UNIT 6 TRADE, INVESTMENT AND SERVICES

Structure

6.1 INTRODUCTION

Often it is said that the process of economic globalisation currently gathering momentum has ushered unparalleled advances in a number of countries of the world. Greater economic integration among these countries has contributed further to increased prosperity and better living standards to its people. The benefits of liberalised trade and investment, as well as increased domestic competition, have been apparent in Australia's improved economic performance. Despite the crisis which enveloped a number of its major markets in Asia, Australia's GDP has continued to grow strongly, with per capita income growth averaging just under 3 per cent a year since late 1991.

Good macroeconomic management has clearly played a key part. It has kept inflation low, and thereby has created a stable environment for investment and consumer demand. But the acceleration in Australia's productivity growth in the 1990s – to rates rivalling the so-called 'golden age' of the early post-war decades – suggests more fundamental influences at the microeconomic level. Australia's 'new economy' owes much to a series of policy reforms over the past two decades which have created better incentives in Australian workplaces to apply new technology and to be efficient, innovative and productive.

These reforms began with the progressive opening of the Australian economy to the pressures and opportunities of the world market. Reductions in barriers to trade and foreign investment have encouraged Australia to compete more efficiently with other countries. By a range of indicators, Australian firms have become much more productive and innovative, including through the adoption of new technologies. Rapid import growth has been broadly matched by export growth, with Australia's trade participation as a proportion of GDP now a third higher than it was in the mid-1970s.

Keeping these developments in view, this Unit attempts to discuss at some length the economic reforms initiated by Australia in recent decades and analyse the impact of these reform measures on the trade, investment and service sectors of the country.

6.2 OBJECTIVES

After studying this unit, you should be able to:

- understand the economic reforms and restructuring undertaken by Australia since early 1980's as a part of US Policy of globalisation and liberlisations as against US earlier policy of protectionism when it practised since the beginning of the 20th Century;

- discuss the impact of economic reforms on Australia's Trade and Investment particularly relating to its structure of exports and imports;
- Australia's investment pattern inflow and outflow, wherein US and UK still remain the major source and destinations of its investments;
- analyse the impact of ICT revolution on Australia's economy; and
- discuss the challenges which lie ahead for Australian economy and the probable initiatives which it might have to take well these challenges.

6.3 ECONOMIC RESTRUCTURING INITIATIVES

In early 1980s, just over a decade ahead of India, Australia officially recognised the need to diversify its economy. Until then Australia remained largely an inward looking economy with tight controls on foreign exchange and trade and in that sense shared the policy objectives of most other developing countries like India. The turn around leading to the restructuring of the Australian economy came on account two factors. One was the poor performance and prospects of resource based industries which traditionally constituted a chunk of Australia's (about 80 per cent) exports. The other was the protectionist policy adopted by the Australian government since the beginning of the last Century.

The long history of industrial protectionism has its roots in the formation of the Australian Federation in 1901. Tariffs and other import controls were used increasingly until early 1970s to protect a wide range on manufacturing industries. That ensured a bigger manufacturing sector than would have emerged under free trade, but it stifled the growth of other sectors, particularly those natural resource-based ones in which the country enjoyed its strongest comparative advantage.

Disenchantment with the interventionist trade and related economic policies gradually spread in the 1960s, but it was not until the 1970s that major tariff reductions began. The tariff reform process was accelerated in the 1980s and continued through the 1990s. As a result, the average effective rate of assistance to Australian manufacturing fell from 36 per cent to about 5 per cent over those three decades. In the 1990s Australia's import tariffs on goods were halved. This brought the average tariff for manufactures down to 4.2 per cent in 1999. The only manufactures with significant tariff protection since were the automobile, textiles, clothing and footwear.

