2

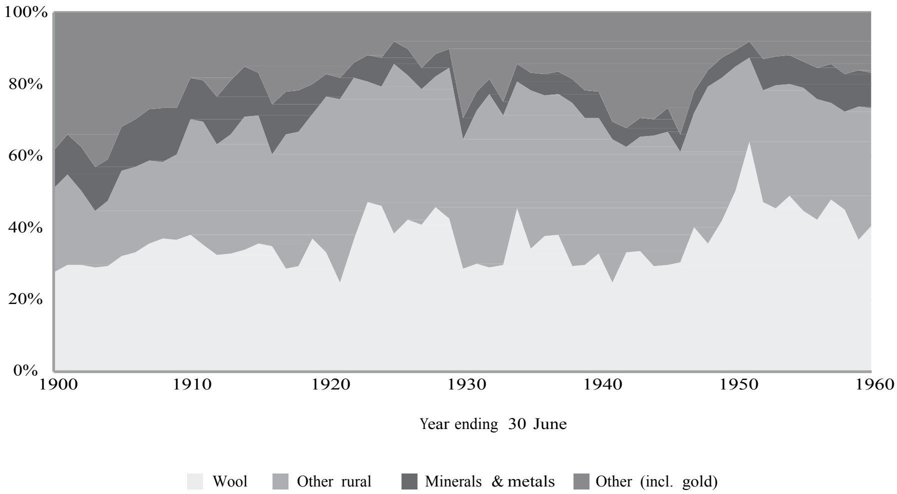
Australia's trade story

Australia has always exported primary products and imported manufactures because of its abundance of land and minerals resources relative to population. For many years, Australia's trade patterns were conditioned by traditional ties with the United Kingdom, protectionism, and closely regulated product, financial and labour markets. In the past half-century or so, we have become a less sparsely populated land, the economy has become less regulated, many trade barriers have been removed, and our trade horizons have broadened: natural resources still dominate exports, but exports of manufactures have diversified and services have emerged as a major component of trade. Asia has become a powerhouse in world trade and it has become the dominant focus of our commercial activities overseas. Trade has become more closely linked with foreign investment and Australian outward investment has surged, promoting new businesses that benefit from links to international value chains.

On the periphery and protected

Until well into the second half of the 20th century, Australia saw itself – and was seen by others – to be on the periphery of an Anglo-centric world. With its small isolated population, Australia could not generate the economies of scale and critical mass of expertise to be a competitive and significant exporter of manufactured goods. Commercial, technological and strategic factors combined to limit the development of resources (minerals and metals) production and exports.[1] The economy was driven by urban-based demand

Figure 2.1 Composition of merchandise exports, 1900–60[2]



SOURCES ABS (1994); RBA (1997); Vamplew (1987, chapter 11); ABS Year Books (cat. no. 3101.0)[3]

and rural exporters. Rural products, led by wool – with wheat, meat, butter and sugar in the main supporting roles – typically accounted for over 70 per cent of exports (see figure 2.1). Australia rode on the sheep's back: 'Merino rams were a symbol of national prosperity and even of national integrity. Several generations of Australians were taught to venerate not lions or eagles or other aggressive symbols of nationalism; they were taught to venerate sheep' (Horne 1964, p. 152).

Exports were volatile, subject to the vicissitudes of climate and agricultural commodity markets: annual exports often rose or fell by more than 20 per cent.[4] Even by the late 1950s, exports remained heavily focused on agriculture: rural exports accounted for around two-thirds of exports and wool contributed over one-third.

