocated for 1991-92.

**4.52** The overall result was that foreign investment in Australia has increased markedly. It was recognised at the time that such increases would produce a short-term deterioration in the current account deficit. It remains to be seen, however, to what degree the investment boom of the 1980s will actually lead to offsetting positive results in reducing the current account through increased exports and greater import replacement.

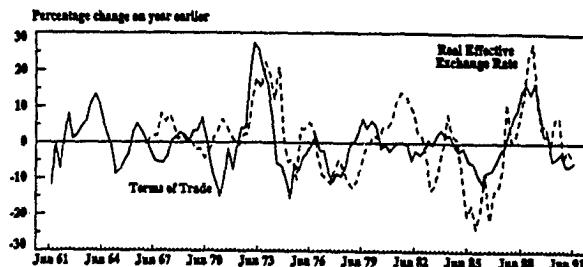
#### The Floating Exchange Rate

**4.53** Coupled with the removal of restrictions on capital inflows and outflows, the decision by the Government to float the Australian dollar in December 1983 was another significant change in the direction of economic policy in the 1980s. Prior to deregulation, Australia had a managed exchange rate system, where the Australian dollar was linked to the trade weighted average value of its main trading partners. Variations in the value of the Australian dollar were made within parameters set by a committee of officials which reported to Cabinet.

4.54 The notion that, under a pegged exchange rate policy, the Australian dollar was overvalued and not sufficiently responsive to changes in international economic circumstances was an important rationale underpinning the decision to float the Australian dollar.

4.55 As can be seen in Figure 4.1, the exchange rate did fall significantly in the period after the Australian dollar was floated. This fall occurred at the same time as a similar fall in the terms of trade (which is the index of export prices to import prices). The fall in the terms of trade over 1986 and 1987 contributed to a merchandise trade deficit over the period. This appears to have had the effect of offsetting any beneficial pressures on the current account deficit that might otherwise have resulted from the depreciating Australian dollar between 1984 and 1986.

Figure 4.1 The Real Exchange Rate and the Terms of Trade, 1961 to 1991



Source: Australian Government, *Budget Statements 1991-92, Budget Paper No. 1*, Australian Government Publishing Service, Canberra 1991.

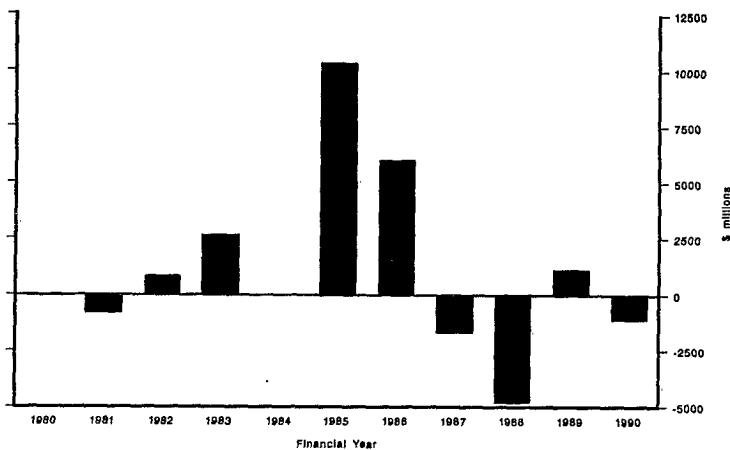
4.56 The Australian dollar has since appreciated and the terms of trade have improved. The experience since the floating of the Australian dollar suggests strongly that exchange rate adjustments to external pressures, such as export price shocks and changes in relative interest rates between Australia and those countries from whom we borrow and who we trade with, now occurs more quickly. Changes in the exchange rate appear to be more closely related to changes in the terms of trade since the float of the Australian dollar.

4.57 However, the volatility of the Australian dollar exchange rate has increased significantly since its deregulation and the removal of exchange controls. On a trade weighted basis the Australian dollar exchange rate is also now more volatile than the exchange rates of the currencies of most of our trading partners. The Australian dollar is also now one of the world's most traded currencies. In the ten months from September 1990 to June 1991 the daily average foreign exchange turnover against Australian dollars was \$18,053 million, which represents 35 per cent of the annual value of exports in 1990-91. This turnover is clearly enormous in comparison with Australia's foreign exchange requirements for trade, interest payments and foreign investment.

4.58 Exchange rate changes have also impacted on the current account deficit and the level of overseas debt in other ways. The growing level of overseas debt and the dominance of debt servicing payments as the major factor in the current account, now means that the impact of exchange rate changes can be considerable on the Australian dollar value of the level of overseas debt and the interest payments in the current account deficit.

4.59 As shown in Figure 4.2, the falling exchange rate of the Australian dollar accelerated the level of debt growth considerably. The appreciation of the Australian dollar since has served to offset this trend. These exchange rate risks on the level of debt, with flow-on effects to the current account, exist because some two-thirds of Australia's foreign debt is denominated in foreign currencies.

Figure 4.2 The Contribution of Exchange Rate Movements to the Level of Gross Foreign Debt, 1980 to 1990



Source: Derived from statistics published by the Australian Bureau of Statistics.

#### Fiscal Surpluses and the Twin Deficits Approach

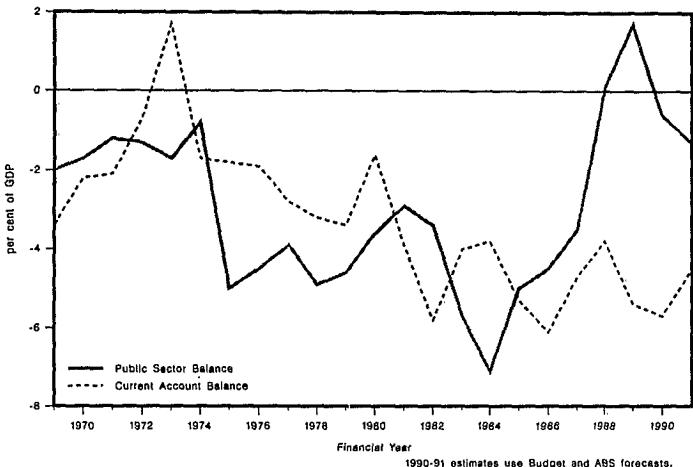
4.60 In the early part of the 1980s Australia experienced a moderately expansionary fiscal policy and an increasing current account deficit.

4.61 This and similar experiences in some other economies gave rise to the "twin deficits" hypothesis. Put simply it was argued that fiscal deficits drive the current account deficit, in that reductions in the fiscal deficit are prerequisite to reductions in the current account deficit. The basis of the "twin deficits" hypothesis is that an expansionary fiscal policy, if not financed by higher taxes, would be financed by higher levels of borrowing particularly from overseas. The servicing of increased public sector borrowings from overseas would then add to the current account deficit.

4.62 The key fiscal policy consideration by the mid-1980s was to generate fiscal surpluses in order to reduce the public sector's impact on the current account deficit. This stance gained credence with the Australian Treasury in the 1980s and it formed the rationale for the fiscal surpluses generated since the mid-1980s.

4.63 However, clearly the relationship between a fiscal surplus and the current account that is implied by the "twin deficits" hypothesis was not borne out by the Australian experience over the 1980s. Public sector fiscal surpluses were consistently generated over the second half of the 1980s, yet the current account deficit grew. Trends in public sector borrowing and the current account deficit are shown in Figure 4.3.

Figure 4.3 Public Sector Borrowing and the Current Account Deficit, 1970 to 1990



Source: Derived from statistics published by the Australian Bureau of Statistics.

4.64 The assumption behind the "twin deficits" hypothesis is that private sector saving and investment remain unchanged. It is evident in the Australian context that any expected reduction in the current account deficit which could be attributed to fiscal surpluses has been more than offset by the effects of rapid increases in overseas borrowings by the private sector. This would have the effect of culminating in an increase in the current account deficit due to increased debt servicing obligations.

#### High Interest Rates

4.65 Deregulation of the financial system has left interest rates as the dominant instrument of monetary policy, deregulation of course having removed the former system of quantitative controls over the money supply.

4.66 In the second half of the 1980s, the emphasis in monetary policy switched to high interest rates in an attempt to reduce inflationary pressures in the Australian economy. The intention was to dampen demand in the Australian economy, including the demand for imports.

4.67 Apart from having produced beneficial effects on inflation, it was hoped that the high interest rates would also reduce the current account deficit through a fall in imports. It seems, however, that the tighter settings in monetary policy through higher interest rates contributed to an appreciation of the Australian dollar at that time which eroded, at least in part, the benefits higher interest rates were expected to have on reducing the demand for imports.

4.68 High interest rates appear to have contributed to a deterioration in the current account in a much more significant way through a contribution to an increase on the debit side of the income balance. Differences between domestic interest rates and overseas interest rates have contributed to making overseas investment in Australia a more attractive proposition. Moreover, Australian corporations and banks have been attracted to overseas capital markets because of the higher interest rates associated with domestic capital markets. These trends, through an increase in overseas debt and the consequent increase in debt servicing obligations, have had an adverse effect on the current account deficit.

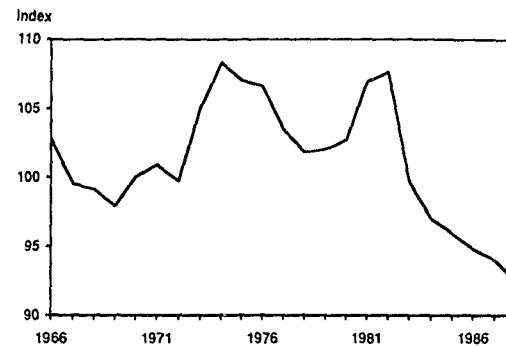
#### Wage Restraint Through the Accord and Productivity

4.69 One of the key reasons for the emphasis on wage restraint in Australia over the 1980s was the desire to bring labour costs in Australia more into line with those of our major trading partners, in order to improve Australia's international competitiveness.

4.70 The downward trend in real labour costs over the 1980s is shown in Figure 4.4. Average real unit labour costs, in the non-farm corporate sector, have declined in a significant and sustained way since the early 1980s. This pattern was very different from that found for the 1970s where real unit labour costs rose significantly to the mid-1970s before falling over the second half of the 1970s.

Another sharp rise occurred for the period 1979 to 1981, prior to the sustained falls of the 1980s.

Figure 4.4 Average Real Unit Labour Costs, Private Non-farm Corporate Sector, 1966 to 1988

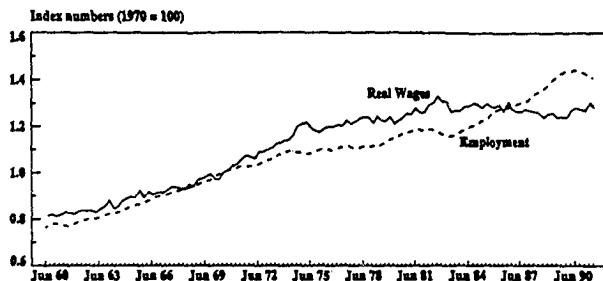


Source: Chapman, B, "The Labour Market" in Grenville, S (ed), The Australian Macroeconomy in the 1980s, Research Department, Reserve Bank of Australia, June 1990.

4.71 This result is largely attributable to the incomes policy under the Accord which commenced in 1983. By the end of the 1980s most commentators agreed that the Accord had been an influential instrument for aggregate wage restraint in the Australian economy. It should be noted that similar restraint has not been exercised in the remuneration of company executives. It has also been argued that another consequence of the Accord has been an erosion of income differentials for skills.

4.72 The result has been to arrest the long-term growth in real wages that was evident in Australia throughout the 1960s and 1970s. As shown in Figure 4.5, real wages in Australia began to fall during the 1980s. This was associated with a period of record employment growth.

Figure 4.5 Real Wages and Employment, 1960 to 1990



Source: Australian Government, Budget Statements 1991-92, Budget Paper No. 1, Australian Government Publishing Service, Canberra 1991.

4.73 However, the Accord has been less successful in producing an acceleration in the rate of increase in labour productivity to a level where the rate of growth in labour productivity in Australia exceeds that of our major trading partners. As shown in Table 4.2, Australia's labour productivity grew at a lower rate over the 1980s than in most other OECD countries. It should be noted though that Australia had very strong employment growth compared with other OECD countries which bears on the measurement of labour productivity.

Table 4.2 International Comparisons of Labour Productivity in the Business Sector, 1979 to 1989

Country	Annual average percentage change in output per employed person 1979 to 1989 (per cent)
Finland	3.8
Spain	3.3
Japan	3.0
France	2.6
Belgium	2.4
Denmark	2.1
Italy	2.1
United Kingdom	2.1
Austria	2.0
New Zealand	1.8
Sweden	1.7
Germany <sup>(a)</sup>	1.6
Switzerland	1.6
Netherlands	1.5
Canada	1.4
Australia	1.1
United States	0.8
Norway	0.6
Greece	0.4
Average OECD	2.1

(a) The data for Germany refer to West Germany, ie the Federal Republic of Germany before the reunification of East and West Germany.

Source: Organisation for Economic Co-operation and Development (OECD), The OECD Economic Outlook, 49, July 1991, Paris.

4.74 Nonetheless, the main impact of incomes policies is generally thought to have been on targeting domestic policy goals, with only marginal implications on the current account balance through effects on the profitability of export and import competing sectors by way of lower increases in wage costs. Wage restraint might also have had some impact in constraining the demand for imports.

## **Microeconomic Reforms**

**4.75** An important policy emphasis is an agenda of microeconomic reforms aimed at the dismantling of barriers to efficiency and competitiveness that exist within Australia. One of the important aims of such reforms is to increase Australia's relative cost competitiveness in relation to the rest of the world. Such reforms are aimed at contributing to an enhancement of Australia's trade performance, thereby lowering the current account deficit.

**4.76** Exposure to international competition, the removal of domestic regulation and improvements in productivity are seen as the most effective means of securing greater responsiveness in the Australian economy to change. The rationale of the microeconomic reform policy approach that has been adopted reflects a recognition that the provision of assistance to one industry can impose costs on others which can impede the development of activities which would otherwise be internationally competitive. The aim of microeconomic reforms in trade and industry policy in recent years has therefore been to move to a lower, neutral and more transparent assistance regime in order to develop an economy with fewer distortions and impediments.

**4.77** In addition to the reductions in tariff and forms of industry protection that were discussed earlier, many far reaching microeconomic reforms are being attempted. The package of reforms on the agenda include shipping, bulk commodity handling, rail and road transport, domestic aviation, post and telecommunications and electricity supply utilities. Changes in the Australian labour market and to Australia's education and training system are also underway.

**4.78** Reforms to shipping are directed at ensuring coastal shipping is cheaper and exposed to more competition, particularly from overseas. International shipping to and from Australia is also included. These reforms are complemented by attempts to achieve a more efficient waterfront with reduced shipping delays at ports.

**4.79** Reforms in the area of bulk commodity handling, particularly for the bulk handling of wheat and coal, are specifically directed at reducing costs in major export industries. Reforms include those in grain storage, transport and handling aimed at reducing the farm-wharf transport cost margin. Significant savings on rail freight for coal are also sought.

**4.80** In the rail transport area significant reductions in costs in freight and passenger rail services are on the agenda through cuts to workforces, rationalisation of rail services and efforts to achieve a national rail freight service.

**4.81** Airline deregulation is geared towards labour and capital productivity gains through increased competition.

**4.82** Reforms to road transport include improved road construction and maintenance through changes to taxation and levies aimed at recovering revenue from the road transport industry.

**4.83** Reforms in the post and telecommunications industry are aimed at price reductions being achieved through productivity gains and increased competition in some areas.

**4.84** Reforms in the electricity supply utilities around Australia are aimed at reduced unit labour requirements, reformed work practices and pricing policies based on greater competition.

**4.85** Reforms have also taken place in many other government business enterprises. The emphasis is on increased productivity, greater competition and other changes geared towards greater market orientation.

**4.86** Considerable progress has been made towards improving Australia's industrial relations system, particularly with respect to overhauling restrictive work practices. Real wages growth has been restrained and linked to productivity increases. New legislation has been enacted to encourage the rationalisation of union structures and the implementation of more flexible dispute settlement procedures. Greater enterprise-based bargaining is also on the agenda for labour market reforms.

**4.87** Continuing change is also underway in the area of education and training. The Government has focussed policy in this area towards the development of the skills needed in the economy to ensure Australia's ability to compete in global markets. In particular major changes have been made with regard to work-based training and steps requiring the involvement of industry to ensure that training is geared towards the required skills.

**4.88** Estimates by the IC put the impact of the real gains from the microeconomic reform process at a total of \$16 billion over the next 10 years, excluding those from the labour market reform process. The Business Council of Australia (BCA) points out that some recent studies suggest increases in productivity of up to 25 per cent could result from labour market reforms.

## **The Changing Policy Environment**

**4.89** The 1980s saw major changes in Australia's economic policy environment. The impact of these changes for the current account deficit and the level of overseas debt has, as a consequence, also been marked.

**4.90** The agenda of the early 1980s was dominated by a number of policy directions, not the least of which was a continuation of the process of promoting freer international trade in Australia's multilateral, bilateral and regional trade policies at the same time as pressing ahead with further reductions in industry

tariffs, quotas and bounty protection. Export marketing incentives and subsidy programs were persisted with over the 1980s.

4.91 The early to mid-1980s also saw significant changes in Australia's financial markets with deregulation and the introduction of a floating exchange rate for the Australian dollar.

4.92 Fiscal policy over the 1980s was considerably tighter than for any previous period, involving record and sustained budget surpluses, allowing the effect of the public sector borrowing on the current account to be considerably diminished.

4.93 Incomes policy based on an accord between the major industry partners and the Government was introduced in 1983 and has contributed to wage restraint and productivity improvements in the Australian economy. However, Australia's labour productivity grew at a lower rate over the 1980s than labour productivity in most of our trading partners, although Australia's employment growth outstripped that found in those countries.

4.94 More recently greater emphasis has been given to microeconomic reforms aimed at yielding enormous benefits to the Australian economy through eliminating costly barriers to efficiency and productivity.

4.95 The Australian approach to addressing the current account deficit and more recently the level of overseas debt, has largely been tied up in the macroeconomic policy settings of the 1980s which were primarily aimed at lowering inflation to rates more comparable with our major trading partners. Apart from reductions in industry protection, microeconomic policies have only recently become much more prominent.

## CHAPTER 5

### THE POLICY DEBATE

...THE POLICY DEBATE

5.1 With the increases in the current account deficit and the level of overseas debt over the 1980s, the ensuing policy debate about what to do to address these problems has first and foremost been about the macroeconomic policy settings and microeconomic reforms required to improve Australia's ability to compete successfully in international markets and to reduce Australia's increasing reliance on overseas borrowings for its investment capital.

5.2 Against the backdrop of the need for appropriate macroeconomic policy and necessary microeconomic reforms, the evidence to this inquiry over the approach to government assistance to improve Australia's trading performance and/or about whether or not any intervention is needed to effect the level of capital inflows to Australia has taken three main forms.

5.3 First are the arguments for re-establishing a highly regulated system that relies heavily on universal industry protection and assistance particularly through tariffs, capital inflow and outflow controls and other forms of across-the-board economic regulation and control.

5.4 Second are the arguments for free trade and deregulation with market forces determining the economic parameters of the Australian economy. This stance emphasises a rejection of government involvement, particularly through regulation and assistance of any kind.

5.5 Third are arguments for targeted forms of assistance that are directed towards industry development to improve Australia's trading position and to reduce our reliance on overseas capital, within the general context of a market-oriented economy. Under this approach targeted interventions are called for but universal regulation and protection is rejected.

#### Calls for Universal Regulation and Assistance

5.6 The proponents of a view which can be termed "new protectionism" argue that the main policy thrusts of the 1980s, which focussed on dismantling industry protection and the deregulation of financial markets, exchange controls and the exchange rate, have left Australia vulnerable and dangerously exposed to volatile fluctuations in international markets. These policies, they point out, have been

associated with large increases in the current account deficit and unprecedented levels of overseas debt. "New protectionists" also argue that these developments have increased Australia's dependence on imports and undermine the ability of the manufacturing sector to produce the full range of manufactures required to meet Australia's domestic needs. This has resulted in a decline in the number of smaller sized manufacturing firms in the Australian economy. A causal link between policies of low protection and deregulation and Australia's deteriorating current account and overseas debt situation is assumed.