Agricultural subsidies and regulatory interventions also were reduced. The average effective rate of assistance to the farm sector has fallen from above 25 per cent in the early 1970s to well below 10 per cent today. There were just two farm groups still benefiting significantly from government programmes in the latter 1990s: tobacco and dairy industry. Deregulation of tobacco marketing arrangements began in 1995 and was completed in 2000, bringing effective assistance to tobacco growing down from 30 to 2 per cent over that period. As from 1 July 2000, the remaining impediments to a free domestic market in dairy products began to be dismantled. Excluding dairy, the estimated effective rate of assistance to Australian agriculture in 1998-99 fell from 8 to 3 per cent.

Service sectors too have not been spared reform. Banking, post and telecommunications, ports, higher education, health, and rail, air, and to some extent sea transport have been opened up. There has been progressive out-sourcing of many government services. At the same time, substantial reforms to competition policy and practice, including divestment of numerous government enterprises, were also launched. In addition, a comprehensive programme of review of government regulations at all levels has been under way since the mid-1990s, all with the objective to reduce and remove regulations that unjustifiably impeded economic activities.

More important, by 1983 with the floating of Australian dollar, efforts were afoot to encourage foreign investment. Not only did it complement financial sector reform but also contributed to the free flow of foreign direct investment (FDI), equity and foreign currency transactions growing at more than three times the pace of Australia's GDP in the past. Even the highly unionised labour market underwent considerable reform, which with higher education reforms encouraged growth in human capital. The freeing of the market for foreign exchange, along with domestic microeconomic reforms, admittedly increased competitiveness in the Australian economy substantially. These, together with the greater scope they provided to specialise in production and reap economies of scale, added considerable dynamism to the Australian economy.

Above all, not only GDP grew faster but also the rate of unemployment declined significantly. The domestic economy registered steady growth in full-time employment and even faster growth in gainful employment. Share of employment distributed in the different sectors in the year 2005 were as follows: 5 per cent in agriculture; 1 per cent in mining, 12 per cent in manufacturing and 82 per cent in the service sector. The unemployment rate, while still higher than desirable given this period of growth, had fallen to a near ten-year low of 6.4 per cent in August 2000 (See Table 1).

Table 1
Composition of Australia's GDP and employment, 1900-01 to 1999-2000
(in percentage)
Share of GDP at factor cost

	Agriculture	Mining	Manufacturing	Services
1900-01	19.3	10.3	12.1	58.3
1955-56	15.9	2.3	28.0	53.8
1968-69	9.6	2.4	26.1	61.9
1980-81	5.4	6.5	20.6	67.5
1991-92	3.1	4.4	15.3	77.2
1999-2000	3.3	4.6	13.1	79.0

Share of employment

	Agriculture	Mining	Manufacturing	Services
1962-63	10	1	26	63
1972-73	7	1	24	68
1982-83	6	1	19	74
1991-92	5	1	15	79
1999-2000	5	1	12	82

Source: Australian Bureau of Agricultural and Resource Economics

6.4 IMPACT OF REFORMS ON TRADE AND INVESTMENT

Generally, economic growth of advanced economies typically is accompanied by declines in the primary and manufacturing sectors' relative importance and relatively rapid growth in the services sectors. That has certainly been the pattern in Australia too. However, the reduction in manufacturing protection enabled the GDP shares of the primary sectors to increase slightly in the 1990s as resources were freed up to allow those more internationally competitive sectors to expand faster.

Manufacturing now accounts for just one-eighth of Australia's GDP and employment, compared with services' shares of around four-fifths. Australia's trade and other economic policy reforms, together with the slow growth in world agricultural trade, contributed to a much more dramatic transformation of the structure of its exports. Australia is abundantly endowed with natural resources per worker relative to the rest of the world, so it is not surprising that it has always been a net exporter of primary products and a net importer of manufactures. The contribution of various sectors to exports has changed considerably during the post-war period though. The share of rural products fell steadily from more than 80 per cent in the early 1950s to less than 40 per cent in the early 1980s and to barely 20 per cent today. Much of that decline was because of the growth of minerals and energy exports from the 1960s to the early 1980s. Since then, however, manufacturing and services exports have grown to the point where they each slightly exceed the one-fifth share of rural products today (see Table 2).