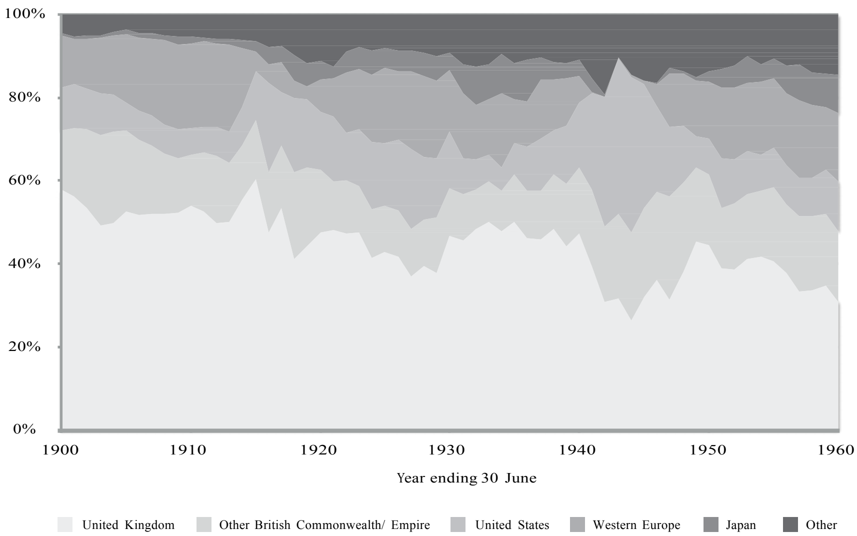
Imports were dominated by inputs for highly protected local industries and by capital goods and were predominantly from the United Kingdom. Consumption goods were imported in increasing volumes from a low base as incomes rose, notwithstanding high tariffs. Services trade was tied largely to freight and personal travel to and from Europe and North America.

Substantial foreign investment flowed into developing infrastructure and expanding import replacement manufacturing and substituted for, rather than complemented, trade.[5] Almost all came from the United Kingdom and the United States. By 1960, these countries still accounted for nearly all inward foreign investment – typically over 85 per cent of inflows. The United Kingdom, however, was less dominant, accounting for around 50 per cent of inflows into Australian enterprises compared with some 75 per cent in the early 1950s (RBA 1997, table 1.17).

While Australia's trading relationship with the United Kingdom dominated through this period, trade with the United States was important too, especially during and immediately following the Second World War. Two-way trade with Japan was substantial in the inter-war years and was based largely on wool, wheat and textiles (see figure 2.2). Japan accounted for around 5 per cent of our trade in the 1920s and up to 10 per cent in the mid-1930s: at this time Australian exports to Japan exceeded those to either the United States or France. Trade with British and European colonies in Asia and the Pacific, especially the Netherlands East Indies, India and Malaya, also was significant. The seeds for Australia's East Asian trade focus in the latter part of the 20th century clearly were sown much earlier than is commonly perceived.[6]

After the Second World War, trade with Asia grew appreciably, especially once business relations resumed with Japan. By 1960, Japan accounted for over 14 per cent of merchandise exports and 5 per cent of merchandise imports, and two-way trade was growing very strongly helped by the 1957 Australia–Japan Agreement on Commerce (see chapter 3). Trade with other East Asian countries was also growing: during the 1950s, their share of Australia's merchandise exports rose from around 4 per cent to over 7 per cent and their share of merchandise imports rose from 6 per cent to 8 per cent.

Figure 2.2 Direction of merchandise trade (exports plus imports), 1900–60



source Bingham (forthcoming)

As the 1950s closed, Australia's traditional trading partners were clearly becoming less dominant. Exports to the United Kingdom were down to around 25 per cent of all merchandise exports, compared with a third or more in the immediate post-war years. Merchandise imports from the United Kingdom also were falling in relative importance, from over 50 per cent of all imports in the late 1940s to below 40 per cent.[7] East Asian economies, especially Japan, were stirring and beginning to look abroad for trade opportunities, including with Australia. Our merchandise exports to Japan were higher than to the United States. Australia was still on the periphery but gradually was becoming less of an outpost of empire.

Protectionism

Protectionism at this time was seen as the key to providing security of employment, especially for city-based workers, and fostering growth of manufacturing industries (see chapter 3). But it made Australia less of a trading nation: from the 1920s onwards, our openness – total trade (exports plus imports) as a proportion of GDP – hovered around 30 per cent, well below the level prevailing at the start of the 20th century.

