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## **On Australia's foreign economic relations**

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## On Australia's foreign economic relations

*This article analyses the current state and trends in Australia's foreign economic relations with respect to the economic rise of Asia. Starting from an evolutionary view of Australia's integration into the global economy, the consequences of the rise in the terms of trade are analysed. Following on from that, an analysis of selected aggregated indicators of Australia's foreign trade and investment is carried out. Finally, the outlook emphasizes the promising perspective as well as the challenges.*

There are only few other countries that could capitalize more in economic terms on the economic rise of Asia as Australia did, in particular over the last decade. Economically appealing to the global growth drivers such as China, India and South Korea, Australia has experienced an unprecedented demand for its production factors. However, Australia's government intends to avoid a „Dutch disease“ by using additional tax revenues<sup>1</sup> for structural policies that adapt to the policy challenges of a balanced shock resilient economy.<sup>2</sup>

Additionally, this resource boom was also driven by on average very low interest rates, which affected commodity prices and currencies, trade flows and competition in challenging ways. The interrelation between capital markets, investment and terms of trade (TOT) is discussed below. However, in most of the industrialized world, the ultra-low interest rate policy of buying time for gradual structural adjustment to the fast changing distribution of growth and wealth and the high degree of indebtedness to mostly Asia also seriously affects Australia, not through the disposition of its trading partners alone. The self-dynamics of the capital markets add to the already existing resource boom pressure and challenges the system stability of the global financial system as well as Australian industry structure, internal prices, industry and productivity as an open coupled-system in particular.

### ***Resource boom and the „Dutch disease“: The two-speed Australian economy***

Since the arrival of the first Shortman cattle that originated in the North East of England, at New Castle in 1791, and the first Merino sheep in 1797, as well as the start of coal mining in 1798, mining and farming have been the major source of growth and wealth in Australia. Over the last 200 years, cheese, wool and leather, wheat and meat, gold and silver, copper and lead-zinc, iron and coal, and others have made up Australia's economic added value.<sup>3</sup> Economic activity was a result of a combination of historical settlements near the coast and most favourable production conditions creating naturally higher productivity.

In considerable ways the current situation for Australia is similar to that of the Netherlands where the word „Dutch disease“<sup>4</sup> was coined to describe the decline of the Dutch manufacturing sector after the discovery of a large natural gas field in the Netherlands in 1959. Principally, the disease was associated with the three characteristics of external strength, high internal unemployment, and a declining manufacturing sector. At this time, the main causes were considered to be a strong currency, high industrial costs, and a use of

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<sup>1</sup> The proposed Australian Mining Resource Rent Tax (former Resource Superprofit Tax) hints to a sharp battle for future mining profit distribution between the public and the corporate interests with a pending final agreement. However, it appears highly reasonable to secure the priority of public interest even in free competitive markets and tax regimes. For details see: <http://www.futuretax.gov.au>

<sup>2</sup> Swan, W., Wong, P. (2011): Budget strategy and outlook, budget paper No.1, 2011-12, accessed at: [http://www.aph.gov.au/budget/2011-12/content/download/bp1\\_prelims.pdf](http://www.aph.gov.au/budget/2011-12/content/download/bp1_prelims.pdf) (20.6.2011)

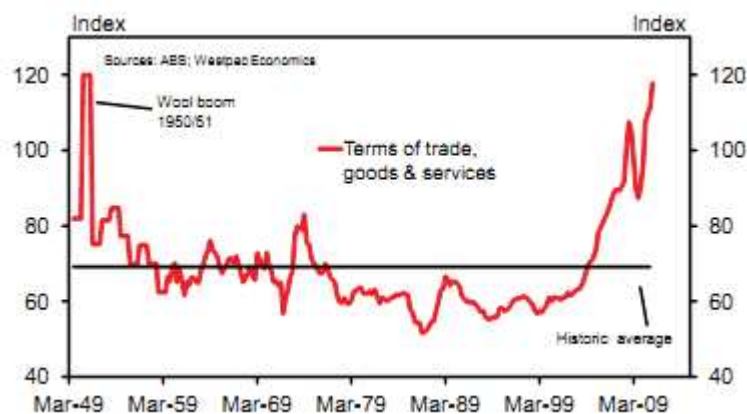
<sup>3</sup> Forbes, V. (2011): Value adding in Australia – the beginning of the end?, in: On Line opinion, accessed at: <http://www.onlineopinion.com.au/view.asp?article=12053> (21.06.2011)