5.7 According to "new protectionists", the policy developments of the 1980s have now left the Australian Government with few, if any, effective measures at its disposal with which to take corrective action when international economic trends work against Australia's long-term economic interests.

5.8 The proponents of "new protectionism" criticise Australia's recent trade policy as being "an obsession with free trade" that has worked against Australia's long-term economic interests. Put simply, the argument is that tariffs and other barriers to imports have been dismantled by Australia at a time when other countries have not implemented similar free trade policies, leaving Australian industry unprotected and exposed to a flood of cheaper imports from other countries which subsidise and protect their industries. It is also argued that the free trade policy has meant that opportunities for the bilateral negotiation of preferred access to many export markets have been lost.

5.9 This has led some groups in the Australian community to call for a reinstatement of a range of regulation and assistance measures designed to protect Australian industry to improve the trade balance, and to control exchange rates and the flow of capital into and out of Australia. It is only through such measures, they argue, that Australia's current account deficit and overseas debt levels can be reduced.

5.10 A key element of such an approach is to implement measures aimed at increasing exports and reducing Australia's reliance on imports. This is fundamental to sustained improvements in the current account. Re-regulation of the exchange rate is essential according to the "new protectionists". The Government could then devalue the Australian dollar, which it is argued is overvalued, in order to promote Australian exports and to reduce the demand for imports into Australia.

5.11 Policies to reduce tariffs should be halted or even reversed, according to the "new protectionist" view, in order to make imports relatively more expensive. They maintain other restrictions should also be enhanced or adopted. Enhanced and new quotas could be adopted to restrict the volume of imports coming into Australia. Import duties and surcharges could be levied to further raise the prices paid in Australia for imports. An import deposit scheme, the "new protectionists" maintain, could be considered which would require importers to lodge a certain proportion of the value of imports as a deposit with the Government for a period of time before it is repaid to importers, thereby discouraging imports through a reduction in the liquidity of importers. Import licensing arrangements can be instigated to restrict

the volume and type of imports coming into Australia. Import embargoes could even be considered if circumstances deteriorated to such an extent as to warrant such severe restrictions.

5.12 Such restrictive trade policies, it is argued, would improve Australia's trade balance and therefore would serve to reduce the current account deficit. The reasons for such a course of action are numerous according to the proponents of protection. First and foremost, universal protectionist policies constitute direct action to make imports more expensive relative to domestically produced goods and services. Such policies serve to counter any dumping of commodities on the Australian market by overseas exporters by making the price of the dumped commodity higher in Australia. Protectionist policies permit retaliation against restrictive practices imposed by other countries by ensuring that imports to Australia's domestic market are similarly restricted. Such policies would also serve to protect new industries until they are sufficiently well established to be able to compete on domestic and international markets and they can be used to protect key industries that are important for defence and national security purposes or that are important for other reasons such as the employment generated.

5.13 There have been numerous calls for exchange controls and the re-regulation of the exchange rate in order to address the level of Australia's overseas debt and the consequent debt servicing obligations which have blown out the current account deficit in recent years. The more than tenfold increase in Australia's overseas debt over the 1980s, it is argued, is principally due to financial deregulation policies.

5.14 A return to policies of either embargoes or restrictions on capital inflows and outflows where variable deposits involving a proportion of such capital flows are lodged with the Reserve Bank for a period of time have been called for. It is only through such policies and through similar controls on foreign ownership of Australian assets, that Australia's economic sovereignty can be guaranteed and that recent trends of rapidly rising overseas debt can be curtailed and reversed, argue the "new protectionists".

5.15 These protectionist and regulatory policies dominated the Australian policy approach until the early to mid-1970s, when the process of dismantling tariffs and reducing other universal industry protection began in Australia. It was not until 1983 that the exchange rate was deregulated and exchange controls were lifted. "New protectionists" are arguing for a complete reversal of these policy directions and a return to the policy approach that existed in Australia up until the 1970s.

#### Rejection of Regulation and Assistance

5.16 Economic policies over the past decade have been much more heavily influenced by approaches based on the rejection of regulation and assistance.

5.17 The overall direction of economic policy over the 1980s was towards what has been described as a "new classical" position. In the purest form of the "new classical" approach government regulation and assistance would be kept to a minimum or eliminated completely. Market forces are then able to operate in an unhindered way, with little or no invention by government.

5.18 Most of the major economic policy trends in Australia over the 1980s were consistent with the so-called "new classical" position. The most notable examples are the promotion of free international trade, the reduction of tariffs and other trade barriers, the floating of the Australian dollar, the deregulation of financial markets and the lifting of controls on the flows of capital to and from Australia.

5.19 A number of major reports in recent years in Australia have come out in favour of further pursuing a "new classical" line.

5.20 In particular the Garnaut Report (Australia and the Northeast Asian Ascendancy, Report to the Prime Minister and the Minister for Foreign Affairs and Trade, Australian Government Publishing Service, Canberra, 1989) argues very strongly for an approach which eliminates all forms of regulation and assistance as the basis for dealing with our balance of payments and foreign debt problems.

5.21 In respect of trade policy the Garnaut Report argues that:

Australia gains more in favourable trade policy changes abroad through pressing ahead with liberalisation, and so enhancing its capacity to lead in bilateral, regional and multi-lateral fora, than it would by waiting to strike a bargain. (Australia and the Northeast Asian Ascendancy, Report to the Prime Minister and the Minister for Foreign Affairs and Trade, Australian Government Publishing Service, Canberra, 1989, page 18)

and

Australia's poor productivity performance relative to other advanced countries over the past four decades is closely related to its parochial orientation. This results partly from geographic isolation but much more from regulatory barriers to trade, especially protection. ... The most important single step that can be taken to enhance export orientation and competitiveness is to complete the process of internationalisation and trade liberalisation that has been proceeding in recent years. The 1988 program of reduction in protection should be continued beyond 1992 with a view to removing all protection by the beginning of the twenty-first century. (Australia and the Northeast Asian Ascendancy, Report to the Prime Minister and the Minister for Foreign Affairs and Trade, Australian Government Publishing Service, Canberra, 1989, page 23)

5.22 To achieve an improvement in our trading position which will ease our current account deficit problems all forms of protection and industry assistance are rejected in the Garnaut Report.

5.23 A similar line was taken in the Hughes Report on improving Australia's export performance (Australia's Exports: Performance Obstacles and Issues of Assistance, Report of the Committee for Review of Export Market Development Assistance, Australian Government Publishing Service, Canberra, 1989). The Hughes Report argues that in the long term Australia's interests would be best served by an export-oriented economy with negligible protection. Hughes only differs from Garnaut by arguing for the continuation of export incentives for a further five years. The Hughes Report rejects regulation and protection and argues:

But although very substantial reductions of protection have been made in agriculture and manufacturing, protection still hinders exporters by raising the prices of domestically produced goods above world prices. Further reduction of protection will make substantial contributions to the competitiveness of Australian exporters and thus to the shift to exports. (Australia's Exports: Performance Obstacles and Issues of Assistance, Report of the Committee for Review of Export Market Development Assistance, Australian Government Publishing Service, Canberra, 1989, page xxii)

5.24 Even though the Hughes Report does argue that export assistance measures should continue for a further five years, the longer term approach it proposes is for the elimination of such assistance. The Hughes Report argues that:

It is widely recognised that export subsidies destroy the international trading environment and that they are particularly harmful to small countries. (Australia's Exports: Performance Obstacles and Issues of Assistance, Report of the Committee for Review of Export Market Development Assistance, Australian Government Publishing Service, Canberra, 1989, page xxiv)

5.25 Export subsidies, particularly production subsidies rather than marketing subsidies, are argued by Hughes to lead to a situation where resources are attracted towards subsidised firms and industries. This has the effect of a long-term misallocation of resources between sectors. These subsidies also often benefit foreigners. For small countries the financing of such subsidies is often through an expansion of the external debt. The impact on small countries can be even higher if retaliatory subsidy action is taken by trading partners.

5.26 The proponents of the "new classical" approach also consistently argue that dealing with the current account deficit and overseas debt problems effectively depends on continuing with deregulated financial markets and ensuring that such markets are able to operate without interference from government. For instance the Garnaut Report stated that:

Australia's external payments deficits are the result of investment exceeding savings, and high levels of capital inflows are necessary to finance those deficits ... [Therefore] restrictions on direct investment would increase reliance on foreign debt, which would render the economy more vulnerable in unfavourable economic circumstances. (Australia and the Northeast Asian Ascendancy, Report to the Prime Minister and the Minister for Foreign Affairs and Trade, Australian Government Publishing Service, Canberra, 1989, page 11)

and

Protection of Australian enterprises against competition from direct investment would only weaken Australian growth performance. (Australia and the Northeast Asian Ascendancy, Report to the Prime Minister and the Minister for Foreign Affairs and Trade, Australian Government Publishing Service, Canberra, 1989, page 12)

5.27 Some proponents of the "new classical" approach have gone as far as to question whether high current account deficits and high levels of foreign debt are problems that should concern the Government at all. Over the late 1980s there was growing interest in these arguments, known colloquially as the "Pitchford line" (after Professor Pitchford of the Australian National University who has led this debate in Australia).

5.28 The argument is that the current account deficit is largely the result of private capital inflows from overseas which are used to finance productive investment in the Australian economy which presumably will yield a sufficient return to service the debt. Furthermore, even if capital inflows were to be insufficient to finance the current account deficit, then under a floating exchange rate adjustments by way of currency depreciations would automatically occur to restore external balance.

5.29 Foreign debt, under this scenario, is not a problem providing it is private sector debt used for investment that can generate returns sufficient to service the debt. It is only when foreign debt is largely made up of public borrowings to finance public consumption that it becomes a "national burden" according to the proponents of the "new classical" approach. Issues relating to private sector foreign borrowings to finance consumption rather than investment, the consequences of poor investment decisions where returns are not sufficient to meet debt servicing obligations, or the consequences for Australia's economic sovereignty of increased overseas ownership of Australian enterprises and assets do not feature in arguments put by the "new classical" proponents.

5.30 The "new classical" conclusion is that under a floating exchange rate regime restoration of external balance, through reductions in the current account deficit and the level of overseas debt, is not an appropriate target for macroeconomic policy. The Government ought instead to concern itself with eliminating distortions caused by regulation, along with eliminating public sector foreign debt and its debt

servicing obligations. It is argued that macroeconomic policies of restraint aimed at reducing the current account deficit and limiting foreign debt growth merely induce recessionary pressures on the economy.

5.31 Some sections of the business community in Australia have also argued very strongly for a non-interventionist approach. For instance, the Australian Chamber of Commerce (ACC), in its submission to this inquiry, concluded:

Overall the Australian Chamber of Commerce believes that structural imbalances and rigidities in the Australian economy must be removed if our external indebtedness is to be reduced. Only by placing greater reliance upon market forces, and reducing intervention by government can this be achieved. (Submission No. 2, page 8)

#### Calls for Positive Assistance

5.32 There is considerable concern across some sections of the Australian community that the Government may well have too eagerly and fully embraced the "new classical" approach in setting economic policy over the 1980s. This would include academic critics of the "Pitchford line" such as Professors Arndt and Gruen, also of the Australian National University. The numbers calling for a return to protectionist policies are relatively small and, indeed, most sections of the community are not calling for a return to universal protectionism and regulation. Yet there is considerable disquiet amongst some sections of Australian industry and by some economic commentators that Australia's current account deficit and overseas debt is now reaching alarming proportions.

5.33 Such groups are rejecting the view that the current account deficit and the level of overseas debt are issues which are of little or no concern to the Government. Instead they are calling for economic leadership by the Government and action to address these issues.

5.34 The Business Council of Australia (BCA) in its submission to this inquiry argued that:

Australia's mounting foreign debt and lack of competitiveness poses Australia's biggest post-war economic challenge. (Submission No. 56, page 907)

and

While foreign debt is not intrinsically a bad thing - depending on the use to which it is put - Australia has entered a "danger zone" in its external obligations where it has been twice previously over the past century. In the absence of a national effort to first stabilise and then lower the external debt as a ratio of GDP, there is a significant risk that future Australian economic development may, for a time, be severely constrained by debt servicing requirements. (Submission No. 56, page 905)

5.35 The BCA further argues that:

There is an urgent need for governments, employees and especially business to take action in three major areas, to lift Australia's economic performance by:

- increasing the level of public awareness of the implications of Australia's foreign debt, debt service and current account problems;
- lifting the competitiveness of Australia's industry to make world standards the standards of our companies; and
- raising the supply of Australian savings to finance our economic development. (Submission No. 56, pages 905-6)

5.36 The Australian Chamber of Manufactures (ACM) argued in its submission to this inquiry that:

Australia's foreign debt - and what to do about it - is now one of the most important economic issues facing the country. (Submission No. 58, page 1067)

and

ACM is concerned with the extent of Australia's current account and foreign debt problems. ... ACM believes that the Government has a major role to play in fixing this problem. ... Government actions must incorporate measures that aim to increase both investment in manufacturing and the production for export and import replacement. (Submission No. 58, pages 1086-7)

5.37 The Metal Trades Industry Association (MTIA) also argued for a leadership role by the Government in addressing Australia's current account deficit and overseas debt problems:

Since the early 1980's, however, Australia's reliance on export earnings from mining and agricultural commodities, to finance our overseas borrowings has been fully exposed as the source of underlying economic vulnerability. This is because these commodities are subject to substantial worldwide cyclical fluctuations in supply and pricing. Also, Australia is facing more and more competition in international commodity markets as developing countries increase exploitation of their resource bases.

As a result Australia's foreign debt has burgeoned. In MTIA's view, reducing this level of debt now represents the major ongoing challenge to Government in effectively managing our economic future as it is the litmus test as to improvements in our international competitiveness. (Submission No. 64, pages 1475-6)

5.38 The MTIA has called for government policies to address a broad range of macroeconomic and microeconomic issues, combined with measures for positive assistance to industry:

Overall MTIA considers that an effective program of direct Government export assistance measures is essential to the operation of a comprehensive economic strategy aimed at achieving greater export orientation within the Australian economy. (Submission No. 64, page 1490)

5.39 The Australian Manufacturing Council (AMC) commissioned PCEK/Telesis to conduct a major examination into Australian manufacturing which was completed in 1990. The report of the PCEK/Telesis study had two major findings. First, that manufacturing does matter to Australia in terms of improving our trade performance. While major opportunities exist for the further processing of natural resources, the PCEK/Telesis study concluded that no country of any size has been able to maintain a vital economy without a strong industrial base that includes at least some "elaborately transformed manufactures" industries.

5.40 The second main finding of the PCEK/Telesis study was that while the consensus agenda of lower protection and microeconomic reform was supported, it would be foolish to ignore the successful pragmatism of many OECD countries including Japan, France and Sweden, as well as the newly industrialised countries of our region - South Korea, Taiwan and Singapore - where at least some measures of support are provided to their industries to expand and to develop them particularly those industries which export.

5.41 The PCEK/Telesis study concluded that the central policy roles for the Government are:

- increasing exposure of industry to international competition through the progressive phasing-down of protection;

- reforms to reduce impediments to industrial development; and
- positive measures to promote the development of a larger number of strong export firms in complex factor industries. (The Global Challenge: Australian Manufacturing in the 1990s, Final Report of the Pappas Carter Evans and Koop/Telesis Study, Australian Manufacturing Council, Sydney, 1990)

5.42 The Australian Council of Trade Unions (ACTU) in its submission to this inquiry stated that:

We have persistently argued for positive measures directed to promoting import replacement and more importantly for export development in higher value added, wealth creating industries. ...

The ACTU believes it must oppose further tariff reductions unless they are part of a total package of promotional measures and structural adjustment assistance. (Submission No. 61, page 1208)

5.43 The ACTU argued for an approach which, in the context of a stable and predictable macroeconomic environment, is focussed on steps to ensure that Australian industry becomes more internationally competitive:

Increased international competitiveness and greater effort to secure export markets is necessary to raise exports and replace imports with domestic production.

While the agriculture and mining sectors will and should continue to provide the bulk of Australia's exports, as a result of natural competitive advantage, there are strong arguments for diversifying our export base with a greater emphasis on elaborately transformed manufactures. (Submission No. 61, page 1194)

5.44 The ACTU also argued that policies which open Australian industries to overseas competition ought to be part of a strategy to improve Australia's international trade position, but that such an approach cannot achieve success by itself. To this end a range of measures of positive assistance are needed.

5.45 The arguments put forward in a number of submissions to this inquiry clearly demonstrate that many sections of industry are now calling for some changes in policy emphasis to address Australia's current account deficit and overseas debt.

5.46 There is widespread agreement that the increases in the current account deficit and the level of overseas debt over the 1980s are cause for considerable concern. There is also support for concerted government action to address these problems. There also appears to be an increasing amount of agreement on the part of Australian business and the union movement that policies of lowering protection and promoting freer trade ought also to be accompanied by

further positive measures aimed at industry development to ease the current account deficit and increased national savings for investment which will reduce Australia's reliance on overseas debt.

5.47 Such an approach is premised on a rejection of universal regulation and protection, opting instead for specific and selective measures aimed at industry development and reducing Australia's heavy reliance on overseas debt. This approach must include measures to offset market failure. It is argued that selective well targeted policies can contribute to an increase in national productivity and our international competitiveness.

## CHAPTER 6

### FUTURE DIRECTIONS IN POLICIES TO ADDRESS AUSTRALIA'S CURRENT ACCOUNT DEFICIT AND OVERSEAS DEBT

#### The Need for a New Policy Approach

6.1 The central concern with the current account deficit in shaping various economic policies in recent years has not been misplaced. Large deficits on the current account and the associated sharp increases in the level of Australia's overseas debt over the past decade are problems which Australia must tackle if present living standards are to be sustained in the medium to long term.

6.2 The Committee rejects the view that economic problems of such importance to Australia require no specific action by government. It has been argued that external balance or a significantly reduced current account deficit is an inappropriate objective for macroeconomic policy. This proposition is based on the view that the current account deficit is largely the result of private capital inflows to finance productive investment, which will presumably yield a sufficient return over time to service the foreign debts incurred in attracting the capital. It is further argued that even if capital inflows are insufficient to finance the current account deficit, then a depreciation of the Australian dollar would automatically result under a floating exchange rate policy. Thus government need not concern itself unduly with these issues. Instead it should focus its efforts on servicing and reducing public sector foreign debt.

6.3 Such arguments presume that markets will automatically adjust to eliminate the problems and that foreign borrowings are exclusively channelled into productive investment. Both propositions are difficult to sustain. Indeed there is insufficient evidence to support the view that overseas borrowings are always channelled into productive investment. There is no evidence to suggest that the exchange rate will adjust sufficiently to correct current account imbalances. Rather the evidence points to extensive market failure including the failure of the exchange rate to adjust to persistently high current account deficits.

6.4 The Committee also rejects the view that a return to fixed exchange rates and high protection would offer a feasible solution to Australia's current account deficit and overseas debt problems. Whilst policies revolving around a return to fixed exchange rates, regulated finance markets with foreign exchange controls and high levels of protection to Australia's industries may offer some short-

term relief, it is difficult to see how such policies could really result in maintained or improved living standards in the longer term. Lower living standards must ultimately result from any policies which restrict Australia's industries to our limited domestic markets. Protectionist policies will tend to make Australian industries less competitive in global markets.

**6.5** The Committee believes that government must play a leadership role and be actively involved with effective, clearly targeted policies if the current account deficit and Australia's overseas debt are to be significantly reduced. Failure to do so will exacerbate Australia's vulnerability to volatile international economic conditions.