Protectionist policies – at home and overseas – stifled Australia's competitiveness and the possibility of two-way trade in manufactured goods as manufacturers turned increasingly to the home market. Manufacturing's share of GDP rose from less than 10 per cent at the time of Federation to about 30 per cent in 1960, equal to the then average for advanced industrial countries. Protectionist policies, however, pushed resources into non-tradable sectors (incorporating many services and utilities sectors) in cases where non-tradables were substitutes for imports (Anderson 2002, p. 4). Protectionist policies certainly discouraged investment in potentially more competitive sectors, in particular minerals. Minerals – gold, along with lead, copper, zinc and tin – accounted for over 30 per cent of our exports at Federation, but typically for less than 10 per cent from the 1920s to the 1950s. Collapsed metals prices after the First World War and during the depression years of the 1930s explain part of this slump.[8] Tariff protection of manufacturing, which artificially increased costs in the mining sector, along with controls on minerals exports, explain most of the rest. Controls were implemented to guarantee local supplies for protected industries and conserve strategic resources in a world preparing for another major war. Iron ore exports were banned from 1938. And responses to protectionism, like Imperial Preference, while highly welcome when introduced in the early 1930s – Australian agricultural products continued to enter the UK market duty free at a time when the volume of world trade was contracting – carried the inter-generational cost of keeping our trade profile largely frozen within an Anglocentric straitjacket.

The protectionist international trading environment, the uncertainties of the time and the fact that the exchange rate was tied to the pound sterling, also restricted Australia's trade and induced a cautious approach to trade and trade-related policies. Ensuring that obligations to overseas investors could be met was a major policy preoccupation – a focus sharpened by painful memories of blowouts in overseas financial obligations, including public debt, associated with the depressions of the 1890s and the 1930s.[9]

Cautious policies resulted in imports being less than exports more often than not, though the resulting trade surpluses were generally insufficient to offset fully interest and dividend payments to overseas investors. The 19th-century pattern of balances on the current account being predominantly in deficit continued through to 1960 and beyond. Current account deficits were typically quite modest and punctuated by surpluses. Their overall modest scale – deficits averaged out at considerably less than the average growth in nominal GDP – meant that Australia drew less on overseas capital. By 1960, the level of foreign investment in Australia – debt plus equity – was down to around 35 per cent, compared with over 160 per cent of GDP in the early 1930s.[10]

In the decade and a half following the Second World War, Australia became even less of a trading nation, notwithstanding broadening trade relationships and the United States joining the United Kingdom as a major overseas investor. In the 1950s commercial links between the major industrial nations grew quickly, helped along by the demands of post-war reconstruction and reductions in tariffs from their 1930s highs. Australia stood isolated, by policy as well as by geography, cosseted by imperial preferences and a high tariff wall that governments were unwilling to lower. Investment flowed in to finance modest current account deficits, but Australian financiers and businesses rarely ventured offshore. By 1960, our ratio of trade to GDP had fallen below 30 per cent, where it languished for the next two decades.

[22 pages following are not included in this extract]

Conclusion

The predominance of resources and rural products in Australia's exports ensures that our trade is inherently volatile. There is irony in this. Notwithstanding the reforms and policy initiatives to widen and deepen Australia's trade and their apparent success through the 1990s, we have come to the second decade of the 21st century seemingly as dependent as ever on exchanging basic commodities exports, albeit led by resources rather than rural products, for manufactured goods. Profound developments in the world economy over the past 20 years, especially in Asia, have extended this volatility to our export base more broadly. In the early and middle 1990s, manufactures and services exports grew very strongly, but the pace slowed during the East Asian Financial Crisis in 1997 and 1998, the slow-down in the world economy in 2001 and 2002, and after the Australian dollar strengthened as the mining boom gathered momentum. The GFC exacted a heavy toll. Manufactures exports fell by 14 per cent in the two years to 2009–10, exports of passenger motor vehicles falling by over 50 per cent. Services exports held up better, increasing modestly in value, though falling in volume terms. On the imports side, domestic demand continued to be the main driver. Imports rose especially strongly once the resources boom began, fell during the GFC, but recovered quickly, boosted by the government's fiscal stimulus. Since 1990, import volumes have been boosted by lower prices (and tariffs), especially for consumer and capital goods and, in recent years, the higher exchange rate.