<sup>4</sup> The Dutch Disease, in: The Economist, November 26, 1977, pp. 82

government gas revenues primarily to increase spending rather than investment. Since then, the focus was rather on the exchange rate than on the other two causes.

In the aftermath of the break down of the Bretton Woods System in 1971, capital flows also increased the pressure on the fixed Australian Dollar exchange rate. Under the new Hawke Labour Government, Treasurer Paul Keating floated the Australian Dollar (AUD) on 12.12.1983. With unemployment more than 10% and high inflation rates, this step was believed to be effective to increase efficiency and competitiveness of the Australian industry.<sup>5</sup> It was accompanied by the liberalisation of other production factors and added value channels like trade and investment, financial market as well as labour and product market regulation.<sup>6</sup> However, it was also an important step to include Australia into the global trade and financial system and the floating currency has proved to be an effective „shock absorber”, in particular in the Asian financial crisis in 1997.

After World War II, Australia had 2 significant Terms of Trade (ToT) booms: As the graphics below shows, in the 1950's world wool prices and hence Australian farmers' incomes surged due to the Korean War, but no adequate investment boom followed.



Source: Westpac Banking Economic Releases, 31.05.2011: Australian current account deficit Q1, p.2., accessed at: <http://www.westpac.com.au/docs/pdf/aw/economics-research/1120778> (20.06.2011)

Another significant increase happened in the mid 1970's with the rise of agricultural commodities and later on with oil and its substitutes like coal. The recent upturn started in 2004, resulting until now in an increase in the ToT highest in almost 140 years. And finally, in the Australian case, the positive relationship between ToT and real exchange rate is well supported by data and, together with the relative price of non-traded goods, the real interest rate differential and the current account deficit to GDP ratio, explain roughly 91% of the movement of the Australian real exchange rate from 2000 to 2010.<sup>7</sup>

It also shows that economic concepts of the „Dutch disease” within a Heckscher-Ohlin framework explain the Australian case rather well,<sup>8</sup> although the degree of income spill over

<sup>5</sup> Atkinson, D.J. (2009): Australian Prime Ministers: Triumph over Adversity – Bob Hawke and the Floating of the Australian Dollar, in: National Historical Challenge 2009, p.2, accessed at: <http://moadoph.gov.au/research/national-history-challenge/docs/2009/dale-atkinson-essay.pdf> (22.06.2011)

<sup>6</sup> McKissack, A. et. al. (2008): Structural effects of a sustained rise in terms of trade. p.16, accessed at: [http://www.treasury.gov.au/documents/1400/PDF/Structural\\_Effects\\_Terms\\_of\\_Trade.pdf](http://www.treasury.gov.au/documents/1400/PDF/Structural_Effects_Terms_of_Trade.pdf) (23.06.2011)

<sup>7</sup> Natraj, G.V. (2010): Australia's Real Exchange Rate Appreciation: Determinants and Implications for the Economy, accessed at: <http://www.rba.gov.au/econ-compet/2010/pdf/first-prize.pdf> (24.06.2011)

<sup>8</sup> McKissack, A. et. al. (2008), p.2

effects to non-traded goods industries and increased tax revenue is questioned.<sup>9</sup> By now, incomes have risen, as have employment and investment, especially in the mining industry and regions where mining is concentrated. The disadvantaged industries have experienced until now partly fewer „Dutch disease” effects than one could have expected.<sup>10</sup>