Table 2
Composition of Australia's exports, 1950-51 to 1999-2000
(in percentage)

	Rural	Mining	Other merchandise	Services	Total
1950-51	86	6	3	5	100
1960-61	66	8	13	13	100
1970-71	44	28	12	16	100
1980-81	39	34	11	16	100
1989-90	26	41	14	19	100
1999-2000	21	35	22	22	100

Source: Australian Bureau of Agricultural and Resource Economics

The growth in the share of manufactures in exports may seem ironic, given that the past two decades has been a period of cuts in government assistance to manufacturers. Its explanation in large part is that the cutting of tariffs that protect Australia's least competitive manufacturers has allowed resources to move to other activities – including other industrial sub-sectors – that can compete better in international markets. For example, not all vehicle parts manufacturing firms survived, but many of those now adopted a global rather than national market perspective. As a result they thereby achieved economies of scale through specialising in producing and now also exporting these products. Technological changes in the late 20th Century have aided the process, increasing the scope to subdivide the processes of production and distribution into parts that can be relocated anywhere in the world according to changes in comparative advantages over time. This process of 'out-sourcing' was done by various means including sub-contracting, licensing, joint ventures, and direct foreign investment by multinational corporations.

The growth in services exports since the mid-1980s was due to domestic policy reforms. No less was on account of the technological change (particularly the digital revolution that made many more services internationally tradable. Besides, the growth in international tourism, and the opening up of service trade abroad, to which the Uruguay Round's General Agreement on Trade in services contributed to an extraordinary increase in the export of services.

6.5 DIRECTION OF TRADE AND INVESTMENT

The direction of Australia's trade in recent decades is moving away from traditional markets in Europe and North America and even Japan, and is destined to the developing East Asian economies (See Table 3).

Table 3
Direction of Australia's merchandise (and services) exports, 1951 to 2000
(in percentage)

Country/Region	1951-55	1968-72	1980-84	1990-92	2000
United Kingdom	36	11	4	4	4
Other Europe	27	16	10	12	9
North America	10	16	13	12	11
Japan	8	26	27	26	19
Developing East Asia	6	12	20	30	34
New Zealand	4	5	5	5	8
Middle East	1	2	8	3	4
Rest of the World	8	12	13	8	9
TOTAL	**100**	**100**	**100**	**100**	**100**

Source: Australian Bureau of Agricultural and Resource Economics

Europe including Britain buys only one-eighth of Australia's merchandise exports now compared with more than twice that share in the early 1970s. But it still supplies nearly one-quarter of Australia's imports of both goods and services, and is a market for one-fifth of Australia's services exports. North America has a similarly large share of Australia's imports and exports of services, and imports of goods, but only half as large a share of its merchandise exports of 11 per cent.

The growth in importance of resource-poor Japan to Australia's trade began to reverse in the 1990s. Japan now accounts for just one-fifth of Australia's goods exports, one-eighth of both goods imports and services exports, and just 6 per cent of services imports. By contrast, East Asia now accounts for one-third of goods trade and one-quarter of services trade, both exports and imports. This trend has continued since China joined the World Trade Organisation (WTO).

Much of the global economic integration in services comes about through commercial presence abroad, that is, via foreign investment. That, together with foreign direct and portfolio investment in goods production, has boomed for Australia as for other countries since the early 1980s. Again the digital revolution plus opening up through policy reforms in many countries have stimulated that growth.

The direction of Australia's foreign investment is somewhat different from the direction of its trade. The United Kingdom and the United States together account for slightly over half of Australia's inflow and outflow of foreign investment (see Table 4), which is more than twice their importance in Australia's trade.

Table 4

Origin and Destination of Australia's Foreign Investment: 2000

(in percentage)

Country/Region	Foreign Investment in Australia	Australian Foreign Investment
United Kingdom	26	17
Other Europe	10	11
North America	28	36
Japan	7	6
Developing East Asia	10	8
New Zealand	2	6
Others	17	16

Source: Australian Bureau of Agricultural and Resource Economics

Continental Europe's share of Australia's investment, by contrast, is just one-twelfth, the same as its share of Australia's exports and well below its share of imports. The Western Pacific, too, accounts for a much smaller share of Australia's investment than its trade: only one-sixth, compared with about three-fifths of trade.