**6.6** There are also concerns that if the situation continues, the large current account deficit and growing overseas debt could ultimately lead to dramatic corrective measures being imposed on our economy from outside. The fear is that our reliance on foreign capital could become so great as to place an impossible repayment burden on Australia. As well, unacceptably high foreign ownership of Australia's assets could result. The Committee does not wish to overstate the possibility of the above scenarios becoming a reality. It is apparent that their probability will rise with the continuation of a large and growing current account deficit and with further substantial increases in the level of Australia's foreign debt.

**6.7** Over the last decade the current account deficit has figured prominently in the Government's justification for its major economic policy decisions to reduce tariff protection, to float the Australian dollar, to deregulate financial markets, and to achieve fiscal surpluses.

**6.8** In 1989 and 1990 policy relied heavily on dampening demand through high interest rates. One of the major justifications for this approach was to alleviate pressures on a worsening current account deficit through attempts to reduce the demand for imports.

**6.9** To date these policies have not produced the required sustained reduction in the current account deficit and Australia's overseas debt. Both increased markedly over the 1980s. It is only in the recent period of an exceptionally severe recession, involving high unemployment and declining private capital investment, and with associated falls in the inflation rate and interest rates, that any sign of slowdown in the worsening current account deficit has been realised. The concern is, however, that the reduction in the current account deficit in 1990-91 will not be sustained as imports will rise as Australia comes out of this recession.

**6.10** In particular, high interest rates have contributed to a larger current account deficit and a growing foreign debt. Certainly high interest rates have contributed to a dampening of demand for imports. However, this positive result has been more than offset by the high costs of capital for Australian industries seeking to develop export markets and import replacement industries. Add to this the impact of high interest rates attracting foreign capital inflows and encouraging

high levels of Australian borrowings directly from overseas and it is hardly surprising that the net effect of high interest rates has been to increase the current account deficit rather than to lower it.

**6.11** The main impact of high interest rates on the current account deficit has not been to improve the trade balance through a reduced demand for imports. Rather, the overriding impact has been to ensure a large rise in net income payments overseas, as a result of servicing Australia's burgeoning level of overseas debt.

**6.12** High interest rates have also contributed to a persistently overvalued Australian dollar. This has had a marked adverse effect on the current account deficit by discouraging exports and encouraging imports.

**6.13** These developments give cause for a reconsideration of the relationship between the industries which are subject to international competition and those industries which are not subject to it. There is a long Australian tradition of recognising and analysing this distinction between the tradeable, or traded-goods sector and the non-tradeable or naturally sheltered sector. "Tradeable" signifies industries which export or compete against imports; it embraces rural, mining and some manufacturing industry.

**6.14** If a country's current payments are in deficit, the implication is that both its exporting and its import competing industries need to expand. Each of these requirements suggests a need for a lower exchange rate to promote competitiveness in those areas. The exchange rate may be regarded as a pricing nexus that relates the comparative conditions of the tradeable and non-tradeable sectors of the economy and a payments deficit implies, *prima facie*, that this pricing nexus is too unfavourable to the trading industries. As a result of deregulation the exchange rate can no longer be used as an instrument of monetary policy with which to effect an improvement in the economic health of the tradeable sector by way of a devaluation of the Australian dollar in order to promote exports. To the extent that recent developments have tended to keep the exchange rate high, they appear to have promoted a structural imbalance between the trading and non-trading sectors.

**6.15** The available evidence points to the existence of such an imbalance and its exacerbation in recent years. Figures derived from ABARE show an index of the relative prices obtained for non-tradeable goods by comparison with prices for tradeable items rose from 102.3 in 1980-81 to 145.2 in 1989-90 (see Table 2.7). A number of elements evidently enter into this trend for disproportionate and inappropriate advantage for investment in non-tradeables: they include movements in the terms of trade and in the exchange rate and the greater opportunities of the non-tradeable producers to pass on higher costs (including interest rate costs) than are available to the internationally competing sector.

**6.16** The Committee has concluded that, while macroeconomic policies over the past decade have gone some way towards laying the foundation for an improved economic environment in the long term, the results to date have been disappointing with respect to the current account deficit and overseas debt. Without further changes in policy it is difficult to envisage a sustained improvement in this situation, despite the positive impact of recent falls in interest rates.

**6.17** Further policy changes are required to encourage a growth of exports. The Committee is concerned that the danger is that a cyclical upswing in economic activity will again cause a blowout in imports providing justification for yet another round of restrictive macroeconomic policies that will have a destructive effect on long-term economic development. Long-term economic changes are required to alleviate the adverse impact of this 'boom-bust' cycle.

**6.18** The Committee is persuaded by arguments for further measures to tackle Australia's current account deficit and overseas debt problems. The core of the proposed approach is to ensure that reductions in the current account deficit and overseas debt levels are given a high priority as central objectives for economic policy in Australia. Such a policy would have the advantage of stimulating employment growth when social dislocation and wasted resources are the result of unemployment levels of around 10 per cent. Government must responsibly take the leading role in ensuring the development of a range of policies designed to achieve these economic objectives.

#### Reducing the Current Account Deficit and Lower Overseas Debt as Objectives for Economic Policy

**6.19** Reducing the current account deficit and the level of overseas debt has figured prominently in the rationale for most macroeconomic policies over the past decade and earlier. Yet government policies have not always been directed at ensuring that these objectives are achieved.

**6.20** The Committee believes the time has come for the Government to reassert its commitment to achieving significant and sustained reductions in the current account deficit and levels of overseas debt. Such an approach is essential to achieving the objectives of low rates of inflation, full employment and improved living standards throughout the remainder of the 1990s.

**Recommendation 1.** The Committee considers that in addition to the fundamental objectives of Australia's economic policy - full employment, low inflation and improved living standards - policy must take explicit account of the objective of reducing the current account deficit and the level of overseas debt.

#### Strategies to Achieve These Objectives

**6.21** If the Government were to incorporate the twin objectives of a significant reduction in Australia's current account deficit and in the level of foreign debt as central objectives of economic policy, together with reductions in unemployment and inflation, then new strategies will be needed to tackle these issues.

**6.22** Against the backdrop of appropriate macroeconomic policy settings and necessary microeconomic reforms, the development of a set of comprehensive industry strategies is proposed. These strategies will need to be aimed more effectively at value-added export and the export of "elaborately transformed manufactures", the export of services as well as goods and, most importantly, the development of import replacement industries. It is only through the development of comprehensive and coordinated approaches to industry development, which are specifically aimed at reducing the trade imbalance, that the Committee sees any real prospect of alleviating Australia's current account and overseas debt problems.

**6.23** Recent reductions in the demand for imports are encouraging, although the Committee is concerned about the inevitable upsurge in the demand for imports following an easing of the recession.

**6.24** The Committee examined the issue of whether or not a policy of restricting imports should be adopted. On balance the Committee rejects such an approach at this stage. Australia's economic future does rely on promoting less protection in global trade. Import restrictions would certainly reduce Australia's living standards. However, this situation ought to be reviewed by the mid-1990s to assess whether or not a reconsideration of the imports issue is required. If Australia's current account deficit continues to grow at very high levels over the next few years, then we may have no option but to accept severe fiscal restraint and/or import restrictions, which would result in a closeted and inefficient economy which would cause a decline in living standards.

**6.25** The Committee is greatly concerned about unfair competition from imports from countries where production and exports are highly subsidised. Australia's anti-dumping and countervailing measures require strengthening.

**6.26** The key to reducing the current account deficit and Australia's overseas debt lies in Australia's ability to reduce its reliance on overseas capital and borrowings and instead to increase and utilise domestic savings for a greater proportion of its investment. Although exports and imports receive the greatest attention in debates about the current account, it should be remembered that the majority of the current account deficit is now attributable to interest payments in servicing our foreign debt. Measures to reduce our reliance on overseas borrowings, therefore, are integral to addressing the current account deficit in the long term.

**6.27** The Committee does not consider that a return to foreign exchange controls and regulated capital inflows should be reconsidered, although this issue may well need to be kept under review. The international climate of opinion could be affronted by such unilateral Australian action which might lead to damaging retaliation. Instead the Committee proposes that a number of measures directed at encouraging increased domestic savings and their utilisation for industry investment purposes be implemented.

**6.28** The Committee is concerned about the disturbing patterns of investment for speculative purposes which emerged during the 1980s. Much of this non-productive investment relied heavily on overseas borrowings for its financing with little long-term benefit to Australia. However, after examining the issue the Committee concluded that there are significant practical difficulties in attempting to distinguish between speculative and productive uses of overseas capital without reverting to cumbersome controls on foreign capital inflows to Australia.

**6.29** Other policy settings are required to complement the measures outlined in this report. Lower comparative real interest rates are fundamental to encouraging investment in export and import replacement industries. Such lower interest rates are also essential if the growth of capital inflows to Australia, particularly speculative inflows, which add to the overall level of debt and debt servicing obligations, are to be reduced. Lower comparative real interest rates are vital in creating the right conditions for a lower value of the Australian dollar.

**6.30** Further progress with other policies which affect productivity and efficiency are fundamental, such as an incomes policy which relates wage increases to productivity and ensures continuing restraint by all sections of the community. An acceleration of the process of microeconomic reform is also required to further reduce business costs and increase efficiency.

**6.31** The 1980s saw Australia's current account deficit shift from being a problem comprised equally of an imbalance in our international trade in goods and services and income payments overseas to service our foreign investment to a deficit which is now dominated by servicing the overseas debt. Interest on foreign debt comprised some 20 per cent of the current account deficit at the beginning of the 1980s. By the end of the decade almost two-thirds of the current account deficit were due to interest on Australia's overseas debt.

**6.32** While Australia's ability to eliminate trade imbalances remains a critical issue, as deficits must be financed by further overseas borrowings, there can be no solution to Australia's current account problems without a change to investment behaviour in Australia. Australia must find ways and means of raising a greater share of its investment capital domestically or from surpluses in earnings from international trade, rather than by continuing to rely on overseas borrowings. There is also an argument for changing the structure of domestic investment.

**6.33** The Committee has concluded that the economic policies required to address Australia's current account deficit cannot be separated from those needed to address the level of foreign debt. The two issues are intertwined. A national policy approach is required which addresses measures not only to improve our trade performance, but also to reduce undue dependence on overseas borrowings for our investment capital. This can only occur against a backdrop whereby a range of macroeconomic and microeconomic policies are implemented which are consistent with achieving the objectives of lowering the current account deficit and the level of overseas debt.

**Recommendation 2.** The Committee recommends that, against a backdrop of appropriate macroeconomic policy and necessary microeconomic reforms, government needs to adopt further comprehensive policies aimed at a sustained reduction in Australia's current account deficit and level of overseas debt that include:

- a set of positive assistance measures designed to improve Australia's international trade situation through investment to enhance our export and import replacement performance (noting that such assistance is essential so long as the international climate in favour of trade subsidies persists); and
- a set of measures specifically designed to reduce Australia's heavy reliance on overseas borrowings and hence our overseas debt, as the predominant source of investment funds.

## CHAPTER 7

### MEASURES TO PROMOTE INDUSTRY DEVELOPMENT IN THE TRADE CONTEXT

#### The Overall Approach to Improving Australia's International Trading Performance

7.1 Sustained improvement in Australia's international trading performance is an essential element of any policy approach aimed at achieving significant reductions in the current account deficit and the level of overseas debt.

7.2 There is an emerging consensus amongst business and union groups in Australia that policies of lowering tariffs and industry protection and promoting freer international trade ought to be pursued. However, they ought not to be pursued in the absence of positive measures that are aimed at enabling Australian industry to restructure and to develop new and enhanced export and import replacement industries.

7.3 The Committee supports this view. The policy approach to achieving sustained improvements in Australia's international trading position ought to have as its centrepiece the phasing out of tariffs and other measures of universal protection and promotion of freer international trade as the basis of our multilateral, bilateral and regional trade strategies, combined with a range of targeted measures to assist Australian industry to better compete internationally.

7.4 Australia's current policies of phasing out tariff protection and promoting freer international trade are, in the Committee's view, pitched in the right direction. The current approach to targeted measures, however, is restricted mainly to assistance provided by AUSTRADE to existing industries to increase their share of existing export markets or to enter new export markets with existing products. In the area of targeted assistance there is insufficient focus on the underlying development of new industries geared to global markets, on the development of value-added export industries that utilise the commodities of Australia's resource-based industries and on the development of import replacement industries.

7.5 The lack of a sufficiently comprehensive approach to measures of positive assistance for industry restructuring is, in the Committee's view, leaving Australian industry overly exposed and vulnerable to adverse international economic trends, when it is remembered that most other nations provide considerable

assistance and subsidies to their industries. To compete effectively on global markets Australian industry must undertake further and substantial restructuring, recognising of course that considerable restructuring of Australian industry has already taken place. Positive assistance measures can facilitate and hasten this process.

**Recommendation 3.** The Committee recommends that, in order to facilitate a substantial and sustained improvement in Australia's international trading performance, Australia's policy approach for the remainder of the 1990s should focus on:

- a continuation of the phasing out of tariff and other universal protection measures, provided these reductions are tied to a package of positive assistance measures;
- a continuation of active and strong promotion of free trade as the basis of Australia's multilateral, bilateral and regional trade strategies; and
- an enhanced and comprehensive package of positive assistance measures that are directed not only towards assistance to increase the export markets of existing industries, but also to facilitate the development of new export industries, particularly value-added exports and to the development of import replacement industries.

**7.6** The Committee believes that Australia needs to accord the development of the APEC initiative even greater priority than it has to date. There can be no doubt that Australia's long-term economic future rests in no small part on the development of enhanced trading relationships with the nations in the Asia-Pacific region. Recent developments in Europe, particularly the changes in Eastern Europe, add even more urgency to the need for Australia to enhance such trading relationships.

**7.7** Australia has resisted, to date, any moves to join in a "trading bloc" or "trade association" with Asia-Pacific nations particularly the North American countries. The Committee notes that the intensifying "trade war" places even greater urgency on the importance of positive outcomes from the Uruguay round of the GATT. Should this round fail to achieve progress towards free international trade, then Australia may have no option but to reconsider its stance on forming trading associations.

#### The Need for a Strategic Approach to Industry and Trade Development

**7.8** The Committee, in considering the extensive evidence put to it over the course of this inquiry, has concluded that there is a lack of strategic direction in tackling Australia's industry and trade development problems.

**7.9** Australia has been very slow to respond to the long-term decline in the terms of trade. Unprocessed primary products still make up almost half of Australia's exports. Much more progress needs to be made in diversifying our export base, particularly with respect to elaborately transformed manufactures.

**7.10** Current patterns of industry development and investment are largely ad hoc and, as far as international trade is concerned, they are overly focussed on Australia's traditional exports.

**7.11** While recognising that industry plans for some industries have been very comprehensive, existing industry plans for many industries tend to have too limited a focus when it comes to strategies for enhanced exports or import replacement in developing a viable industry base that can carry Australia into the twenty-first century. Moreover, not all industries have plans.

**7.12** The industry export strategies, which are export industry plans developed by industry with assistance from AUSTRADE, are highly focussed on export marketing of existing products including the export promotion of existing products through market entry to new overseas markets.

**7.13** The Committee believes that a more strategic and coordinated approach to industry and trade development is a fundamental prerequisite to a sustained improvement in Australia's international trading performance.

**7.14** To this end government should strengthen its approach and take the lead in facilitating the process of ensuring that a new set of industry and trade development strategic statements are developed. These strategic statements should be developed by the major industry parties - the relevant business and union groups in conjunction with the relevant government department(s) or agency that covers the industry.

**7.15** This tripartite approach should be aimed at ensuring that the relevant parties in each industry get together to try to develop a more strategic approach to long-term industry and trade development. A fundamental aspect of this approach would be identification of, and hopefully agreement about, just what are the overall objectives for industry development for the remainder of the 1990s.

**7.16** First and foremost, the strategy statements would need to be focussed on identifying new and enhanced opportunities for international trade by each industry. This should incorporate any existing export strategies which are focussed on the enhanced promotion of existing products to overseas markets including the development of new markets. Just as important is the need to plan strategies for the development of new products for export. Particular emphasis is needed on the development of value-added products for export which utilise Australia's national resource-based commodities and on a range of elaborately transformed manufactures, where appropriate.

7.17 All industry and trade development strategy statements ought to include the results of a full and comprehensive consideration of the potential for the development of import replacement products.

7.18 Industry and trade development strategic statements also need to include identification of areas where microeconomic reforms and enhanced public infrastructure are considered to be essential prerequisites to industry and trade development.

7.19 Each industry should also identify, for inclusion in its statement, its overall view of skills and research and development requirements. In particular the statement should include the identification of any major gaps in the skills levels of the existing or potential workforce and industry's view of any enhanced or new education and training programs or courses that are required to meet those gaps. Intended industry research and development strategies should also be spelt out.

7.20 Each strategy should identify any environmental concerns or barriers and a suggested approach to overcome such concerns. When environmental issues are likely to be prominent, for instance such as in a forestry and wood products strategy, then relevant environmental groups should also participate in the development of this element of the strategy.

7.21 These industry and trade development strategy statements ought to enhance the existing industry plans (developed in conjunction with DITAC) and industry export strategies (developed in conjunction with AUSTRADE).

7.22 The Committee believes that the development of strategy statements covering the full range of Australian industries is needed.

7.23 In the Committee's view it is vital that employer groups and companies and unions and employees are involved in the process of developing a more strategic approach to securing Australia's economic and international trading future. Government leadership is required to facilitate the process. The Committee is also of the view that once the industry and trade development strategy statements are finalised, then ratification and endorsement of the statements by the executive arm of government is highly desirable. This is to ensure that government commitment to the industry and trade strategies is forthcoming so that governments can play their part in supporting the implementation of the strategies, such as through the provision of resources, where appropriate.

**Recommendation 4.** The Committee recommends that, for each industry, government should facilitate the development of an Industry and Trade Development Strategy Statement on a tripartite basis involving the relevant business and union groups in each industry and the relevant government departments or agencies that cover each industry. These plans should enhance all existing industry plans and export marketing strategies. The statements should spell out a

strategic vision for each industry for the remainder of the decade. For each industry the statement should identify:

- the objectives and priorities for industry development over the remainder of the 1990s;
- export strategies for existing products to enhance market share in existing markets and to enter new markets;
- strategies for the development of new products or services for export with particular emphasis on the development of value-added products and elaborately transformed manufactures;
- strategies for the development of import replacement products;
- areas where microeconomic reforms and new public infrastructure are required as essential prerequisites or complements to industry and trade development;
- gaps in the skills needed for industry and trade development and priorities for new or enhanced education and training programmes and courses that could redress any skills shortfalls;
- an industry research and development strategy; and
- likely environmental issues and concerns and feasible strategies to address any such concerns.

#### Targeted Measures to Promote Exports

7.24 Export incentives and marketing assistance are, in the Committee's view, both legitimate and necessary interventions by government. These measures can play a major role in further enhancing Australia's export performance.

7.25 Such targeted measures to promote exports are important in assisting firms to meet the high costs associated with expanding export market share or entering new export markets. When firms are located in a country like Australia, which is relatively isolated geographically from its major export markets, these costs can be particularly high and such assistance is most important for expanding the nation's exports.

7.26 Export subsidies are also recognised as interim measures under the GATT rules until there is multi-lateral agreement on their reductions.

7.27 The Committee notes that export assistance was recently the subject of a major review. The Report of the Committee for Review of Export Market Development Assistance, the Hughes Report, was released in 1989. The Report endorsed the use of export subsidies and recommended some changes and

enhancements to schemes, not the least of which was a continuation of such assistance for a further five years. The Government has responded favourably to these findings.

**7.28** The Committee in conducting this inquiry also examined the major types of targeted measures to promote exports that are used in Australia. These are AUSTRADE's services to exporters, the Export Market Development Grants Scheme (EMDGS), the International Trade Enhancement Scheme (ITES), the Export Finance and Insurance Corporation (EFIC) and the Development Import Finance Facility (DIFF).

**7.29** To reduce the uncertainty of the environment in which Australia's exporters are operating, the Committee believes that government should give an unequivocal undertaking to continue each of these initiatives for at least the remainder of the 1990s. The Hughes Report recommended a continuation of measures for a further five years taking us to the mid-1990s. A longer time frame is, however, necessary if uncertainties are to be reduced and if planning processes are to be improved.