The policy challenge remains, and with it the institutionalization issue: the experience of the Netherlands as well as Nigeria, Azerbaijan and even the previous Australian resource booms shows that there is strong evidence that „a country’s own policies, for better or worse, and followed over a long period, also make a significant difference to its economic outcomes.”<sup>11</sup> There is strong cross-country evidence that „sound institutions and policy responses are key explanations why some resource-rich countries have had better outcomes than others.”<sup>12</sup>

Many of the inward and outward foreign direct investments (FDI) strive for capitalizing on the huge upswing in commodity prices, including the set of strategic goals like securing access to raw material deposits at sea (gas) and on land (iron ore, gold, coal), be it by M&A, joint ventures or any other form of capital alliance. Together with North America, Australian companies continue to dominate recent mining M&A activities.<sup>13</sup> Concurrently, Australian investment in Africa, mainly in gold, uranium, copper, platinum, and diamonds has tripled to more than 20 billion since 2005.<sup>14</sup>

However, the collision of economic systems with more or less reciprocal strategies, fear of the dominance, rejection of the non-transparent, ecological concerns, social acceptance and governmental deficits indicate that there is a major concern about resource nationalism.<sup>15</sup> There is also a growing governmental involvement in the battle for take-over bids, as the failed Chinese Chinalco bid for British-Australian Rio Tinto and the interference of Australian BHP Billiton indicate. Beside that, vertical integration increasingly drives producers back and forward in the added value chain.<sup>16</sup>

### *The dynamics of Australian foreign trade*

With the fading of economic structuration of the British Empire and the Europeanization of Great Britain, Australia was progressively excluded from European markets, the more so as the UK included itself into the European Communities (EC). EC barrier protection and in particular EC agricultural subsidies had a large impact on the Australia, in particular Tasmanian fruits and the south-east Australian lamb production.<sup>17</sup> As Great Britain turned towards Europe, Australia had to become more „Asian” in many respects.

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<sup>9</sup> Richardson, D. (2009): The benefits of the mining boom – where did they go?, accessed at: [http://www.ccag.org.au/images/stories/pdfs/mining\\_boom\\_final.pdf](http://www.ccag.org.au/images/stories/pdfs/mining_boom_final.pdf) (24.06.2011)

<sup>10</sup> McKissack, A. et. al. (2008), p. ii

<sup>11</sup> Stevens, G. (2011): Cross-currents in the Global Economy, in: Reserve bank of Australia 2010, p.4, accessed at: <http://www.rba.gov.au/publications/bulletin/2010/dec/pdf/bu-1210-10.pdf> (21.06.2011)

<sup>12</sup> Swan, W., Tanner, L. (2010): Budget strategy and outlook, budget paper No.1, 2010-11, p.4-11, accessed at: <http://www.aph.gov.au/budget/2010-11/content/bp1/download/bp1.pdf> (20.6.2011)

<sup>13</sup> PwC (2011): Mine 2011 – The game has changed. Review of global trends in the mining industry. Accessed at: [http://www.pwc.com/en\\_GX/gx/mining/pdf/mine-2011-game-has-changed.pdf](http://www.pwc.com/en_GX/gx/mining/pdf/mine-2011-game-has-changed.pdf) (25.06.2011)

<sup>14</sup> Swanepoel, E. (2010): Australia's investment in African resources tops A\$ 20 bn, accessed at: <http://www.miningweekly.com/article/australias-investment-in-african-resources-tops-a20bn-2010-09-01> (24.06.2011)

<sup>15</sup> *Ibid.* This does not only apply to commodities. The rejection of the 8,4 billion AUD take over bid in 2010 from Singapore Exchange Ltd. For Australian competitor ASX Ltd. by Australian treasurer Wayne Swan and several Australian lawmakers indicate that this concern stretches all across the entire economy.