According to reliable forecasts the composition of Australia's trade is likely to see the mining export share continuing to fluctuate with the global business cycle around a long-run trend. In contrast, the manufacturing and services export shares will continue to move upwards. Tourism services in particular are likely to increase remarkably. As for direction, with the recovery of East Asia from the financial crisis of the late 1990s, Australia's share of exports and especially investment funds will grow further. Subdued growth in sales to Japan appears to be set to continue, while trade with South Asia, especially India, may well keep expanding from its low base if its reforms continue along with the boom in its information technology industries.

Despite the dramatic changes in the composition of Australia's trade, the majority of its exports are still natural resource-based, at a time when those products account for barely one-sixth of global trade in goods and services. Not surprisingly, then, Australia's economy is still perceived as being commodity-based and so its currency still follows the international price of primary products. No doubt, for Australia, the long-run trend in the relative price of primary commodities has been and is likely to continue to be downwards. That does not mean Australia may abandon exporting primary products. But whatever the loss the country may suffer would be more than compensated as the country's comparative advantages in manufactures and especially services strengthen.

A further contribution to Australia's economic growth from abroad has been the opening up of overseas markets, which has boosted the demand for Australia's exports both directly and indirectly. The Closer Economic Relations (CER) agreement with New Zealand, the opening of China and other former socialist economies, the broader Asia Pacific Economic Co-operation (APEC) process, and especially the GATT/ World Trade Organisation (WTO) agreements have all been quite significant. Australia experienced a setback earlier because the multilateral trade negotiations under the GATT (General Agreement on Tariffs and Trade) failed prior to the mid-1980s. More so, because they failed to address the growth and spread of agricultural protectionism, especially following the loss of markets for farm products when UK joined the European Community in 1973. By forming the Cairns Group of agricultural exporting countries in 1986 Australia helped to keep agriculture on the agenda of the Uruguay Round of trade negotiations. While the implementation of the Uruguay Round's Agreement on Agriculture itself has not yet lowered agricultural distortions greatly, it has at least placed agriculture in the GATT/WTO agenda. Meanwhile, Australia is also beginning to benefit from the opening up of services markets abroad, following the Uruguay Round's General Agreement on Trade in Services.

6.6 INTERNATIONALISATION OF AUSTRALIAN ECONOMY

Since 1990s, not only governmental but also other barriers that contribute to the costs of interacting internationally have been decreasing. Falls in transport costs and the huge decline in communication and information costs have combined in the late 20th Century to accelerate the process of economic globalisation. The current digital revolution in transport and communications technology, aided by deregulation of telecom markets in many countries, is lowering enormously long-distance communication costs and especially the cost of rapidly accessing and processing knowledge, information and ideas from anywhere in the world. Science has been among the beneficiaries of the digital revolution, spawning yet another revolution, namely in biotechnology. A side-effect of the Internet's expansion is the growth in the use of the English language: it has been claimed that there are now more people using English as a second language than there are people for whom it is a first language. This too is lowering costs of communicating between countries, as is the on-going decline in the real cost of international air travel.

This digital revolution benefits Australia in at least two ways: its well-educated, English-speaking population is adopting new digital technologies quickly; and its relatively long distance from key markets is effectively falling. The countries making the most of the digital revolution, however, are those that are becoming not only consumers but also producers of the new information and bio-technologies. That in turn requires large-scale research and development investments by consortia involving private corporations and universities, something that is more common in the United States and to a lesser extent Western Europe than it is in Australia.

6.7 CHALLENGES AHEAD AND NEEDED POLICY INITIATIVES

One of the key challenges for Australia in the 21st Century is to maintain its current pace of trade liberalisation and reforming faster than its trading partners. It is imperative because of two factors. One is that Australia started its economic restructuring well behind others in the 1980s. The other is because its comparative advantages in respect of resource exports are such that it is likely to continue to face a long-run decline in its terms of trade.