**7.30** The Committee is of the view that AUSTRADE's general range of services to exporters are valid and useful. Nevertheless, the Committee endorses the Government's response to the McKinsey & Company Report (*Organising to Deliver Export Impact*; Australian Trade Commission, McKinsey & Company, December 1990) whereby AUSTRADE is being restructured to focus Australia's export marketing efforts more heavily on the Asian region. The Committee believes that further emphasis is also needed on developing countries in other regions of the world, including the Pacific, as they are becoming increasingly important export markets for Australia.

**7.31** The EMDGS and ITES programs are both important and useful initiatives to assist Australian industries and firms to develop their export markets. Both schemes should be continued beyond the mid-1990s to at least the turn of the century. The Committee believes that the scope of ITES, as a concessional loans scheme, can be considerably expanded with emphasis on assisting smaller to medium firms to enter international markets. The Committee was persuaded by the view that current arrangements place too much emphasis on larger firms that are already established exporters. The current full year funding of over \$21 million per year for the ITES is, in the Committee's view, not sufficient to meet the full range of industry needs in considerably expanding export markets.

**7.32** The Committee endorses the move by the Government to re-establish EFIC as an independent statutory corporation on 1 September 1991. EFIC is being given an enhanced capacity to use interest subsidy arrangements in a more aggressive way. This is important given the extensive use of concessional credit used by other countries in their export marketing and because many Australian exporters are finding it increasingly difficult to meet the bonding requirements demanded by overseas buyers. The Government announced the establishment of:

... a new \$50 million facility to cover bonding requirements for firms with a proven record of performance but which are unable to meet the requirements of private bonders. (*Building a Competitive Australia, 12 March 1991*, Australian Government Publishing Service, Canberra, page 5.41)

**7.33** The Government is also taking steps to increase the adequacy of EFIC's insurance guarantee and lending operations through the provision of some \$200 million in call capital to supplement EFIC's existing reserves of around \$160 million.

**7.34** The Committee supports these moves and would urge government to give a firm undertaking to Australia's exporters that it will continue to underpin EFIC's activities for the remainder of this decade, at the very least.

**7.35** The Committee was persuaded by the arguments put from a number of quarters that the DIFF initiative ought not only be maintained, but also that there is considerable scope for its expansion. Developing countries are becoming increasingly important export markets for Australia and the Committee believes this trend will continue. Australia's ability to rapidly increase exports to many of these emerging markets will, however, depend critically on the expansion of assistance to those countries through an enhanced DIFF program. An expansion in the order of a doubling of DIFF is proposed.

**Recommendation 5.** The Committee recommends that government give Australia's export industries a firm commitment to continue targeted export assistance measures for the remainder of the 1990s, recognising that such measures have a valid and continuing role to play in any long-term policies designed to enhance Australia's export performance. In particular government should:

- continue with the current range of AUSTRADE services to exporters for the remainder of the 1990s, continue with the reorientation of AUSTRADE efforts towards the Asia-Pacific region and hasten the process of reorientation to export markets in developing countries in other regions of the world;
- continue with the Export Market Development Grants Scheme (EMDGS) for the remainder of the 1990s;
- continue the International Trade Enhancement Scheme (ITES) for the remainder of the 1990s and considerably expand the funding for this scheme, as a concessional loans scheme is preferred over a grants program for export promotion, with particular priority on assisting small to medium firms to enter export markets;

- continue with the Development Import Finance Facility (DIF) for the remainder of the 1990s and double the funding available under the program, by way of an overall increase to Australia's overseas aid budget, to encourage the rapid expansion of Australia's exports to developing countries; and
- continue and enhance the operations of the Export Finance and Insurance Corporation (EFIC).

7.36 The administration of all of these measures will require a reconsideration if the Committee's proposals for the development of Industry and Trade Development Strategies are adopted. All targeted measures to promote exports should become an integral part of each industry's strategy.

**Recommendation 6.** The Committee considers a more strategic approach to the use of export assistance measures by industry is needed to maximise the effectiveness of such assistance. The tripartite industry groups - the relevant business, union and government bodies - should, in developing an Industry and Trade Development Strategy Statement for each industry, include a strategy for the coordinated use of export assistance measures that is consistent with the other elements of the statement. Government should also reorganise the administration of all targeted export assistance measures so that they can be used in a more strategic way in line with each industry's Industry and Trade Development Strategy Statement.

7.37 The Committee also notes that the Government has asked the Industry Commission (IC) to undertake a review of export assistance measures used by other nations and to report on their possible implications for Australia by the end of 1991. Specifically the IC has been asked to undertake a review of:

- the methods by which Australia's main trading partners promote export and import replacement activities;
- the direct costs and wider economic implications for these economies of these measures;
- the extent to which these measures are consistent with GATT obligations; [and]
- the economic implications of these activities for Australia. (Building a Competitive Australia, 12 March 1991, Australian Government Publishing Service, Canberra, page 5.39)

7.38 Obviously the outcomes of the IC review will need to be given full consideration by the Government in the context of finalising Australia's policy approach, for the rest of the 1990s, towards targeted measures to enhance Australia's trading performance.

#### The Process of Identifying Investment Priorities for the Further Development of Export and Import Replacement Industries

7.39 Australia's targeted assistance measures for export marketing and promotion are reasonably comprehensive. This assistance is clearly geared towards established export products and services and established industries.

7.40 The same observations cannot be made when it comes to the investment capital needed for the development of new export industries and new import replacement industries.

7.41 There is, in the Committee's view, a clearcut case of market failure when it comes to investment in Australia applying to the flow of investment funds to projects that are not expected to break even in the immediate short term. Small to medium sized firms face considerable difficulties in obtaining sufficient funds to develop new products for export and import replacement.

7.42 While some improvements have been made in recent years it is also clear there is insufficient investment in Australia in value-added exports, particularly in elaborately transformed manufactures.

7.43 The Committee is particularly concerned that it is in the area where returns to investment are expected to be lagged and long term, where many potentially highly profitable business ventures are experiencing inordinate difficulties in attracting investment capital. A strong case for perceptions of market failure can be made concerning investment in Australia that is considered to be "high risk". Even worse are those cases where capital is not forthcoming because returns are long term in the sense that any significant returns from the investment cannot be expected for some years to come. The Committee could find no similar evidence for a shortage of investment capital when it comes to ventures that are expected to yield returns in the short term, particularly with respect to speculative commercial property investment. Yet as it turns out some of these investments in recent years have proven to be extremely "high risk".

7.44 The overwhelming view that emerged from the submissions and evidence put to this inquiry was that there is a shortfall in the level of investment required to maximise Australia's international trading performance. There is, however, less consensus about how large the shortfall might be.

7.45 The Committee is aware of some estimates done by BIS Shrapnel. In relation to the question "How much investment would be required to reduce the current account deficit to zero?" the estimates were that it:

... would require an increase in investment in plant and equipment in the tradeable goods sector of an estimated 200 per cent over current levels. ... This equates to an increase in total investment in plant and equipment of 57 per cent. (Gelber, F. "Reducing the Underlying Current Account Deficit: Rebuilding Manufacturing is Easier Said

Than Done" in Neville, J. [ed] Australia's Foreign Debt, Committee for Economic Development of Australia, May 1990, page 67)

**7.46** These estimates, if accurate, imply that an increase of over \$10 billion per year in investment in plant and equipment in the Australian economy would be required to reduce the current account deficit to zero. This would be additional to total new investment in plant and equipment each year which is currently around \$18 billion. These figures can be considered conservative estimates because they exclude investment in plant and equipment in the public sector and the agricultural sector. They also exclude all investment in buildings and structures.

**7.47** While not necessarily arguing that it is essential for Australia's economic future that the current account deficit needs to be totally eliminated, or that the above estimates are a precise measure of the amount of investment that is actually needed, it is overwhelmingly clear that investment in productive capital in Australia needs to be substantially increased if sustained inroads into reducing the current account deficit are to be made.

**7.48** The Committee is convinced that, in addition to the macroeconomic and microeconomic issues referred to in Chapter 9, investment on this scale will not occur without some leadership being exercised by government to create the conditions for a change in Australian investment patterns.

**7.49** This leadership should involve government facilitating a process whereby relevant business, union and government groups jointly identify the existing investment gaps and the priorities for the short and long-term investment that is needed to enhance exports and fully develop import replacement opportunities. Investment strategies need to be part of each industry's Industry and Trade Development Strategy Statement.

**7.50** Measures for securing investment funds, once priorities for investment are identified, are discussed in Chapter 8.

Recommendation 7. The Committee considers it is essential to recognise that there must be a substantial increase in investment in plant, equipment and infrastructure in order to achieve a sustained and substantial improvement in Australia's international trading performance - an increase of an order which could be in excess of \$10 billion in capital each year if the current account deficit were to be completely eliminated. The Committee recommends that each Industry and Trade Development Strategy Statement include, as an integral element, the joint identification by the relevant government, industry and union participants of investment priorities for the development of new international trading opportunities. In particular the strategy statements should identify, where appropriate, strategies for:

- the investment needed for the development of value-added exports and elaborately transformed manufactures in each industry;
- the investment needed to develop new import replacement opportunities in each industry;
- the investment that is needed in each industry to enable smaller to medium sized firms to develop new products for export and import replacement and/or to enter new export markets;
- the investment that is needed in each industry to develop new products for export or import replacement where long time frames are involved before break-even returns will be realised and where difficulties are currently being experienced in securing adequate investment capital to embark on such ventures; and
- the investment that is needed to provide essential underlying public infrastructure in situations where the microeconomic reform of public utilities is an essential prerequisite to industry and trade development and where current public infrastructure investment is inadequate.

#### Restricting Imports

**7.51** Movements towards trade blocs and the intensifying "trade war" between the United States and the European Communities (EC) is a disturbing trend that is jeopardising moves towards freer world trade. Calls for Australia to change its stance on free trade on the grounds of the need for some form of retaliatory action are also intensifying.

**7.52** The Committee is opposed to any moves to restrict imports as a retaliatory measure against a loss of export markets due to the "trade war". Moreover, such measures could serve to have an adverse effect on Australia's international trading prospects which, in the long run, would be counterproductive in terms of reducing the current account deficit. Australia's living standards would also inevitably fall if a policy of import restrictions were to be adopted.

**7.53** Australian industry must, however, be protected from the unfair trading practices of other nations. In particular, Australia's anti-dumping measures require some streamlining to ensure that Australian industries are not subjected to cheap imports being dumped on our domestic markets. Dumping occurs when the price of imports to Australia is less than the normal price of the goods in the domestic market of the country of origin. In such cases there can be no question that the imposition of countervailing duties is both legitimate and necessary.

7.54 The Committee notes Australia's anti-dumping and countervailing measures have been the subject of a recent Senate inquiry. The Committee notes that the Senate inquiry report contains:

... a package of proposals designed to improve Australia's anti-dumping system. The adoption of the recommendations ... has the potential to halve the costs involved in the preparation and consideration of an application by a particular industry. (Senate Standing Committee on Industry, Science and Technology, *Inquiry into Australia's Anti-Dumping and Countervailing Legislation*, Australian Government Publishing Service, Canberra, June 1991, page xiii)

7.55 The Senate inquiry recommended a range of reforms that is designed to improve the efficiency of Australia's anti-dumping system. These reforms are based on the elimination of all onerous practices and requirements of the existing arrangements that are not absolutely essential requirements of the GATT Anti-Dumping Code.

7.56 The Committee endorses the findings of the Senate inquiry and urges the Government to adopt the inquiry's recommendations. Australian industry must be as well protected as possible from the insidious practices of some countries of subsidising and dumping their produce on our domestic market.

**Recommendation 8.** The Committee recommends that government, as a matter of urgency, implement a range of reforms to Australia's anti-dumping and countervailing duties system to ensure that Australian industries are fully protected from unfair import competition resulting from the practice of dumping. These reforms should be aimed at reducing the costs and time faced by industry in lodging an application for consideration that dumping is occurring. These reforms ought also to eliminate any onerous elements of current arrangements that are not absolutely essential under the requirements of the General Agreement on Tariffs and Trade (GATT) Anti-Dumping Code.

7.57 The Committee also believes that government needs to continually examine its own expenditure to ensure that government purchases of imports are only made when no reasonably priced Australian produced alternatives are available. Similarly, the Committee is concerned about the level of defence equipment imports.

## CHAPTER 8

### REDUCING RELIANCE ON OVERSEAS BORROWINGS

THEMIS REPORT AND BUDGET 1991-92

#### The Overall Approach to Encouraging Savings to Finance Investment

8.1 Conceptually, the current account deficit represents the difference between national savings and investment. The gap between savings and investment for the economy as a whole must therefore be met by borrowings from overseas. Thus the current account deficit is financed by additions to Australia's overseas debt.

8.2 In Australia it is usual for national investment to exceed the level of national savings. Currently the gap between national savings and investment is of the order of 5 per cent of GDP. This gap must be reduced to lower the current account deficit and the level of overseas debt by way of a rise in savings, a fall in investment or a combination of both.

8.3 A fall in investment would have a most damaging effect on the Australian economy in the long term by reducing the growth of productive capacity. Ultimately lower growth and living standards would be the result of any policies designed to rein in the current account deficit and overseas debt through a reduction in investment.

8.4 This means that policies designed to lower the current account deficit and overseas debt must therefore revolve around greater levels of domestic savings to finance investment in Australia.

8.5 A continuing heavy reliance on the savings of foreigners places Australia in an undesirable situation in the long term because our economic sovereignty would be compromised through greater foreign ownership of Australian assets and a growing proportion of the fruits of Australian economic endeavour accruing directly to overseas interests (see Chapter 3 for statistical information).

8.6 The Committee notes the Economic Planning Advisory Council (EPAC) recently completed a major study on private saving in Australia. EPAC found that:

Private saving rates have trended downwards since the mid 70s, especially if we adjust for the effects of inflation on interest income and for depreciation. The net private saving appears to be at an historical low. (EPAC, *Trends in Private Saving*, Council Paper No. 36, Australian Government Publishing Service, Canberra, December 1988, page vi)

8.7 In this environment it is hardly likely, in the Committee's view, that the gap between savings and investment can be bridged in the absence of government action aimed at reducing Australia's reliance on overseas debt through an increase in domestic savings.

8.8 The Committee also notes that the PCEK/Telesis study conducted for the Australian Manufacturing Council reached a similar conclusion:

In the long run we must strive to create a virtuous circle, much like the Japanese have, where low inflation and high savings rates create a low cost of capital, stimulating productive investments. In turn, these generate a positive trade balance and strong economic growth which in turn help to perpetuate the high savings rate. (*The Global Challenge: Australian Manufacturing in the 1990s*, Final Report of the Pappas Carter Evans and Koop/Telesis Study, Australian Manufacturing Council, Sydney, July 1990, page 97)

**Recommendation 9.** The Committee considers an essential element to breaking the cycle of higher current account deficits and higher levels of overseas debt rests with raising the level of domestic savings, as an alternative to the heavy reliance on overseas borrowings to finance investment. The Committee recommends that government implement a package of measures designed to increase domestic, business and household savings as the fundamental basis of policies designed to lower the current account deficit and the level of overseas debt.

#### The Role of Superannuation Funds

8.9 While private savings levels fell as a proportion of GDP over the 1980s, another form of savings - superannuation - emerged during the 1980s with the potential to fundamentally change the savings and investment scene in Australia.

8.10 Superannuation funds are growing rapidly. In only a few years during the 1980s the total assets of superannuation funds, including Approved Deposit Funds (ADFs), grew to reach some \$90 billion by June 1988. By 31 March 1991 these funds reached a total of \$132.1 billion.

8.11 The assets of superannuation funds are projected to reach staggering levels by the year 2000. The Committee is aware of estimates by Mintel which project that the assets of superannuation funds will reach some \$950 billion by the year 2000. Government estimates have been somewhat more conservative, projecting superannuation fund assets to be in the range of \$600 billion by the year 2000 (these estimates are given in Submission No. 70, page 1686).

8.12 It is important to note that the growth in the level of these superannuation funds for the rest of the decade will be largely determined by further government decisions about the required rate of contribution to superannuation funds and by the rate of return on the investments made by the managers of the funds. A key point is that by the end of 1988 just over half of employed persons aged 15 to 74 years in the Australian workforce were covered by a superannuation scheme. This rate will almost certainly grow as governments seek to ensure that the whole workforce is covered by superannuation. The Committee also notes the increasing calls from various sections in the community for expanded superannuation contribution levels and for a fully comprehensive national approach to superannuation. Such moves are expected to add even more to the total assets of superannuation funds for the remainder of the 1990s.

8.13 The emergence of superannuation funds over the 1980s, and their expected growth for the remainder of the 1990s, has laid the foundation for the most important single change in the savings-investment scene in Australia's history. Any further steps taken to expand the coverage and enhance the contributions by employers and employees can only serve to improve Australia's savings situation even though the growth in savings through the superannuation funds could result in lower savings in other forms.

8.14 In particular the emergence of superannuation has laid the foundation for Australia to reduce its reliance on overseas borrowings as the predominant source of new investment capital. It is only through the sustained generation of new investment capital from domestic sources that any sustained reductions can be expected in the current account deficit and in the level of overseas debt in the long term.

8.15 The Committee notes that despite this potential, the overall impact of superannuation on savings appears to have been disappointing to date in terms of meeting some key industry requirements for investment funding and in terms of sufficiently reducing our reliance on overseas borrowings. Estimates outlined in Chapter 7 suggest a shortfall in excess of \$10 billion for the finance of additional new investment each year needed to eliminate the current account deficit. Moreover, the existing national savings investment gap is still around 4 per cent of GDP, necessitating new overseas borrowings which were in excess of \$15 billion in the last financial year.

8.16 The problem, in the Committee's view, can be seen in terms of the way in which superannuation fund investments are being managed. There appears to be a tendency for the funds to be managed in an attempt to maximise short-term yields. This is surprising given that superannuation funds are retirement incomes funds which ought therefore to be maximising long-term returns for contributors. This preoccupation with short-term yields may well be stimulated by the way short-term performance is emphasised in the press despite the fact that this is not necessarily the principal concern of contributors.

8.17 This shortcoming has led to the concentration of superannuation fund investment in so-called "blue chip" stocks associated with established larger companies and in government bonds. Moreover, almost 12 per cent of total superannuation fund assets are invested overseas.

In December 1990 the assets of superannuation funds and ADFs continued to be concentrated in shares (23.0%), long term financial assets [mainly government bonds] (21.1%), land and buildings (15.4%) and assets overseas (11.7%). (Australian Bureau of Statistics, Assets of Superannuation Funds and Approved Deposit Funds, December Quarter 1990, Catalogue No. 5656.0, Canberra, page 1)

8.18 In the Committee's view the evidence is compelling that there is insufficient superannuation fund investment in small to medium sized firms and in projects which are expected to yield sound returns in the medium to long term rather than immediately. There also would appear to be insufficient investment in some key strategic areas where more investment is essential if Australia's international trading performance is to be improved and if our reliance on overseas debt is to be replaced by domestic savings. Investment in firms and new industries capable of entering export markets and of developing import replacement products is essential.

8.19 The Committee is of the view that government needs to take some action to ensure that the rapidly increasing superannuation funds are invested in the full range of economic opportunities in Australia in the long-term interests of the nation as a whole and its people - the superannuation fund contributors. This means investment in projects that are expected to yield reasonable returns only in the long term as well as short-term investment; investment in new as well as established businesses; and investment in small to medium sized firms as well as large firms.

8.20 There are a number of options that could be considered whereby the Government could take action to seek a more balanced investment outcome by the superannuation funds in Australia. These range from a voluntary approach to a highly regulatory approach.

8.21 Under a voluntary approach government would monitor investment outcomes, point out gaps and shortfalls and encourage the superannuation funds to alter their investment decisions to address these gaps and shortfalls.

8.22 On the other hand a highly regulatory approach would involve government direction, through legislation, over the investment decisions of all superannuation funds.