<sup>16</sup> *Ibid.*, pp.18

<sup>17</sup> Catley, B. (1996): *Globalising Australian Capitalism*. Cambridge, New York, Melbourne, Cambridge University Press, pp.197

In 1965, 35% of Australian exports went to Western Europe, and half of them went to the UK. In 1989, 15% went to Western Europe with less than half of them to the UK. In the same period, exports to East Asia had grown from 29% in 1965, with 16,6% to Japan, Hong Kong 2%, and South Korea and Taiwan nearly zero, to 50% in 1989, with Japan 26%, Hong Kong 4%, South Korea 5,3% and Taiwan 3,5%.<sup>18</sup> Exports to China substantially increased in the 1990s, constituting 5,5% of Australian exports in 1965, 3,7% in 1980 and 2,9% in 1989 respectively.<sup>19</sup>

Imports to Australia changed their structure as well: with the complementary export-oriented industrialization strategy first applied by Japan and other Asian countries following, imports to Australia grew higher as trade restrictions were abandoned and free flow of products and services became predominant. With the foundation of ASEAN in 1967, and APEC in 1989 as well as the global trade liberalisation in the Uruguay Round and Free trade Agreements with New Zealand, Singapore, the US, Thailand, Chile, and ASEAN, free trade was institutionally promoted and achieved results.<sup>20</sup> Trade as a share of Australian GDP rose from 32,5% in 1988/1989 to 47,1% in 2008/2009, seeing a rise in value from 55,5 billion AUD to 284,7 billion AUD respectively.<sup>21</sup>

In 1965, 11,6% of Australian imports came from North-east Asia and 4,1% from ASEAN region, 27,3% from North America and 42,7% from Western Europe. In 1989, imports from North-East Asia amounted for 31,6%, 6,3% for ASEAN, 23,6% from Northern America and 26,8% from Western Europe.<sup>22 23</sup> Since then, Australia's foreign trade experienced a further major shift towards Asian trading partners. In 2010, 22,6% of Australian exports went to China, 16,0% to Japan, 7,9% to South Korea, 6,9% to India, and only 5,1% to the US as well as 4,4% to the UK respectively.<sup>24</sup> Overall, APEC accounted for 73,4% of Australian exports, with ASEAN amounting to 10,5% and EU27 for 9,5%.<sup>25</sup> Imports to Australia still look slightly different: China amounts for 15,3% of all imports, the US for 13,2%, Japan for 7,6%, Singapore for 5,3%, Thailand 4,8%, and Germany for 4,5% respectively. Overall, imports from APEC amount for 67,8%, ASEAN10 for 18,9%, and EU27 for 19% respectively.<sup>26</sup>

Since the input factor requirements for Asian growth match largely the production factor endowment profile of Australia, this match is reflected in the structure of the traded goods and services. In 2010, Iron ore with 27,4%, followed by coal with 25,1%, education related services with 6,2%, gold with 5,3% and travel services excluding education with 4,3% had the biggest share of the 284,7 billion AUD exports.<sup>27</sup> The biggest shares of the overall imports of

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<sup>18</sup> Catley, B. (1996), p.198

<sup>19</sup> *Ibid.*

<sup>20</sup> For an overview of the Australian foreign and trade policies see: Australian Bureau of Statistics (2010): Yearbook Australia 2009-10, No.91, Canberra

<sup>21</sup> Australian Department of Foreign Affairs and Trade (2009), Australia's trade performance 1988-89 to 2008-09, accessed at: <http://www.dfat.gov.au/publications/stats-pubs/australias-trade-performance-1988-89-to-2008-09.pdf> (24.06.2011)

<sup>22</sup> OECD (1994): Economic Surveys, Australia, Paris; Australian Department of Foreign Affairs and Trade (1992): Australia and Northeast Asia in the 1990s: Accelerating Change, Canberra

<sup>23</sup> After the trade and investment liberalization period under the Hawke Government from 1983 the share of Australian foreign trade (exports plus imports) rose dynamically, with growth accelerating in the 1990's. The process of trade and investment promotion was considerably institutionally strengthened with the establishment of the Australian Trading Commission (Austrade) under the Australian Commission Act 1985.