At the time of writing, the investment-intensive phase of the resources boom was giving way to the production phase and beginning to flow through to substantial increases in resources export volumes. Resources prices had retreated from 2011 peaks.[30] This had been accompanied by a fall in the terms of trade (see box 2.3) and by a depreciation of the Australian dollar to below parity with the US dollar.

Services exports are increasing again, though at modest rates, while manufacturing exports are still somewhat below levels achieved before the GFC. Rural exports have regained ground following the breaking of the drought and with higher prices on world markets. Services, manufactures and rural exports stand to benefit significantly if the fall in the Australian dollar is sustained (see chapter 6). Imports growth has moderated with the passing of the peak in resources-related investment and a sustained increase in household saving since the financial crisis, which has tempered growth in consumption goods imports. Trade-related foreign investment flows, especially inward direct investment, remains robust.[31]

Exchanging commodities for manufactures will continue to account for the bulk of Australia's trade for years to come. It is the natural consequence of our comparative advantages. The emergence of Asia as a ready market for resources and as a world manufacturing hub has only reinforced this enduring pattern. But in making this point, it is important not to miss three things.

First, Australia has emerged as a significant services exporter, including of education, tourism and professional services, and of services embodied in resources and manufactures. This is apparent in trade statistics calculated on a gross value basis and is even more pronounced in newly developed value added based statistics (see chapter 8), in which exports are assigned to sectors and countries where value is added to products as they move through various stages of production. By this latter measure, domestic value added from services sectors contribute over one-third of Australia's total exports, including around 20 per cent of mining exports and over 25 per cent of many manufactures exports (OECD & WTO 2013).[32]

Second, Australia rightly focuses on opportunities in Asia, while developing links with new markets (such as Latin America) and broadening links with established markets in Europe and North America. Again this is apparent from conventional trade statistics but is more apparent from value-added data. These data show that Australia exports more proportionately to US and European markets on a value-added basis than on a gross value basis. This is largely because many of Australia's resources exports end up in final products exported to the United States and Europe from China and other Asian trading partners. Furthermore, the US and European markets are major markets for our services and manufactures and the domestic value-added content of these exports is proportionately greater than for unprocessed or lightly processed commodities bound for Asia (OECD & WTO 2013). Similarly on a value-added basis, Australia's imports from the United States exceed those from China because of their higher domestic value-added content and the prominence of US inputs in the exports of other countries.

Third, Australia's geographical investment and trading patterns remain very different from each other, with investment from and to Europe and the United States still dominant. Investment relationships with Asia lag well behind trading relationships in relative importance. This reflects several factors associated with the preponderance of exchanging resources for manufactured goods rather than services trade, which typically is more closely associated with investment flows; greater restrictions on investment in Asian countries; and lack of familiarity with business environments – for potential Asian investors in Australia as well as Australian investors in Asia.

To the extent that these inhibiting factors are addressed and that progress is made in raising Australia's education and skills levels, harnessing our cultural diversity and advancing technologies across transport, communications and information, Australia's trade profile should become more diverse in coming years. Prospects for services trade and accompanying direct investment, including in Asia, are especially promising. But however the trade profile evolves, making the most of the benefits from exporting, importing and associated investment requires policies that support openness, promote flexibility and facilitate flows of resources to sectors and activities where they can be best used. No sectors can be exempt since all must contribute to Australia's competitiveness in global markets and therefore to its trade performance.