8.23 The Committee rejects the introduction of a regulatory approach at this stage. Government direction over the investment decisions of all superannuation funds is unnecessary at this stage, though the investment decisions of the funds must be monitored and future action determined in response to their activities.

8.24 The Committee believes that the massive growth of superannuation funds over the remainder of the 1990s will go a long way towards removing the need for Australia to rely so heavily on the savings of foreigners for our investment capital. Hence the potential exists in a way that has never before been the case for Australia to reduce its dependence on overseas borrowings. Estimates of average growth in superannuation for the rest of the 1990s range between just over \$45 billion and up to some \$80 billion per year. When superannuation growth reaches this level it will be sufficient to fully meet Australia's new investment requirements (as outlined in paragraph 8.15), without the need to continually rely on massive injections of foreign capital.

8.25 Nevertheless the mere existence of massive growth in superannuation does not automatically guarantee that our current account deficit and overseas debt problems will be solved.

8.26 The Committee is of the view that government needs to encourage superannuation funds to change their investment decisions in such a way as to reduce the need for Australian industry to rely so heavily on overseas borrowings for investment.

8.27 It is essential that government engages in greater dialogue with the superannuation funds over various processes to identify the shortfalls in existing patterns of investment and in developing strategies for just how these gaps might be met. In particular government needs to make it clear to the superannuation funds that it is no longer satisfactory for them to ignore the national interest in terms of the role they must play in ensuring that Australia's heavy reliance on overseas borrowings for investment capital is reduced substantially.

**Recommendation 10.** The Committee considers that superannuation funds in Australia must recognise that they have a vital role to play, through their investment decisions, in ensuring that Australia's inordinately heavy reliance on overseas borrowings to finance new investment is reduced. The Committee recommends that government establish a formal but voluntary process of dialogue with all major superannuation funds and Approved Deposit Funds (ADFs) over:

- the best ways in which the shortfalls evident in existing patterns of investment might be jointly identified; and

developing agreed broad investment strategies that might be voluntarily introduced which are consistent with the investment priorities identified in each industry's Industry and Trade Development Strategy.

8.28 The Committee is not, however, convinced that moral suasion will be a sufficient approach. The Committee is of the view that government also should give serious consideration to the establishment of an Industry and Trade Development Fund, whereby all superannuation funds and ADFs are required to lodge a certain percentage of their total assets with the Fund. The level of contribution required to this fund needs careful consideration but something in the order of 1 per cent of total assets could well be an appropriate level at this stage. This level should be subject to review every few years.

8.29 The Fund would be directed at some of the investment priorities in each industry's Industry Development and Trade Strategy jointly identified by the relevant business and union groups and government agencies (as proposed in Chapter 7). In particular the fund should be directed at industry developments that are considered to have good prospects for long-term viability but where adequate investment funds cannot be found from other Australian sources.

**Recommendation 11.** The Committee recommends that government establish an Industry and Trade Development Fund, whereby all superannuation funds and Approved Deposit Funds (ADFs) are required to lodge one per cent of all new assets from 1 January 1992 in the Fund. This Fund should be used to provide loans, including on concessional terms (where appropriate), to ventures that are identified as having a high priority and good prospects for long-term viability in each industry's Industry and Trade Development Strategy where adequate investment funds cannot be found from domestic sources.

8.30 The Fund could be managed by a government body such as the Australian Industry Development Corporation (AIDC). However, the Committee favours an approach whereby the Government and the superannuation funds jointly establish an agency to manage the Industry and Trade Development Fund within the context of investment priorities established in each industry's Industry and Trade Development Strategy.

8.31 In terms of the expected growth of superannuation fund assets, the Industry and Trade Development Fund established with 1 per cent of new superannuation fund assets from 1 January 1992 could be expected to have funds for investment of between \$6 billion to \$9 billion by the year 2000.

8.32 The Committee notes that superannuation fund managers are generally opposed to any direction whatsoever from government about where they ought to be investing. The grounds for such opposition are usually couched in terms of the obligations of fund managers to their contributors and of an abhorrence of any interference by governments.

8.33 It should be stressed, however, that what is being proposed here is a process where only 1 per cent of funds are directed towards investments consistent with priorities established by the relevant industry and union groups in conjunction with relevant government agencies. It is intended that such investments would yield sound returns in the medium to long term. Moreover, the investment decisions over the other 99 per cent of superannuation funds would continue to be made in the same way as at present.

8.34 The Committee also notes that the superannuation fund managers, while arguing strongly against any hint of government direction over where funds are invested, make no such objections to government regulations which ensure that these large amounts of superannuation contributions are available for investment in the first place. This point was made by Michael Stutchbury of The Australian Financial Review:

So far, the big life offices (which reject government directions over where to invest their funds but welcome regulations which funnel super money into their coffers) have dulled any business opposition to award-based superannuation. (The Australian Financial Review, Wednesday, July 31, 1991, page 13)

8.35 The investment priorities identified in each industry's Industry and Trade Development Strategy will include the identification of the investment that is needed to provide the essential underlying public infrastructure. Government will need to consider various options to finance investment in public infrastructure. These could include additional public borrowing from domestic sources through the issuing of bonds and/or the earmarking of some proportion of the total Industry and Trade Development Fund for the provision of essential underlying public infrastructure.

8.36 The latter option would entail, in effect, a superannuation levy or tax on a small proportion of the total assets which could then be applied to finance investment in public infrastructure. If, for instance, a 0.01 per cent levy or tax was to be imposed on all new superannuation fund assets from 1 January 1992, then some \$600 million to \$900 million in funds for investment could be expected to be generated by the year 2000.

**Recommendation 12.** The Committee recommends that government consider various options for raising additional resources for public infrastructure investment that is identified as being essential in each industry's Industry and Trade Development Strategy.

#### **Taxation Reforms to Encourage Savings and Investment**

**8.37** While further developments in superannuation ought, more than any other single measure, to set the scene for a major change in the level of savings in Australia, the Committee is also concerned about some of the distortions in the tax system which mitigate against savings in favour of debt. These distortions affect both individuals and enterprises.

**8.38** The Committee recognises that current taxation arrangements in Australia provide incentives by way of taxation concessions for debt, yet they require full payment of tax by individuals and enterprises for any interest earnings on savings. This encourages the accumulation of debt. Private savings must be increased if we are to create the conditions in Australia that are necessary to lower the current account deficit and the level of overseas debt.

**8.39** EPAC estimated the rates of marginal tax on interest income in Australia for 1988. They found that for taxable incomes over \$5,100 the marginal rate of tax on interest income varied between 24 to 49 cents in the dollar depending on the overall level of taxable income. EPAC estimated that effective marginal tax rates, however, varied from 24 per cent to 172 per cent depending on the individual's taxable income level and the underlying assumptions made about real interest rates and the inflation rate. EPAC has found in its investigation of private savings in Australia that:

The taxation of nominal interest income can produce prohibitive rates of tax on real interest income in periods of inflation; ... in effect, tax being partly levied on repayment of principal to the lender. This will affect the composition of saving as well as tend to reduce the overall saving incentive to some extent ...

However, the fact remains that households can face prohibitive rates of tax on interest receipts. ... These are often households of modest resources for whom deposit institutions (eg, banks and building societies) are a readily accessible channel for marginal saving. (EPAC, *Trends in Private Saving*, Council Paper No. 36, Australian Government Publishing Service, Canberra, December 1988, page 22)

**8.40** Nevertheless EPAC, in examining this issue, was somewhat ambivalent in its findings about the desirability or otherwise of taxation concessions to encourage savings. For instance EPAC noted that:

Most OECD countries attempt to reduce anti-saving effects of income taxation by various concessions on property income. Major areas for concession have been in respect of capital gains, home ownership, retirement saving and various other tax favoured savings instruments. Resulting complexity of tax systems has also provided opportunity for tax minimisation more generally. (EPAC, *Trends in Private Saving*, Council Paper No. 36, Australian Government Publishing Service, Canberra, December 1988, page 19)

**8.41** The Committee notes that a number of countries have introduced or are considering the introduction of tax-free thresholds on the interest earned from private savings.

**8.42** Japan has for many years operated a system of tax-free savings accounts - the "Maruyu" accounts - which, it is argued, have contributed to Japan's high savings rate. Japan did, however, recently abolish these concessions, apart from those for low paid and disadvantaged groups. It should be pointed out that this decision was taken as part of a broader policy decision in Japan to encourage increased consumption and reduced savings. These circumstances are rather different from those currently applying in Australia.

**8.43** More recently the United Kingdom and the United States have taken or intend to take steps to encourage private savings by way of introducing tax concessions on interest earned. The United Kingdom introduced Tax Exempt Special Savings Accounts (TESSAs) on 1 January 1991. TESSA enables individuals to hold private savings of up to £9,000 without attracting tax on the interest earned from those savings. The US President, in his 1991 State of the Union Address, also announced the introduction of tax-free family savings accounts.

**8.44** In order to create an environment that removes some of the taxation distortions faced by Australians when they attempt to increase their savings, the Committee believes that government should introduce tax-exempt savings accounts. If the TESSA system of the UK were to be followed then private savings of up to around \$20,000 would not attract income tax.

**8.45** The Committee believes that the introduction of tax exemptions on savings in Australia would prove to be an initiative that would help to boost the overall level of domestic savings - a necessary prerequisite to reductions in the current account deficit and our level of overseas debt.

**Recommendation 13.** The Committee recommends that government introduce tax exemptions on the interest earned on savings up to a certain level of savings, in order to reduce the distortions in current taxation arrangements which favour debt over savings. Government should introduce tax exemptions on interest to increase domestic savings in Australia as an essential part of a package designed to reduce our reliance on overseas debt and to lower the current account deficit. If a model along the lines of the recently introduced Tax Exempt Special Savings Accounts (TESSAs) of the United Kingdom were to be adopted in Australia, then private savings up to around \$20,000 could earn interest without attracting any income tax.

**8.46** In terms of taxation reforms to encourage business investment the Committee notes the overhauled depreciation provisions that were announced in the Government's industry statement of 12 March 1991. These changes are expected to yield savings to business in the order of \$100 million. These taxation reforms involved definition of the effective life and self-assessment of depreciation rates, broad banding of depreciation rates, the pooling of items for depreciation purposes and the immediate deduction for items of plant where its estimated life does not exceed three years or its unit value does not exceed \$300.

**8.47** These initiatives are, in the Committee's view, likely to prove to be useful in encouraging further investment in Australia's productive capacity.

**8.48** However, these arrangements apply to taxation deductions for depreciation against income earned from that investment. Thus current arrangements apply to taxation concessions more heavily in favour of investments that yield immediate returns. Projects where the returns are not generated for some years are not able to benefit from these concessions in the short term.

**8.49** The Committee believes government must also give full consideration to a range of taxation concessions that might equally benefit or provide incentives to investors where return is not expected in the short term. The Committee is particularly concerned that maximum encouragement is given to long-term investments that have economic and social benefits that are wider than the profits generated by the investing firms. The Committee notes the proposals of the Very Fast Train consortium in this regard.

**8.50** The Committee is persuaded by arguments for further reforms to taxation arrangements to enable the adoption of more accelerated depreciation allowances. Such depreciation allowances need to encourage greater investment in projects which are of national significance in terms of increasing value-added exports and import replacement industries development. In the case of investment in new projects for the development of value-added exports and import replacement an accelerated depreciation allowance enabling complete write-off over four years is proposed. These provisions should, however, be restricted to investment in new value-added export and import replacement projects. They should not be available to existing primary commodity export industries. The Committee notes that such

an initiative, while having the impact of reducing taxation revenue in the short term, can be expected to have minimal impact on reduced taxation revenues or even to add to them in the long term.

**Recommendation 14.** The Committee recommends that government adopt a further reform to taxation arrangements by way of an accelerated depreciation allowance which permits the complete write-off over four years of new investment in value-added export and import replacement ventures. These reforms would further encourage investment in Australia's productive capacity. Accelerated depreciation allowances should not be available to primary commodity exporters. Consideration is also needed of options to ensure equity in arrangements whereby immediate taxation incentives are also available to projects where the investment is not expected to yield a return in the short term, noting that current arrangements for the claiming of depreciation allowances are distorted in favour of investments yielding immediate returns.

#### **Limiting Australia's Reliance on Overseas Savings**

**8.51** With the advent of financial deregulation and the lifting of exchange controls capital inflows and outflows to and from Australia have not been subject to restriction.

**8.52** The Committee notes that this policy has created the circumstances whereby massive inflows of foreign capital to Australia have occurred over the past decade, culminating in a tenfold increase in the level of Australia's overseas debt over this period.

**8.53** The Committee also notes that a sustained reduction in the current account deficit and the level of our overseas debt will only be possible if Australia is able to substitute domestic sources of investment finance for overseas borrowings.

**8.54** Measures aimed at encouraging domestic savings and investment in Australia have been considered in this chapter. Superannuation, in particular, is likely to grow at a level whereby the conditions ought to emerge in the rest of the 1990s so that Australia can substantially reduce its reliance on overseas borrowings.

**8.55** The Committee notes, however, that the mere existence of such domestic sources of investment capital does not necessarily guarantee a reduced reliance on overseas debt.

**8.56** Australian interest rates continue to be attractive to overseas investors. Even more importantly, Australia continues to offer a relatively secure and stable political and economic environment for overseas investment.

8.57 The Committee does not believe that Australia's interests would be best served by the reintroduction of controls on capital inflows and outflows as the basis for reducing our reliance on overseas debt. If, however, the debt growth continues at an unabated rate through the 1990s, then such controls may prove to be necessary. The Committee is strongly of the view that severe restrictions should only be contemplated as a last resort.

8.58 Having said this, the Committee believes that with the advent of an enhanced capacity to generate domestic savings such as through superannuation growth, the time has come for Australia to rethink its attitude towards overseas borrowings and the accumulation of further foreign liabilities generally. The emphasis must now be on the generation and use of domestic funds. The attitude that overseas debt is a "necessary evil" needs now to be seriously questioned.

8.59 While rejecting the need to resort to the reintroduction of controls on the volume of capital inflow, the Committee believes that government can and should play a role in a number of important ways to encourage the limiting of Australia's reliance on overseas borrowings.

8.60 First, government should reconsider the rate of withholding tax on the interest earned by non-residents. Currently overseas lenders are charged an interest withholding tax at a flat rate of 10 per cent of the interest earned.

8.61 The Committee notes that some aspects of Australia's withholding tax arrangements were recently examined by the House of Representatives Standing Committee on Finance and Public Administration (House of Representatives Standing Committee on Finance and Public Administration, Follow the Yellow Brick Road: The Final Report on an Efficiency Audit of the Australia Taxation Office: International Profit Shifting, Australian Government Publishing Service, Canberra, March 1991). Their findings were focussed on the need for some administrative improvements particularly with respect to changes designed to minimise taxation avoidance. The review did not recommend an increase in the rate of interest withholding tax as a means to reduce tax avoidance, for fear that it may have led to undesired effects discouraging needed capital inflows to Australia.

8.62 The issues of the adequacy of the existing rate of withholding tax has been examined in this inquiry in the context of the need to reduce the current account deficit and the level of overseas debt.

8.63 In examining this issue the Committee considered recent research done at the Reserve Bank of Australia by Dr David Gruen. He found that the existence of comparably high real interest rates in Australia provides foreign investors with a premium even when they expect the Australian dollar exchange rate to depreciate to offset the domestic/foreign inflation differential. Dr Gruen concluded that:

... a real interest equalisation tax is designed to eliminate the real interest premium earned by foreigners investing in domestic nominal assets. ...

... introducing an inflation-neutral tax system leads to the same equilibrium in the real economy as is achieved by eliminating inflation. (Gruen, D.W.R., The Effect of Steady Inflation on Interest Rates and the Real Exchange Rate in a World with Free Capital Flows, Research Discussion Paper 9101, Reserve Bank of Australia, Sydney, February 1991, page 15).

8.64 Australia's withholding tax on interest paid by non-residents requires reconsideration to ensure that any premium earned by non-residents because Australia's real interest rates have exceeded those of most of our trading partners is eliminated.

8.65 The Committee felt that the flat 10 per cent rate of withholding tax on interest paid by non-residents appears to be somewhat inadequate both in terms of the level charged and in terms of a lack of flexibility. Flexibility is required to vary the rate as Australia's requirements for overseas capital changes.

8.66 The Committee notes that in Canada, for instance, a withholding taxation rate of up to 25 per cent is imposed. However, a rate of 15 per cent is applied where Canada has taxation treaties with other nations. Canada also has exemptions in its law where the right to tax interest paid to foreigners can be waived altogether at times when circumstances dictate the need to encourage capital inflows.

8.67 The Committee believes that this approach ought to be adopted in the Australian withholding tax system.

Recommendation 15. The Committee recommends that the reimposition of controls on the volume of capital inflows to Australia should not be contemplated as an appropriate policy approach to reducing the current account deficit and the level of overseas debt at this stage. Government should, however, overhaul Australia's 10 per cent flat rate withholding tax on interest paid to non-residents. This tax is inflexible and inadequate. Government should introduce a flexible withholding tax, the rate of which could be varied according to Australia's differing requirements for overseas capital at different times. The overhauled withholding tax ought to include provision for levying a rate of up to 25 per cent but limiting it to 15 per cent in case of nations with which Australia has a taxation treaty.

**8.68** While rejecting a return to quantitative controls on capital inflows, and notwithstanding the overhaul of withholding tax arrangements proposed above, the Committee is concerned that government currently has insufficient measures at its disposal to enable it to limit capital inflows to Australia at times when these inflows are the cause of grave concern. There were times during the investment boom of the late 1980s when some discouragement of the inordinately high capital inflows to Australia would have been a prudent course of action. Australia's level of overseas debt would be lower today had such measures been at government's disposal.

**8.69** This issue was recognised by the Committee of Inquiry into Australia's Financial System - better known as the Campbell Committee. The Campbell Committee advocated a deregulated financial system for Australia, which was subsequently accepted by government. The Committee also argued for the introduction of a capital inflow/outflow tax. This latter proposal, of course, was not taken up by government. The Campbell Committee argued a capital inflow/outflow tax was needed:

... as a last-resort measure, providing a buffer against external fluctuations which cannot be handled satisfactorily with the available policy tools ... (Committee of Inquiry into the Australian Financial System, Australian Financial System, Final Report of the Committee of Inquiry, Australian Government Publishing Service, Canberra, September 1981, page 150)

**8.70** In reaching this conclusion the Campbell Committee noted that Australia had relied upon the Variable Deposit Ratio (VDR), along with embargoes on short-term borrowings, to regulate capital inflows during the 1970s. While acknowledging that the VDR, which acts to discourage capital inflows by adding to the cost of overseas borrowing, was preferable to quantitative controls, the Campbell Committee also identified the VDR as having several limitations. Instead, it argued that:

The authorities might therefore give some thought to a capital inflow/outflow tax - a variant on a dual exchange rate system. (Committee of Inquiry into the Australian Financial System, Australian Financial System, Final Report of the Committee of Inquiry, Australian Government Publishing Service, Canberra, September 1981, page 149)

**8.71** In the light of Australia's experience since deregulation, the Committee believes government must reconsider its decision not to accept a capital inflow tax as originally proposed by the Campbell Committee. Government should have at its disposal an instrument to discourage inordinately high levels of capital inflows at times when speculative investment booms are the cause of significant inflationary pressures.

**8.72** The Committee believes that a capital inflow tax should be used sparingly as a measure of last resort. Its too frequent use would be likely to create expectations which would introduce distortions to capital investment markets. The capital inflow tax ought to apply to inflows of debt and equity investment.

**Recommendation 16.** The Committee recommends that government establish a capital inflow tax, with a rate that can be varied according to changing circumstances. The capital inflow tax should be a measure of last resort that is applied at times when an investment boom threatens to cause significant inflationary pressures.