<sup>24</sup> Australian Department of Foreign Affairs and Trade (2011): Australia's trade in goods and services by top 10 partners 2010, accessed at: <http://www.dfat.gov.au/publications/tgs/partners-top10-2010.pdf> (24.06.2011)

<sup>25</sup> *Ibid.*

<sup>26</sup> *Ibid.*

<sup>27</sup> Australian Department of Foreign Affairs and Trade (2011): Australia's goods and services by top 25 exports 2010, accessed at: <http://www.dfat.gov.au/publications/tgs/exports-top25-2010.pdf> (24.06.2011)

267,8 billion AUD had „personal travel excluding education” with 7,6%, crude petroleum with 6,1%, passenger cars with 5,9%, refined petroleum with 3,7%, and freight transport services with 3,2% respectively.<sup>28</sup>

Long term, the best trade performance among broader product categories from 1988/1989 to 2008/2009 was demonstrated by „Other goods” (among them Australian wine) with 8% annual average trend growth, followed by manufacturing with 5,8%, services with 5,6%, resources with 4,8%, and gold with 3,3%.<sup>29</sup> Regarding imports, gold (largely for refining and re-export) leads with 13,2%, followed by capital goods with 12,2%, and consumption goods with 8,9%.<sup>30</sup>

Finally, a top growth driver and with 17,7 billion AUD the third largest export sector was education related travel-services, whose share of service exports almost tripled from 2000 and amounted to 33,75% in 2010. 10,4 billion AUD of service revenues were obtained in higher education, followed by 4,8 billion AUD in vocational training. The strategically well-positioned Australia’s education sector is likely about to turn into a hub for Asian English speaking education. The respective major market shares were 23,8% for China, 17% for India, 6% for Korea, and 19,2% ASEAN countries. Among ASEAN countries, Vietnam (37,3%), the Philippines (36,9%) and Thailand (14%) have the highest 5-year average growth dynamics. Balanced built-up of capacity that secures the until quality of teaching as well as hospitality is a real challenge for the future. Additionally, the sector has been experiencing meaningful signs of a „Dutch disease” after the sharp appreciation of the AUD. However, if students-driven, with customer-made curricula and an appropriate university hospitality as well as staff infrastructure, the prospects for a further substantial rise in high quality higher- and vocational education-related services are very promising. Recent Austrade education-marketing projects for Japan, Nepal, India and other countries are about to strengthen the Australian brand that in turn might resist the impact of exchange rate pressure. In spite of the recent clashes and a sharp decline in student visas granted to Indians in 2010, India still has huge potential for Australia’s education industry.<sup>31</sup>

## *Outlook*

As is shown, Australia could until now strongly contribute to the economic rise of Asia, in particular China, India and Japan, and increasingly to the ASEAN states. The change from the white Europe-centric country towards a multicultural state might bring about social conflicts and intercultural challenges, which, if coped up with, might prove to be crucial for further economic success, in the same way as the rising global environmental ethics is. Establishing an Australian sovereign wealth fund, sustainable regional redistribution of resource tax revenues, strengthening of the overall and banking resilience to possible global interest rate and currency shocks, together with a socially acceptable, environmentally friendly sustainable growth-path require a wise policy-making. In particular, the effective transfer of regionally balanced and individual adaption support is needed. It is needed not only for those industries which are said to be adversely affected by the „Dutch disease” curse. Provided this is achieved, Australia might in future become even more of a hub to anchor Europe in Asia.

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<sup>28</sup> Australian Department of Foreign Affairs and Trade (2011): Australia's goods and services by top 25 imports 2010, accessed at: <http://www.dfat.gov.au/publications/tgs/imports-top25-2010.pdf> (24.06.2011)

<sup>29</sup> Australian Department of Foreign Affairs and Trade (2009): Australia’s trade performance 1988-89 to 2008-09, accessed at: <http://www.dfat.gov.au/publications/stats-pubs/australias-trade-performance-1988-89-to-2008-09.pdf> (24.06.2011)

<sup>30</sup> Ibid.

<sup>31</sup> Roberts, G. (2010): Australia, India sign education deal. Accessed at: <http://news.smh.com.au/breaking-news-national/australia-india-sign-education-deal-20100408-ru4p.html> (25.06.2011)