Continuing the trade and industry reform process will be more difficult than in the past two decades because the sub-sectors such as textiles, clothing and footwear and motor vehicles and parts in manufacturing still requiring reform are the most politically sensitive. More so, reforms in utilities such as telecommunications, broadcasting, postal services, higher education, and health are especially important for Australian business to be able to take full advantage of the on-going information revolution.

Another key challenge facing Australia is to provide an environment in which producers can more easily develop comparative advantages in industries that are growing. The domestic business environment is certainly much more growth-enhancing now than it was in the past. Australia's wine industry is a shining example of how a concerted effort by leading producers to broaden attitudes within an industry can create without government assistance, an export culture that is welfare-generating.

As a small economy Australia benefits greatly from the reduced uncertainty that a rules-based trading system provides now under the auspices of WTO. Admittedly, the current WTO round of multilateral trade negotiations offers probably the best prospects for agricultural-exporting countries such as Australia. No wonder, Australia is now considered a very responsible WTO member, particularly with the substantial amount of unilateral economic reform it has undertaken in the past two decades. To keep building on that reputation, and the disproportionately large influence that allows Australia to have a role in shaping the WTO's future path, Australia needs to remove its past protectionist policies and engage in further liberalisation.

Critics of reform in Australia argue that Australia should not open its economy further until its trading partners reform more. Protagonists of economic liberalisation, however, state that to not reform further will be 'unfair' to the vast majority of Australian producers and consumers who are harmed by remaining market interventions. Being a small economy, it needs to enhance its bargaining power in the multilateral trade-negotiating arena. It is for these considerations, Australian government while pursuing the multilateral is supplementing it by regional integration initiatives such as via the Asia Pacific Economic Co-operation process and the Indian Ocean Rim countries, provided members of these regional initiatives also remain committed to WTO-consistent open regionalism.

6.8 SUMMARY

Since 1990s the benefits of liberalised trade and investment, as well as increased domestic competition, have been apparent in Australia's improved economic performance impacting favourably on the country's GDP growth. Reductions in barriers to trade and foreign investment have encouraged Australia to compete more efficiently with other countries. Rapid import growth has been broadly matched by export growth, with Australia's trade participation as a proportion of GDP now a third higher than it was in the mid-1970s. Keeping these developments in mind, an attempt was made to discuss at some length the economic reforms initiated by Australia in recent decades and analyse the impact of these reform measures on the trade, investment and service sectors of the country.

Until recently Australia remained largely an inward looking economy with tight controls on foreign exchange and trade and in that sense shared the policy objectives of most other developing countries like India. Beginning in the 1990s Australia restructured its economy and further liberalised trade by reducing tariffs. The freeing of the market for foreign exchange, along with domestic microeconomic reforms, admittedly increased competitiveness in the Australian economy substantially.

Despite the dramatic changes in the composition of Australia's trade, the majority of its exports are still natural resource-based, at a time when those products account for barely one-sixth of global trade in goods and services. Australia experienced a setback earlier because the multilateral trade negotiations under the GATT (General Agreement on Tariffs and Trade) failed prior to the mid-1980s. By forming the Cairns Group agricultural exporting countries in 1986 Australia helped to keep agriculture on the agenda of the Uruguay Round of trade negotiations. Meanwhile, Australia is also beginning to benefit from the opening up of services markets abroad, following the Uruguay Round's General Agreement on Trade in Services.

6.9 EXERCISES

1) Explain briefly the circumstances leading to the economic restructuring and trade liberalisation initiatives of Australia in the recent decades.

2) Critically examine the impact of economic reforms on Australia's trade and investment.

3) Describe the orientation of trade and investment of Australia since the 1990s.

4) What are the challenges that Australia faces in respect of its trade and investment in the era of globalisation?

6.10 SUGGESTED READINGS

Anderson, K. and R. Garnaut, *Australian Protectionism* (Sydney: Allen and Unwin, 1986).

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