**8.73** In Chapter 4 it was noted that Australia has an Investment Promotion Program (IPP) which is designed to encourage foreign investment in Australia. The Committee is of the view that the IPP ought to be abolished. The IPP encourages more foreign investment in Australia. This is at odds with the need to reduce Australia's reliance on foreign investment as part of the policy approach that is needed to encourage a lowering of the current account deficit and the level of overseas debt.

**Recommendation 17.** The Committee recommends that the Investment Promotion Program (IPP), which promotes Australia as a destination for foreign investment, be abolished. Australia must reduce its reliance on overseas investment if the current account deficit and overseas debt levels are to be reduced.

## CHAPTER 9

### GENERAL ECONOMIC POLICY SETTINGS

#### The Overall Approach to Economic Policy

9.1 The policy measures aimed at improving Australia's international trading performance and at reducing Australia's reliance on overseas borrowings that were discussed in Chapters 7 and 8 are essential, in the Committee's view, if Australia's current account deficit and overseas debt are to be substantially reduced.

9.2 There can, however, be no substantial and sustained reductions in the current account deficit and the level of overseas debt unless these measures are also accompanied by appropriate general economic policy settings. It goes without saying that some policy settings of the 1980s had adverse effects on the current account deficit and on the level of overseas debt. The positive effects expected from the proposals made in Chapters 7 and 8 will not be sufficient in themselves. There is a danger that, when implemented, they could be undermined by the effects of inappropriate macroeconomic policy settings.

9.3 Australia cannot afford to persist with economic policies that are inconsistent with lowering the current account deficit and the level of overseas debt.

9.4 In the Committee's view these policy settings need to revolve around five main areas. First and foremost is an easing of monetary policy to create the conditions for sustained reductions in the exchange rate for the Australian dollar.

9.5 Second is the need to find alternatives to high interest rates as the vehicle for demand management of the Australian economy, noting the impact the high interest rates have had on the current account deficit and overseas debt level in recent years.

9.6 Third is the need to continue with fiscal policy settings that do not increase government borrowings as a proportion of GDP and that ensure the further repayment of existing public sector debt incurred from borrowing overseas.

9.7 Fourth is the need to ensure that incomes policy is aimed at restraint of all incomes, not just wage incomes.

9.8 Finally, rapid and sweeping microeconomic reforms are needed and they should be directed not only at improvements in efficiency through restructuring to realise savings in business costs but also at ensuring Australia's underlying infrastructure is both adequate and sufficient to ensure that Australia can compete effectively in the global economy. The composition of government outlays also requires some reconsideration to ensure an approach that is consistent with achieving an improved international trading position.

**Recommendation 18.** The Committee recommends that economic policy settings in Australia, for the remainder of the 1990s, be aimed at lowering the current account deficit and the level of overseas debt in a substantial and sustained way, as well as reducing unemployment and inflation. The general policy settings that are required at present are:

- an easing of monetary policy to create the conditions for a lower exchange rate;
- the adoption of alternatives to high interest rates as the vehicles for demand management of the economy;
- a continuation of prudent fiscal policy;
- an incomes policy based on continuing restraint not only in wages growth but in the growth of incomes generally; and
- major microeconomic reforms that are aimed not only at improved productivity through realising savings but also at ensuring that Australia has the underlying infrastructure, research and development strategies and workforce skills that are necessary for achieving improvements in Australia's international competitiveness.

#### Exchange Rates

9.9 The Committee, in considering the impact of the exchange rate on the current account deficit and overseas debt level, has concluded that there can be no lasting improvement in the current account deficit without an Australian dollar which is valued to provide strong encouragement for Australia's exporters and a disincentive to imports. This means that the Australian dollar needs to be valued at a rate that is lower than at present.

9.10 The Committee notes that the appreciating Australian dollar over the late 1980s has had an adverse impact on Australia's export performance, while encouraging rapid rises in imports.

9.11 An Australian dollar which has a lower value is essential to achieving a sustained improvement in the trade balance by way of greater exports and a reduced demand for imports through the higher prices paid for them by domestic consumers. This will in turn produce a positive effect on the current account through downward pressure on the deficit.

9.12 The Committee notes, however, that a lower exchange rate would also have the effect of adding to the interest and principal repayment burden of those whose overseas debts are denominated in a foreign currency by making it more expensive, in Australian dollar terms, to purchase those currencies to service their debt. This would lead to a short-term increase in the net income deficit within the current account, but this should be outweighed by an improvement in the trade balance.

9.13 An Australian dollar that is valued at a lower rate than at present would have the effect of an added debt servicing and repayment impost for a large number of existing debtors with foreign obligations. This is because some two-thirds of Australia's overseas debt is denominated in foreign currencies.

9.14 There can be no question that a depreciated Australian dollar is in Australia's long-term economic interests. It would promote exports and discourage imports. It would also serve to discourage overseas borrowings in the long term, particularly those held in foreign currencies.

9.15 The Committee is of the view that on this question Australia's long-term economic interests must take precedence over the additional impost on those with existing overseas debts.

9.16 However, the Committee does not advocate any return to a regulated exchange rate to achieve a depreciated Australian dollar. Instead the Committee believes that the Government needs to ensure that its policies generally are consistent with creating the conditions for a lower exchange rate. For instance lower interest rates are an essential prerequisite and the Reserve Bank of Australia should ensure that its actions are geared towards moving the Australian dollar to a level more consistent with the size of the current account deficit.

9.17 The Committee is also concerned that the public perception, including by some parts of the media, is that a falling dollar is somehow a bad thing, while a rising value of the dollar is generally being described as "a gain in the dollar". These perceptions have contributed to a misplaced concern when the value of the dollar has fallen. The Government will need to ensure that greater emphasis is put on explanations as to why a falling dollar is in Australia's interests. Public education about the importance and desirability of a lower exchange rate is required, along the lines of that recently stated by government leaders and Reserve Bank officials.

**Recommendation 19.** The Committee considers that government should recognise that a lower value of the Australian dollar is fundamental to underpinning a lower current account deficit and to discouraging overseas borrowing. A lower Australian dollar would encourage Australia's exports, make imports relatively more expensive and would discourage further reliance on overseas debt. The Committee recommends that government economic policy settings be consistent with creating the conditions for a lower exchange rate, particularly by maintaining persistently lower interest rates.

#### Interest Rates, Inflation and Monetary Policy

**9.18** On balance, high interest rates have had a negative impact on the current account deficit.

**9.19** They have contributed to a stifling of the efforts of Australian industry to export by imposing additional costs on the borrowing often necessary for investment.

**9.20** High interest rates have produced a disappointing result in terms of reducing imports, while contributing to a serious recession with high levels of unemployment. Although the rationale for tight monetary policy through high interest rates was to dampen demand, particularly through a dampening of the demand for imports, the result has been only a marginal fall in imports in the past year. This is hardly surprising when it is remembered that almost half of Australia's merchandise imports are not the consumption of final goods but rather, they are the purchases of machinery and transport equipment which are necessary inputs to production in Australia. High interest rates have had a significant effect on increasing the costs of borrowing to purchase these inputs.

**9.21** High real interest rates in Australia, relative to other OECD nations, have also contributed to the attractiveness to overseas investors of investments in Australia, thereby leading to additional overseas debt. Interest repayments on this debt have added to the current account deficit.

**9.22** For all of these reasons it is quite clear, in the Committee's view, that an easing of monetary policy through sustained reductions in interest rates is absolutely essential if sustained reductions in the current account deficit and overseas debt levels are to be realised.

**Recommendation 20.** The Committee considers that governments must recognise that high interest rates, although having been justified traditionally in terms of reducing the demand for imports, are an inappropriate vehicle for lowering the current account deficit and overseas debt levels. The Committee recommends an easing of monetary policy through lower real interest rates in order to realise sustained reductions in the current account deficit and overseas debt levels.

**9.23** An easing of monetary policy through lower interest rates must be managed carefully if Australia is to avoid a resurgence of inflationary pressures as the recession eases. Continuing low inflation is important to Australia's international economic competitiveness.

**9.24** This means that alternatives to high interest rates are needed for demand management of the economy. Higher taxes are the conventional means for this. The Committee notes, however, that apart from being highly unpopular, higher taxes often serve only to reduce the consumption of individuals and households and to limit private sector investment while at the same time increasing the capacity for public sector consumption and investment. While such transfers may be desirable for other reasons, they do not necessarily reduce the inflationary pressures in the economy.

**9.25** In terms of demand management of the economy that is consistent with a low rather than high current account deficit and lower overseas debt, the Committee believes that Australia must find and use alternatives to higher taxes or tight monetary policy through high interest rates.

**9.26** The Government should give serious consideration to the use of measures that involve forgoing current consumption in favour of increased savings when attempting to dampen demand in the Australian economy. Such measures would be consistent with easing pressure on the current account deficit, rather than adding to it.

**9.27** To this end the Government might explore the option of adopting a superannuation surcharge (or bond) that could be levied on employees at times when high aggregate demand in the economy is thought to be a problem. These funds could be retained in trust and used for investment purposes as the need to restrain demand in the economy eases. For individuals this would constitute a period of enforced savings and forgone consumption in the current period. The individual would, however, directly benefit in the long term by these enforced savings, in contrast to attempting to restrain demand through other measures such as higher taxes or higher interest rates. The superannuation surcharge could be set at zero or a very low rate at times when restraint of aggregate demand in the economy is not required.

**9.28** Enterprises also need to play their part. The Government could consider the introduction of a compulsory "investment bond", along the lines of that applying in Sweden, whereby firms are required to purchase "investment bonds" equivalent to a proportion of profits in periods when the level of economic activity is thought to be too high. These bonds can then be drawn upon by the enterprises in periods of economic downturn, to stimulate investment and employment. Such an approach is also designed to increase economic stability.

**Recommendation 21.** The Committee recommends that government explore mechanisms for demand management of the economy that are alternatives to high taxes or tight monetary policy through high interest rates, if it is also to achieve low inflationary outcomes without creating pressures which add to the current account deficit and overseas debt level. Government seriously needs to consider mechanisms that force individuals and enterprises to forgo current consumption in favour of compulsory savings at times when excess demand in the economy is thought to pose considerable problems. Options for this include the introduction of a superannuation surcharge (or bond) which could be levied so as to require higher superannuation contributions by employees at times when government wishes to curtail consumption demand and the introduction of a requirement on business for the purchase of an "investment bond" which could later be drawn upon to stimulate investment in periods of economic downturn.

**9.29** The Committee is also of the view that the Trade Practices Commission (TPC) powers and resources require some enhancement to ensure that all forms of anti-competitive behaviour, which add to inflation, can be eliminated.

#### Fiscal Policy

**9.30** Government borrowings as a proportion of GDP have fallen sharply since the early 1980s. Since the mid-1980s the general government sector was in surplus - a net saver enabling the repayment of debt. The Committee recognises that a continuation of this situation would serve to lower pressures on the current account deficit and to reduce overseas debt levels.

**9.31** The Committee also notes that further relative declines in government net borrowings will be by no means sufficient to solve Australia's current account deficit and overseas debt problems, given that the 1980s saw private sector borrowings increase massively, resulting in the major overseas debt servicing obligations shifting to the private sector.

**9.32** Nevertheless continuing fiscal moderation and further restraint in government borrowing would make a contribution to lowering the current account deficit and the level of overseas debt.

**9.33** Such a policy, however, should not be pursued so rigidly as to prevent increases in public outlays that would contribute to long-term improvement in the current account deficit.

**9.34** For instance, elsewhere in this report measures have been proposed to improve both Australia's long-term international trading performance and its domestic savings and investment situation, which require some changes or even increases to government outlays. These measures include investments in public infrastructure, enhanced training expenditures, policies to encourage research and

development, taxation reforms aimed at increased savings and investment and enhanced targeted assistance for exporters. These measures are essential even though they increase outlays and reduce revenue. They must be pursued as a necessary part of Australia's long-term efforts to reduce the current account deficit and overseas debt levels.

**Recommendation 22.** The Committee recommends that government continue to pursue fiscal moderation directed at minimising its borrowings as a proportion of Gross Domestic Product as part of a long-term strategy to ensure that borrowings are not contributing to a high current account deficit and a high level of overseas borrowings. Nevertheless this policy should not be pursued at the expense of enhanced outlays that are necessary to improve Australia's long-term international trading performance and domestic savings and investment situation.

#### Incomes Policy

**9.35** Income restraint contributes to a reduced current account deficit, not least by providing an alternative to exchange rate appreciation at times when policies aimed at dampening demand are required. Income restraint is also important in stabilising expectations about pay and price increases under a floating exchange rate regime.

**9.36** The Committee acknowledges that appropriate fiscal and monetary policy settings are much more likely to contribute in a significant way to reducing the current account deficit and the level of overseas debt. Nevertheless, incomes restraint has a vital role in creating a non-inflationary environment conducive to restraint in increases in labour input costs in Australia's export and import competing sectors.

**9.37** To this end it is essential that downward pressure on inflation be maintained, not at the cost of continuing extremely high levels of unemployment, but through a policy of comprehensive income restraint and more effective measures to increase competition within industries.

**9.38** The Committee is of the view that an impediment to income restraint recently has been the excessive income increases of executives, for this obliterates the equity justification for income restraint.

**9.39** The Committee considers that every part of the community must share the costs of the income restraint necessary in the pursuit of an effective anti-inflationary policy. The TPC inquiry into professional incomes is important in this regard. TPC powers and resources may require some strengthening to ensure that all forms of inflationary behaviour arising from the growth in professional incomes can be attacked effectively.

**Recommendation 23.** The Committee considers that in order to maintain downward pressure on inflation, government needs to ensure that a policy of continuing income restraint is pursued. The Committee recommends that such a policy must ensure restraint in all incomes and not just those of wage earners, to ensure equity across all sectors of the community.

#### Microeconomic Reforms

9.40 The Committee notes that a considerable range of microeconomic reforms has been or is being implemented that will serve to increase efficiency and productivity and to reduce the costs of inputs to industries that seek increased export and import replacement production.

9.41 In particular the Committee commends the progress made towards the microeconomic reform of shipping, road and rail transport and in increasing efficiency in public utilities.

9.42 The Committee is, however, concerned that the microeconomic reform process must be seen as more than simply an exercise of restructuring to save costs.

9.43 Effective microeconomic reforms will require further investment in public infrastructure to complement other measures taken to improve Australia's international competitiveness.

9.44 A process was proposed in Chapter 7 for the joint determination by employer groups and companies and unions and employees, in conjunction with relevant government agencies, of priorities necessary for microeconomic reforms which require investment in public infrastructure. Options for financing increased investment were discussed in Chapter 8.

**Recommendation 24.** The Committee considers that a policy of continuing microeconomic reforms is essential to underpin the efficiency and productivity gains that are needed to improve Australia's international trading performance. The Committee recommends that the microeconomic reform process encompass investment in new public infrastructure, in addition to restructuring to reduce industry input costs.

9.45 These reforms also need to be associated with measures to improve Australia's capacity for innovation which can lead to the development of new export and import replacement industries.

9.46 An essential complementary strategy to the process of microeconomic reforms is the need to enhance Australia's education and training system to ensure that it is able to meet the challenge of ensuring that Australia has the skills base necessary to diversify its export and import replacement industries. The highest priority is for increased support for the Technical and Further Education (TAFE) sector.

**Recommendation 25.** The Committee recommends that real outlays on research and development and education and training should be increased so that strategies identified in each industry's Industry and Trade Development Strategy can be implemented to improve Australia's international trading performance.

Chris Schacht  
Senator  
Chairman

10 October 1991

## MINORITY REPORT

Minority Report by Senator D.G.C. Brownhill, Senator H.G.P. Chapman, Senator N.A. Crichton-Brownne, Senator D.J. MacGibbon, Mr D.M. Connolly, MP, Dr H.R. Edwards, MP, Mr R.G. Halverson, MP, Mr N.J. Hicks, MP, Hon. M.J.R. MacKellar, MP, Hon. J.C. Moore, MP and Rt. Hon. I.M.C. Sinclair, MP.

The Report of the Joint Committee on Foreign Affairs, Defence and Trade on the reference "Causes of the Australian current account deficit, the consequent growth of overseas debt and measures for reducing the deficit" addresses issues fundamental to national economic policy.

Aspects of the subject were canvassed in Statement 2 of this year's (1991-92) Budget Paper No. 1.

That part of Statement 2 headed "Lessons from the Cycle" (2.31 - 2.33) and "Present Policy Challenges and Opportunities" (2.33 - 2.42) (attached) examines developments in the 1980s; puts the case for relating economic policy more to the medium term; and spells out a comprehensive package of policy and reform, notably labour market and microeconomic reform - to which we would add tax reform - to achieve sustained low inflation economic and employment growth, rising living standards and a reducing current account deficit as specified in the terms of reference. It stresses the importance of making significant progress simultaneously on all policy fronts.

We are in substantial agreement with the Treasury position in this extract from Statement 2.

The recommendations of the majority of the Committee in our view are not a suitable response to the issues under reference although we concur with Recommendations 1 and 8.

In our view Australia needs urgently a comprehensive program of policy reform to effect fundamental change to boost national production, productivity, exports and savings.

We do not believe this emphasis comes through in the Report.

As an alternative to the other recommendations from which we dissent (and given the constraints of time and limited resources), we present this letter and the extract from Statement 2 as a Minority Report on the appropriate economic policy package to reduce Australia's current account deficit.

## Excerpt from Budget Paper No. 1, Budget Statements 1991-92

### LESSONS FROM THE CYCLE

Looking back over the second half of the 1980s, a number of observations can be made. As the economy accelerated out of the 1986 slowdown, its likely path was clouded by the stock market crash of October 1987, that saw the largest market disruption since the crash of 1929. Understandably concerned to ensure the stability of the world financial system and minimise the possible real effects on activity, monetary authorities stood ready to support the financial system. This led Central Banks worldwide to err on the side of easier credit conditions. As events turned out, the confidence effects of the crash and its impact on activity proved to be much less significant than expected by governments and financial markets worldwide.

In Australia's case, monetary policy was eased substantially in 1987 as part of a policy reweighting which involved significant fiscal tightening. After the stockmarket crash, Australia was one of the first countries to tighten policy with an increase of around 1 percentage points in official short-term interest rates during April-May 1988. With the benefit of hindsight, however, the initial and subsequent tightening in 1988 may have been unduly cautious as subsequent data indicated that the terms of trade were moving substantially in our favour and demand was picking up. Earlier adjustment may have lessened the extent of the subsequent policy tightening. In addition, as early tightenings were not highlighted by formal announcements by the authorities, the announcement effects (and immediate impact on expectations) were not as pronounced as they might have been.

Overlaying all this, the policy trade-off between monetary and fiscal policy in the upswing proved less favourable than was expected. Fiscal policy was not moderating demand pressures as effectively as expected. The impact of the asset price boom on demand was at the same time not fully appreciated.

Over the cycle, the interpretation and operation of monetary policy were complicated by the effects of financial deregulation and innovation as well as asset price swings. The upswing in the terms of trade, the asset price cycle and the upswing in non-dwelling

(16) For more detail on the changing contribution of stocks to the economic cycle see The Treasury (1991) *Economic Round-Up*, Winter edition.

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construction worked to offset the effects of tighter monetary policy during late 1988 and 1989.

In deregulated financial markets, private sector expectations play a much more important role in determining the speed of the transmission of monetary policy changes to the real economy. In particular, judgments about the likely future course of interest rates—and the economy more generally—affect the response of business decisions to changes in current interest rates. One factor which bears on these judgments is the perceived willingness of governments to sustain policy changes to their intended end. As a result:

- the degree of 'policy credibility' can be important in determining both the size of required policy adjustments and the speed of the flow-through effects;
- announcement affects, where the changes in interest rates and their relation to the policy stance are immediately and clearly articulated, can be important—especially as borrowers and lenders are coming to terms with the 'new environment'; and
- continued adherence to defined policy objectives can help build credibility minimising confused signals and inappropriate policy adjustments.

Given the difficulties of assessing and interpreting the impact of monetary policy in such an environment, it is necessary to guard against the danger of over-reacting to current and short-term developments in judging the setting of policy. While, for the reasons mentioned above, the length and distribution of the impact of changes in monetary policy are difficult to predict, an average lag of the order of a year seems to be involved. If such lags are not allowed for, monetary policy can have unintended, and possibly pro-cyclical, effects.

That said, Australian and international experience shows that setting policy successfully in such a prospective framework is a very significant challenge, not least because of the limited availability of genuinely forward-looking statistical and other information that provides a reliable guide to future trends. The recent cycle has been a reminder of those difficulties.

Not all of the key lessons of the past cycle relate to what may be perceived as policy shortcomings. One of the key policy lessons of the 1980s was the powerful positive effects on investment, employment and growth potential associated with real wage restraint and improved levels of profitability.

Overall, the past five years have provided a clear reminder of the difficulties that macroeconomic policy faces when economic events are unusually difficult to predict, where economic trends are not easily discernible and where policy responses operate with substantial and uncertain lags. Those circumstances will always confront, in varying degree, an internationally open economy like Australia's. This points to the advantages of relating policy more to the medium-term and assigning policy instruments to their area of greater effectiveness. Such a framework entails:

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- monetary policy clearly enunciated and focussed on reducing inflation and inflationary expectations but remaining very much alive to the implications of settings for domestic demand;
- fiscal policy targeted towards contributing to an appropriate balance between domestic demand and production, particularly through its contribution to raising national savings; and
- wages policy aimed at restraining aggregate wage pressures to maximise employment growth and contribute to progress on inflation, while increasing labour market flexibility.

It is important to appreciate that a policy focus on such medium-term objectives does not rule out the desirability or likelihood of policy changes in response to changing economic circumstances. Quite clearly, the need for such policy adjustments will remain. However, such changes need to be cognisant of the difficulties of fine tuning given the lags and uncertainties involved in economic systems.

A necessary corollary of the medium-term objectives for macroeconomic policy is the need for flexible goods and labour markets to enable smooth and timely adjustments to external influences and other factors. This need is heightened in Australia's case by our susceptibility, as a commodity exporter, to movements in commodity prices. Greater flexibility in goods and labour markets can significantly ease the adjustment costs associated with economic cycles, as well as increase medium-term growth potential via more efficient utilisation of both labour and capital. Lack of flexibility, on the other hand, by inhibiting the relocation of resources within the domestic economy, can magnify dislocation costs and result in a lower long-term growth path.

#### PRESENT POLICY CHALLENGES AND OPPORTUNITIES

Australia faces a number of important policy challenges as we move into the next upswing and beyond. The fundamental objective of macroeconomic policy remains unchanged: achieve a solid and sustainable rate of economic growth. But, given the circumstances Australia now faces, important elements in achieving this objective will be:

- generating enduring employment growth;
- ensuring that the gains made on inflation are sustained and built upon; and
- reducing the current account deficit and stabilising our external debt relative to GDP.

As the experience over the past cycle demonstrated, achieving these goals will require a co-ordinated and consistent policy response, embracing all of the arms of macroeconomic policy and industry reform.

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#### Sustained Employment Growth

Renewed scope for employment growth can be expected as the recovery proceeds. As noted previously, one lesson apparent from the 1980s is the critical role of wages in influencing employment growth. If Australia is to achieve sustained employment growth in coming years, wages growth must be consistent with continued moderation of labour costs.

The shift toward enterprise bargaining now under way provides an important mechanism by which lower unit labour cost growth can be achieved through linking nominal wage increases and other costs of employing labour more closely to productivity growth. But increasing labour productivity requires appropriate incentives to change work practices and upgrade skill levels. Some recent progress has been made toward enterprise-bargained wage increases involving direct incentives for delivering improvements in productivity. This process will need to be continued and extended.

Moderate growth of real unit labour costs is essential to ensure the greatest possible employment gains from recovery. However, as the recovery in prospect is likely to be relatively subdued (see Part III), the reduction in unemployment may not be rapid. It will therefore be particularly important both to encourage the most cyclically sensitive sectors of the labour market (such as potential new entrants) to actively seek work and to minimise the de-skilling of the unemployed.

These factors contributed to significant increases in long-term unemployment in 1984-85, which subsequently took much of the decade to unwind. The Government has, in recent times, established several programs designed to help alleviate these problems, as well as develop a better trained, more highly skilled and more flexible workforce. Such programs are important in addressing weaknesses in certain areas of the labour market.

#### Australia's Inflation Performance in the 1980s: Costs and Current Opportunities

In the 1980s, Australia's annual inflation rate averaged around 8 per cent. This rate was consistently above that of our major OECD trading partners and usually above the OECD average. Indeed, prior to the recent downturn, Australia's rate of inflation had been above the average of our major OECD trading partners since the early 1970s, with the exception of 1980 when world inflation rates accelerated (Chart 1, Panel A). By contrast, Australia's inflation rate is now significantly better than these countries. However, inflationary outcomes in many OECD countries will probably improve over the next year or so in response to tighter policy settings. The challenge for Australia is to maintain the progress now firmly in prospect for this year into 1992-93 and beyond.

The current slowing in inflation presents an opportunity to lower inflation on a sustainable basis and realise the benefits of low inflation growth. Overseas experience shows that a number of major OECD countries were successful in reducing inflation in the early 1980s and experienced a period of sustained economic growth once inflation and inflationary expectations were wound back to pre-1970 levels and kept there.

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Inflation has significant economic costs. It creates important distortions to economic decision-making, impairs the efficiency of the price and taxation systems, generates arbitrary redistributions of income and wealth and can result in a lower medium-term growth outcome. While various arrangements have been devised to allow sections of the community to live more comfortably with inflation, these are at best only a partial remedy and, indeed, may over time perpetuate relatively high inflation by discouraging the development of an effective anti-inflation constituency such as exists in several major OECD countries<sup>(17)</sup>.

Over the past year the rate of inflation, as measured by the CPI, has fallen to 3.4 per cent. Inflationary expectations have also fallen significantly as indicated by surveys of consumers and business as well as the significant reduction in yields of long bonds.

International experience suggests that inflationary expectations may not be wound back as quickly as inflation itself partly because markets take time to be convinced of policy makers' commitment to sustained anti-inflationary policies. Ultimately, the credibility of policy commitment depends on maintaining low inflation.

A major challenge as the economy enters the recovery phase will be to consolidate the gains made on the inflation front. This important objective will be aided by the moderately paced recovery forecast through the course of 1991-92. Monetary settings will also have an important role in influencing inflation and inflationary expectations as the recovery unfolds and beyond.

Nominal short-term interest rates have fallen to their lowest levels since early 1988 and long-term rates to their lowest levels in more than a decade. However, real interest rates remain higher than at the turning point of previous recessions, reflecting relatively high international real interest rates and the risk premium required by markets on Australia's external debt. Markets are also conscious of the policy challenge involved in achieving further and sustained reductions in inflation as the recovery proceeds.

In the medium-term, continuing reform of the labour and product markets will have an important role to play in achieving sustained levels of low inflation. More flexible and responsive markets are crucial in allowing future inflationary shocks to pass through the economy quickly without being built into underlying inflation and inflationary expectations—and in minimising the extent to which economic growth may need to be slowed to counter inflationary expectations. More generally, increased competition, including reduced levels of protection, and further decentralisation of wage bargaining, will help achieve a sustained lower inflation outcome by promoting the better use of resources and raising productivity.

#### External Liabilities and the Restraint on Growth

As noted earlier in Part II, the growth and persistence of large external imbalances under a regime of high capital mobility and flexible exchange rates were important features of the international economy during the 1980s. Australia was no exception in that regard. The willingness of international financial markets to continue financing historically large

(17) Some of the costs of inflation are canvassed in more detail in B. Cassidy (1991) *The Redistributive Effects of Inflation*, Treasury Research Paper No 2, AGPS, March.

current account deficits over a longer period has, however, led to a reappraisal of the nature of current account imbalances and their implications for economic policy.

In a theoretical world where there are no resource allocation distortions and there is internal macroeconomic balance, savings and investment decisions should always be optimal. Rational domestic borrowers and informed lenders or investors abroad would ensure that any current account deficit generates the cash flow necessary for it to be serviced. In these circumstances, neither the current account deficit nor any resulting build up in external debt would be a matter of public policy concern.

In practice, of course, there are always distortions impacting on such decisions. The fact is that many private investment decisions have turned out to be sub-optimal in the 1980s. In addition, there was a sharp rise in the public sector borrowing requirement (PSBR) in the mid-1970s and again in the early 1980s. This all helped sustain the increase in the current account deficit and the build-up in external indebtedness.

Many of the distortions that contributed to the build-up in external debt over the 1980s are now being addressed. In particular, the public sector is paying more attention to the cost of—and return on—its borrowings. The excess demand pressures have been removed and considerable progress has been made in reducing inflation. In such an environment, it will become increasingly possible to have greater confidence that savings and investment decisions are more likely to be soundly based, which in turn will reduce the concern over any resulting current account outcome and related changes in foreign liabilities.

Moreover, as outlined earlier in this Part, there has been an important change recently in the method of financing the current account deficit, with equity investment once again exceeding debt financing. If this trend is sustained during the 1990s, it will moderate the increase in the external debt to GDP ratio and facilitate earlier debt stabilisation than would otherwise occur. One advantage of equity investment is that the return on it tends to vary with overall domestic profitability and the cost of servicing it at least partly reflects the economy's 'capacity to pay'.

Nevertheless, the consequences of the build-up in external debt over the 1980s remain and interest obligations must be serviced from current export receipts and/or by issuing new overseas debt. This makes Australia more prone to the effects of rapid reassessment by international financial markets of our economic prospects.

Although the balance of merchandise trade was in surplus in 1990-91, the servicing costs of current net external liabilities are such that a large and sustained trade surplus is required to stabilise these liabilities relative to the size of the economy. Around 20 per cent of export earnings are currently required to service external debt. With a large proportion of production already devoted to meeting income demands of foreign lenders, the nation is more vulnerable to shifts in the sentiment of those holding Australian debt. Stabilising—and eventually reducing—the level of external debt as a proportion of GDP will minimise those risks and facilitate adjustment in a more measured way.

The 1 1/4 percentage point reduction in the current account deficit as a proportion of GDP in 1990-91 compared with 1989-90 is a significant improvement. Without the cost of

servicing existing net external liabilities, we would have recorded a current account surplus.

While this improvement in the current account is expected to be maintained as economic recovery gets under way, further progress is necessary in order to stabilise external debt. This will require a considerable period in which the rate of growth of domestic production exceeds the growth in domestic demand—with the difference constituting an increase in net exports. The requirement is to produce a sufficient wedge of net exports so that the rate of growth in foreign debt accumulation is below the rate of growth in GDP.

The achievement of external debt stabilisation within an acceptable time-frame requires making progress simultaneously on all policy fronts. There is no single, magic cure for Australia's external debt position.

- At the macroeconomic level, policies need to be appropriately firm to hold the growth in spending below the growth in production, so that demand growth does not unduly spill over into imports or draw resources away from exports.
- While there has been a largely cyclical deterioration in the budgetary position recently, fiscal policy settings during the recovery phase will need to be consistent with a substantial structural public sector surplus in order to boost national savings. The Government's initiatives to encourage the spread of superannuation should encourage higher private savings over time.
- Monetary policy can assist the policy process by keeping inflation and inflationary expectations low and creating a more stable and less distortionary environment for investors.
- Some aspects of structural reform may also assist by improving the efficiency with which the existing capital stock is used, thereby lowering investment requirements and the demands placed on savings.

There is much debate on the role of the exchange rate in this process. A lower real exchange rate would certainly improve Australia's competitiveness and in turn the trade-off between growth and external adjustment but the policy scope for achieving a lower real exchange rate is constrained. Lowering the real exchange rate by achieving a relatively better inflation performance than our trading partners would be consistent with the policy requirements outlined above. The alternative of a nominal depreciation has implications for other policy settings, especially for wages and monetary policy. A marked nominal depreciation would add to inflationary pressures and, depending on the wage response, may not achieve its intended effect of improving competitiveness. It would also add to the cost of servicing external debt.

A relaxation of monetary policy with the short-term aim of lowering the exchange rate, even if successful in reaching that goal, would not produce any lasting gain in

competitiveness unless the likely impact on wages and the general price level were fully offset by other policies.

The exchange rate should continue to be determined by the market. As a major commodity exporter, Australia can expect significant swings in the value of the dollar as our terms of trade change. This, in essence, is one of the consequences we have to bear of the very significant benefits of being a resource rich nation. But the challenge for policy is to accommodate those external influences with the minimum disruption to achieving the primary objective of maximum sustainable long-term growth.

#### **The Contribution of Microeconomic Reform**

The importance of injecting greater flexibility into the economy is recognised by many commentators both in Australia and overseas. In essence, the economy will be better placed to absorb external and other shocks, and the adjustment costs will be smaller, if the reallocation of labour and capital to more efficient uses is made easier and quicker.

Microeconomic reform has a key role to play in that process and can also contribute to meeting the policy challenges noted earlier in a number of important ways.

- By raising the supply potential of the economy, higher rates of growth in output, employment, domestic demand and living standards can be sustained.
- By reducing interference with price signals in labour and product markets and enhancing competition in these markets, resources will be used more efficiently and downward pressure can be exerted on inflation.
- By facilitating the stabilisation of our external debt through improving the efficiency with which the capital stock is used, the demands on domestic saving may be reduced without reducing living standards.

The microeconomic reform strategy currently operates through several channels.

#### *Internationalising the Economy*

A number of measures have been taken to make the Australian economy more international in outlook over the course of the 1980s. An important element in the process of microeconomic reform is to promote increased competition in domestic markets and, importantly, by exposing business to international competition. In 1988 the Government introduced a plan to phase down most tariffs to either 10 or 15 per cent by 1992. Although more generous treatment was allowed for the passenger motor vehicle, and textile, clothing and footwear industries, the protection barrier for these industries was also scaled back. This program of reducing protection was extended in the March 1991 Statement, which included:

- general tariffs phasing to 5 per cent by 1996;

- tariffs on passenger motor vehicles and components, reducing to 15 per cent by 2000; and
- tariffs on textiles, clothing and footwear phasing to a maximum of 25 per cent by 2000.

The Industry Commission has estimated that the long-run effects of the measures announced in March would be to generate a 1/2 per cent increase in the level of real GDP (or some \$15 billion in 1989-90 prices), a 2 per cent fall in the level of the CPI and a small positive impact on the balance of trade. These estimates do not take account of the dynamic benefits arising over the longer term from being linked into the world economy, including from more outward looking and flexible attitudes and increased innovation<sup>(18)</sup>.

#### *Other Domestic Reform Measures*

Interdependence is a key consideration in the reform agenda. The continuing reduction in protection must be accompanied by further progress in other areas of microeconomic reform, including reforms to the non-traded goods and services sectors particularly where they affect business costs and competitiveness. This includes the transportation system, the waterfront and services provided by Government Business Enterprises (GBEs).

Some important progress has already been made in the provision of GBE services, especially in telecommunications and electricity supply. EPAC preliminary data suggest that in recent years aggregate GBE labour and total factor productivity has been increasing at faster rates than the private non-farm market sector<sup>(19)</sup>. It will be important, however, to sustain the pace of reform in those areas as large potential efficiency dividends exist.

At the July Special Premiers' Conference, agreement was reached on a number of key areas of microeconomic reform:

- The establishment of a National Rail Corporation charged with providing an efficient interstate rail freight network. The Corporation is to operate as a fully commercial entity in line with best practice overseas.
- Agreement to establish a National Road Transport Commission responsible for regulating heavy vehicles in a nationally consistent manner and developing a heavy vehicle charging regime. Uniform operating regulations in such areas as dimension standards and roadworthiness inspections will remove impediments which have restrained productivity growth in the road transport industry. Similarly, a more efficient heavy vehicle charging regime will remove the cross-subsidy from lighter to heavier freight vehicles, and minimise the incentives to 'shop-around' for lower charges between States and Territories and thus encourage a more appropriate vehicle choice, with resultant cost savings.

(18) Industry Commission (1991) *Chances to Manufacturing Industry Assistance*, March 1991, Industry Commission Information Paper, AGPS, July.

(19) EPAC (1990) *The Size and Efficiency of the Public Sector*, AGPS, October, p3.

- Agreement in principle to the implementation of mutual recognition of regulations and standards for both goods and occupations where uniform national standards are not essential. Cross border regulatory differences have needlessly inhibited the mobility of both people and goods.
- Agreement to establish a National Grid Management Council designed to encourage and co-ordinate a more efficient and economic electricity generation industry for eastern and southern Australia. The absence of a broader approach has resulted in higher costs owing to excess capacity, inappropriate plant mix and inflexible fuel use.
- Establishment of a framework for national performance monitoring of government trading enterprises. The activities and decisions of these enterprises impact upon a significant part of the nation's resources, and the efficiency of their deployment is fundamental to economic performance and assists international competitiveness.

The other major area of reform is the labour market. Increased decentralisation of industrial relations arrangements and wage determination processes will mean that the parties most exposed to the needs and demands of a competitive trading environment will play a larger role in the determination of workplace rules and conditions (including wages). Enterprise level negotiations hold out the potential to:

- facilitate the removal of inefficient and outdated work practices and hence provide a better utilisation of labour resources in the face of changing economic and technological requirements;
- establish more appropriate wage relativities and better incentive structures for skill acquisition, retraining and labour mobility; and
- improve real wage flexibility, provide for a more efficient allocation of labour resources across and within industry, and generate higher levels of productivity.

The year ahead will be very important in continuing the transition to a more devolved wage setting system. That transition will need to be managed—and that management should involve important roles for the Australian Industrial Relations Commission together with the Government, the ACTU and employers. An overly rapid transition without an appropriate framework would have obvious implications for Australia's inflation rate and competitiveness as well as employment growth.

Clearly, some enterprises will be better placed to take more responsibility for the setting of employment and wage conditions than others. Some—and possibly predominantly the larger—enterprises may feel more comfortable with a more devolved process. Others may feel more comfortable with a slower transition. With that in mind, the Commission could play an important role in this transition by contributing to the further development of agreed principles for enterprise bargaining and by ensuring that enterprise agreements are genuine in delivering productivity growth.

As well as demands placed on government and employee groups, there are important challenges for management in the process of structural change. These include an increased international focus and achieving international best practices of performance; and the most effective use of all human and non-human resources available to the enterprise. This includes:

- the adoption of better management techniques and systems;
- greater focus on identifying possible areas of future expansion (both domestically and overseas);
- the optimal deployment of available labour and capital inputs including familiarity with and use of the most up to date technology; and
- removal of barriers and impediments to stronger domestic competition.

A point to be emphasised is that with microeconomic reform, it is not enough simply to be making progress. Our international competitors are also moving forward. If Australia is to improve its relative position and become more competitive, microeconomic reform has to deliver larger productivity gains in the private and public sectors than are being achieved by competitors.

#### *Reform of International Markets*

The moves to internationalise the Australian economy and increase domestic competition are supported by policies to achieve multilateral trade liberalisation and improve our access to important trade markets. A top priority for Australia and the Cairns Group is to achieve a successful outcome on agriculture in the Uruguay Round. This would encompass substantial and progressive reductions in internal support, market access barriers and export subsidies. Reductions in EC coal subsidies and the signing of a liberal framework for, and initial concessions on, trade in services are also important objectives in the Round. The imperative for a successful outcome to the Uruguay Round has been underlined all the more by increasing indications of a move towards trading blocs as the global fallback position were the Round to fail.

#### *Implementation of Microeconomic Reform*

Microeconomic reform is one of the most difficult areas of government policy insofar as implementation is concerned. The capital and/or labour costs are usually borne up-front by specific enterprises, industries or regions, whereas the benefits tend to flow to the community at large and are achieved over a longer time frame. This underlies the importance of progressing microeconomic reform on a broad front so that the benefit and costs are shared across the community. It also emphasises the need to encourage informed community debate on industry reform and make special efforts to identify the overall benefits of reform. The Industry Commission, through its independent advice to the Government and its public inquiries and information dissemination processes, plays

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an important role in that regard. The work of the Prices Surveillance Authority and the Trade Practices Commission is also useful.

A final point is the relationship that inevitably exists between the scope for microeconomic reform and the success of macroeconomic policies. While individual firms can make worthwhile structural changes during a downturn, a stable and steadily growing economy is likely to offer the environment most conducive to sustained progress on broad-scale microeconomic reform. Most importantly, such an environment is likely to provide alternative employment opportunities for those displaced from their previous jobs and the framework within which business investment can expand into new areas with confidence.

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**APPENDICES**

## APPENDIX 1

### Historical Data on the Current Account and the Level of Overseas Debt

1945-46 to 1990-91

Table 1 Current Account, 1945-46 to 1990-91

Year	Merchandise Exports	Merchandise Imports	Merchandise Balance	Services Balance	Income Balance	Unrequited Transfers	Current Account
	(\$ million)						
1945-46	313	-215	98	101	-82	-18	99
1946-47	546	-408	138	-55	-86	-88	-91
1947-48	610	-560	150	-42	-70	-5	13
1948-49	1,050	-817	243	-79	-81	-21	62
1949-50	1,207	-1,048	159	-116	-102	-12	-71
1950-51	1,974	-1,441	533	-171	-121	8	249
1951-52	1,354	-2,033	-679	-276	-126	-7	-1,088
1952-53	1,223	-1,000	723	-144	-119	-31	389
1953-54	1,655	-1,323	332	-145	-159	-32	-4
1954-55	1,552	-1,642	-90	-190	-164	-33	-477
1955-56	1,568	-1,597	-29	-189	-186	-41	-448
1956-57	1,986	-1,382	605	-156	-189	-43	217
1957-58	1,643	-1,211	122	-106	-107	-18	-309
1958-59	1,646	-1,554	92	-191	-254	-33	-386
1959-60	1,898	-1,820	78	-218	-305	-26	-471
1960-61	1,884	-2,060	-176	-249	-301	-22	-748
1961-62	2,185	-1,705	480	-166	-242	-20	8
1962-63	1,888	-1,770	88	-201	-233	-22	-468
1963-64	2,764	-2,242	522	-219	-360	-13	-70
1964-65	2,605	-2,743	-138	-268	-355	-19	-780
1965-66	2,655	-2,826	-71	-292	-388	-38	-889
1966-67	2,547	-2,411	113	-134	-414	-44	-59
1967-68	2,968	-3,164	-196	-360	-551	-24	-1,131
1968-69	3,242	-3,207	35	-403	-603	-9	-980
1969-70	3,998	-3,561	437	-416	-697	-12	-688
1970-71	4,244	-3,806	438	-455	-704	-28	-740
1971-72	4,146	-3,714	92	-211	-708	-56	-323
1972-73	6,027	-3,817	2,210	-585	-783	-88	754
1973-74	6,754	-5,757	987	-990	-738	-180	-921
1974-75	8,512	-7,665	847	-1,119	-723	-200	-1,195
1975-76	9,476	-7,930	1,546	-1,250	-1,393	-326	-1,423
1976-77	11,446	-10,500	1,096	-1,068	-1,420	-26	-1,445
1977-78	12,006	-11,149	857	-1,820	-1,720	-257	-2,990
1978-79	14,072	-13,385	687	-1,792	-2,179	-340	-3,624
1979-80	18,589	-15,831	2,758	-1,890	-2,727	-135	-1,994
1980-81	16,718	-17,177	-39	-2,477	-2,759	-140	-5,465
1981-82	19,000	-16,658	-3,288	-409	-3,008	-12	-2,977
1982-83	20,656	-21,705	-1,049	-2,762	-2,788	-195	-6,794
1983-84	23,682	-23,497	185	-2,782	-4,883	115	-7,365
1984-85	29,212	-30,093	-881	-2,869	-6,792	198	-11,344
1985-86	32,308	-35,676	-3,480	-3,936	-6,795	709	-11,613
1986-87	35,223	-37,159	-1,735	-1,133	-5,950	1,213	-12,446
1987-88	40,541	-40,386	155	-2,596	-10,502	1,664	-11,279
1988-89	43,073	-47,032	-3,959	-3,160	-13,619	2,198	-18,540
1989-90	47,815	-50,991	-3,176	-4,143	-17,037	2,346	-22,280
1990-91	51,793	-49,250	2,543	-3,455	-16,879	2,482	-15,309

Source: Australian Bureau of Statistics, *Balance of Payments, Australia*, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

## APPENDIX 1

### Historical Data on the Current Account and the Level of Overseas Debt

Table 2 The Current Account as a Proportion of GDP, 1945-46 to 1990-91

Year	Merchandise Exports	Merchandise Imports	Merchandise Balance	Services Balance	Income Balance	Unrequited Transfers	Current Account
	(per cent)						
1945-46	10.7	-7.3	3.3	3.4	-2.8	-0.6	3.4
1946-47	17.5	-12.1	4.4	-1.1	-2.4	-2.6	-2.9
1947-48	21.6	-17.6	4.0	-1.8	-2.4	-1.1	-3.3
1948-49	23.7	-18.3	5.4	-1.8	-1.8	-0.5	1.4
1949-50	22.9	-19.9	3.0	-2.2	-1.9	-0.2	-1.3
1950-51	26.2	-20.6	7.6	-2.4	-1.4	0.1	3.6
1951-52	18.0	-27.0	-9.0	-2.4	-1.7	-0.1	-1.4
1952-53	20.2	-11.7	8.5	-2.2	-1.4	-0.4	4.6
1953-54	17.7	-14.2	3.6	-1.6	-1.7	-0.3	-0.0
1954-55	15.6	-16.5	-0.9	-1.8	-1.6	-0.3	-4.8
1955-56	14.5	-14.8	-0.3	-1.8	-1.6	-0.4	-4.2
1956-57	16.9	-11.8	5.2	-1.3	-1.6	-0.4	1.9
1957-58	13.7	-12.7	1.0	-1.7	-1.6	-0.3	-2.6
1958-59	12.8	-12.1	0.7	-1.5	-2.0	-0.3	-3.0
1959-60	13.5	-12.7	0.5	-1.5	-2.0	-0.2	-3.3
1960-61	12.4	-14.5	-1.2	-1.6	-1.0	-0.1	-4.9
1961-62	13.9	-10.9	3.0	-1.2	-1.7	-0.1	-0.1
1962-63	12.8	-12.3	0.5	-1.2	-2.0	-0.1	-2.8
1963-64	14.9	-12.0	2.8	-1.2	-1.9	-0.1	-0.4
1964-65	11.7	-12.5	-0.7	-1.2	-1.1	-0.1	-3.4
1965-66	12.3	-13.1	-0.8	-1.4	-1.8	-0.2	-1.4
1966-67	12.4	-11.9	0.5	-1.3	-1.7	-0.2	-2.8
1967-68	11.6	-12.4	-0.8	-1.4	-2.2	-0.1	-4.4
1968-69	11.2	-12.2	0.1	-1.4	-2.2	-0.0	-3.4
1969-70	12.6	-11.2	1.4	-1.3	-2.2	0.0	-2.4
1970-71	12.1	-10.8	1.2	-1.3	-2.0	-0.1	-2.1
1971-72	12.1	-9.7	2.4	-1.2	-1.8	-0.1	-0.7
1972-73	13.5	-8.5	4.9	-1.3	-1.7	-0.2	1.7
1973-74	12.6	-10.5	1.8	-0.6	-1.8	-0.3	-1.7
1974-75	13.2	-11.9	1.3	-1.7	-1.1	-0.3	0.6
1975-76	12.4	-10.4	2.0	-1.6	-1.8	-0.4	-1.9
1976-77	13.1	-11.9	1.3	-1.9	-1.8	-0.3	-2.8
1977-78	12.7	-11.8	0.9	-1.9	-1.9	-0.3	-3.2
1978-79	13.0	-12.4	0.6	-1.7	-2.0	-0.3	-4.4
1979-80	15.2	-12.9	2.2	-1.5	-2.2	-0.1	-1.6
1980-81	13.4	-13.7	-0.3	-1.5	-2.0	-0.1	-3.9
1981-82	12.1	-14.2	-2.1	-1.5	-2.0	-0.1	-5.8
1982-83	12.0	-12.7	-0.6	-1.6	-2.5	-0.1	-4.0
1983-84	12.2	-12.1	0.1	-1.4	-2.5	0.1	0.5
1984-85	13.5	-13.9	-0.4	-1.8	-3.1	0.1	-5.3
1985-86	13.4	-14.9	-1.4	-1.6	-3.3	0.3	-6.1
1986-87	13.3	-14.0	-0.7	-1.2	-3.3	0.5	-4.7
1987-88	13.5	-13.5	0.1	-0.9	-4.5	0.6	-5.6
1988-89	12.7	-13.6	-1.2	-0.9	-4.0	0.7	-5.5
1989-90	12.9	-13.7	-0.9	-1.2	-4.6	0.6	-6.0
1990-91	13.7	-13.0	0.7	-0.9	-4.5	0.7	-4.0

Source: Australian Bureau of Statistics, *Balance of Payments, Australia*, Cat. Nos. 5302.0 and 5303.0, Canberra, various issues.

## APPENDIX 1

### Historical Data on the Current Account and the Level of Overseas Debt

Table 3 The Level of Overseas Debt, 1969 to 1991

Year at 30 June	Level of gross foreign debt			Proportion of GDP		
	Official	Non-official (\$ million)	Total	Official	Non-official (per cent)	Total
1969	1,747	1,638	3,385	6.1	5.7	11.8
1970	1,636	2,019	3,655	5.1	6.3	11.5
1971	1,600	2,989	4,589	4.6	8.5	13.1
1972	1,497	4,027	5,524	3.8	10.3	14.1
1973	1,350	3,957	5,347	3.0	8.9	11.9
1974	1,163	3,632	4,995	2.2	7.2	9.3
1975	1,334	4,356	5,970	2.1	7.2	9.2
1976	1,403	4,575	5,978	1.8	6.0	7.8
1977	2,325	5,497	7,812	2.7	6.3	9.0
1978	4,228	5,905	10,133	4.5	6.2	10.7
1979	5,740	6,911	12,651	5.3	6.4	11.7
1980	5,687	7,811	13,498	4.6	6.4	11.0
1981	4,816	10,403	15,219	3.4	7.5	10.9
1982	5,692	18,658	24,350	3.6	11.8	15.4
1983	7,682	28,209	35,891	4.5	16.4	20.9
1984	8,874	35,227	44,101	4.6	18.1	22.7
1985	14,883	52,590	67,473	6.9	24.3	31.2
1986	23,409	68,641	92,050	9.7	28.6	38.3
1987	29,857	75,845	105,702	11.3	28.6	39.9
1988	33,536	89,266	122,802	11.2	29.4	41.0
1989	37,192	108,178	145,370	11.0	31.8	42.8
1990	38,772	118,545	157,317	10.4	31.9	42.3
1991	37,590	128,114	165,704	9.9	33.7	43.6

Source: Australian Bureau of Statistics, *Foreign Investment, Australia*, Cat. Nos. 5305.0, 5306.0 and 5307.0, Canberra, various issues.

## APPENDIX 2

### List of Public Hearings and Witnesses

#### Sydney - 27 September 1990

Mr John Patrick McAuley

#### ALCATEL Australia Limited

Mr Michael Walter Howard Lamb  
Business Development Manager

Mr Gerald Ernest York  
Export Director

#### Australian Chamber of Manufactures

Mr Philip Duncan Anderson  
Manager  
Economics and Industry Policy

Mr Philip Matthew Holt  
Chief Executive and National Director  
Trade and Industry

#### Australian Railways Union

Mr Stephen Michael O'Neill  
Research Officer

Mr William James Waters

#### Reserve Bank of Australia

Dr Stephen Alexander Grenville  
Deputy Chief Manager and Acting Head  
Research Department

Mr Bruce Hockman  
Economist  
Balance of Payments Section  
Research Department

**University of New South Wales**

Associate Professor Ronald Anthony Bewley  
Director  
Business Econometrics and Forecasting Group

Ms Shauna Louise Phillips  
Research Associate  
Business Econometrics and Forecasting Group

**Melbourne - 4 October 1990**

Professor Carl Boris Schedvin

Mrs Louise Anne Wilson

**Australian Council of Trade Unions**

Mr William Nixon Apple  
Member of the Board of Directors of the Australian  
Trade Commission

Mr Stephen Marcus de Rozairo  
Research Officer

**Australian Manufacturing Council**

Mr Joseph Burke  
Acting Assistant Director

**BHP**

Mr Bernard Delaney  
Manager  
Government Relations  
BHP Steel

Mr Ross McDonald  
Manager  
Economic Services  
BHP Steel

Dr Brian Robin Stewardson  
Principal Economist  
BHP Co Ltd

**Business Council of Australia**

Dr Matthew William Butlin  
Director  
Policy Analysis and Research

Mr Peter Andrew McLaughlin  
Executive Director

Mr John Denis Stuart MacLeod  
Group Economist  
CRA Ltd

Mr Julian James Pearce  
Chief Economist  
National Australia Bank

**Canberra - 30 October 1990**

Professor Heinz Wolfgang Arndt

Professor Francis Geoffrey Castles

Honourable William Charles Wentworth

**Agritec Australia Ltd**

Mr Anthony Edwin Botsman  
Deputy Chairman

Mr Ronald William Murnain

**Industrial Supplies Office**

Mr Robert Alexander Kee  
National Coordinator

Canberra - 19 November 1990

**Australian Chamber of Commerce**

Mr Robert Brent Davis  
Chief Economist

**Australian Council of Trade Unions**

Mr Peter James Ewer  
National Research Officer  
Amalgamated Metal Workers Union

Mr Stephen Marcus de Rozairo  
Research Officer

**Australian Mining Industry Council**

Mr Peter Crowley  
Economist

Mr Ron Knapp  
Assistant Director

**Department of Foreign Affairs and Trade**

Mr Edwin Franklin Delofski  
First Assistant Secretary  
Economic and Trade Development Division

Mr Thomas Geoffrey Taylor  
Director  
Economic Analysis and Forecasting  
Economic and Trade Development Division

Mr Kevin William Wilkinson  
Acting First Assistant Secretary  
Multilateral Trade Division

**Metal Trades Industry Association**

Mr Bernard Henry Trevanion  
Assistant Director  
Trade and Commercial Services

**New South Wales Farmers' Association**

Mr John Roger Crosby  
Vice-President and Chairman  
Economics Committee

Mr Terence James Ryan  
Policy Director

Canberra - 21 March 1991

**Centre for International Economics**

Dr Andrew Stoeckel  
Director

**Department of Industry, Technology and Commerce**

Mr Andrew Addison Bain  
First Assistant Secretary  
Heavy Industries Division

Dr John Donald Bell  
Deputy Secretary

Dr Robert Gore Hawkins  
Director  
Bureau of Industry Economics

Mr Michael Sean Lawson  
Senior Economist  
Economic Conditions

Mr Lyle Melvin Russell  
Assistant Secretary  
Business Environment Branch

**Department of the Treasury**

Mr John Henry Cosgrove  
First Assistant Secretary  
Fiscal Policy Division

Mr John Fraser  
Deputy Secretary (Economics)

Mr Anthony Maitland Hinton  
Assistant Secretary  
Monetary Policy Branch  
Capital Markets Division

Mr Gary Ronald Potts  
First Assistant Secretary  
Economic Division

Mr Arthur Sinodinos  
Director  
Balance of Payments Section

**University of Western Sydney**

Professor Colm Kearney  
Professor of Economics  
Centre for Product Innovation and Export Development

Canberra - 22 March 1991

**ALCOA of Australia Ltd**

Mr Philip Spry-Bailey  
Executive Director  
Finance and Administration

**AUSTRADE**

Mr Richard Henry Carr  
Senior Economist

Dr Edric Charles Druce  
Manager  
Export Strategy Division

Mr Geoff Hickey  
Manager  
Group Development and Services  
Austrade - EFIC

Mr Ronald Patrick Maxwell  
Group Executive

Mr Andrew Lochiel McIntosh  
Manager  
International Operations

Mr Colin Leonard Williams  
Manager  
Trade and International Business Development

**Reserve Bank of Australia**

Dr Stephen Alexander Grenville  
Head of Economic Analysis

### APPENDIX 3

#### List of Submissions

Submission No.	From
1.	Mr E Mark Fowler
2.	The Australian Chamber of Commerce
3.	Piccolo Aviation
4.	Tax Revolt Association
5.	Australian Agricultural Machinery Manufacturers Association
6.	A G Crooks
7.	Mr A Towsey
8.	The National Recovery Council
9.	Mr Leon Francis
10.	Mr Scott Sturgess
11.	Mr D M Gray
12.	Dr James S H Hunter
13.	Australian Railways Union
14.	Sukhwant Singh
15.	Mr John Burgess
16.	Mr Ian Burnet
17.	M C Hall

18.	Professor Francis G Castles	40.	Mr K J Davies
19.	Mr Richard Ryan	41.	Mr Harry N Medlicott
20.	Engsoft Computer Consultants	42.	Mr Arnold Sandell
21.	Lee Nightingale	42a.	Mr Arnold Sandell
22.	R M Rabbidge	43.	Associate Professor Ronald Bewley and Ms Shauna Phillips
23.	The Association for Good Government	44.	Australian Scientific Industry Association
24.	Mr John Iggylden	45.	NSW Farmers' Association
25.	Mr E P Manners	46.	Industrial Supplies Office
26.	Michael Styles	47.	Northern Territory Government Hon M Perron, MLA, Treasurer
27.	David Yap	48.	Mr Peter Cullen
28.	Reserve Bank of Australia	49.	Ms Diana O Balmain
29.	Rear Admiral I McL Crawford, AM, RANEM	50.	Australian Mining Industry Council
30.	Astra Computer Enterprises Pty Ltd	51.	Australian Petroleum Exploration Association Limited
31.	Ricardo, Smith Pty Ltd	52.	GEC Alsthom Australia
32.	Bulk Materials (Coal Handling) Pty Ltd	53.	Australian Skeptics Inc
33.	N Seif	54.	National Association of Forest Industries Ltd
34.	Leslie James Architects Pty Ltd	55.	Associate Professor Peter Newman
34a.	Leslie James Architects Pty Ltd	56.	Business Council of Australia
35.	Mr Alex N Campbell	57.	ALCATEL Australia Limited
36.	Agritec Australia Ltd	58.	Australian Chamber of Manufactures
36a.	Agritec Australia Ltd	59.	Department of the Arts, Sport, the Environment, Tourism and Territories
37.	Mr Tony Makin	59a.	Department of the Arts, Sport, the Environment, Tourism and Territories
38.	Mr John P McAuley		
39.	Dr Henri D Rathgeber		

60. Mr Peter Frankel  
61. Australian Council of Trade Unions  
62. Hon W G Wentworth  
63. Department of Foreign Affairs and Trade  
64. Metal Trades Industry Association  
65. Rear Admiral I McL Crawford, AM, RANEM  
66. AUSTRADE  
67. Department of Industry, Technology and Commerce  
68. Professor Colm Kearney  
69. The Treasury  
70. Mr Patrick J Byrne  
71. Alcoa of Australia Limited  
72. Ms Barbara Smith

#### APPENDIX 4

#### List of Exhibits Incorporated into Committee Records

##### Exhibit No. From

1. Ms Louise Wilson
2. Professor David E Ingram
3. Reserve Bank of Australia
4. Professor H W Arndt
5. Agritec Australia Ltd
6. Westpac Banking Corporation
7. Associate Professor Ronald Bewley and Ms Shauna Phillips
8. Professor G W Ford
9. Professor John Pitchford
10. Mr R W Baldwin
11. ALCATEL Australia Limited
12. Mr J P McAuley
13. Professor R Bewley
14. Reserve Bank of Australia
15. Australian Chamber of Manufactures
16. Mr J P McAuley
17. Australian Mining Industry Council

18. Bureau of Tourism Research
19. Mr Tony Makin
20. Department of Primary Industries and Energy
21. Dr Andrew Stoeckel
22. The Treasury
23. The Treasury
24. Centre for Export Marketing