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## **UNIT 11 AUSTRALIA IN THE WORLD ECONOMY**

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## **11.1 INTRODUCTION**

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By all accounts, the Australian economy has undergone far-reaching changes since the decade of 1980 largely as a consequence of the changes in the international economic environments. In turn, these changes have led Australia to modify gradually its traditional economic policy of inward-looking protectionism towards market and export orientation. In the process, like most industrialised countries, Australia too has opened its economy, liberalising foreign trade and payments, deregulating its financial system, promoting competition and a more flexible labour market, privatising state enterprises and encouraging foreign direct investment-all of which has resulted in an increase in the relative importance of foreign trade and capital movements, creating thereby a degree of internationalisation of the national economy. These transformative changes came in the wake of hike in world oil price which coincided with the decline in Australia's terms of trade during the 1970s. It is in these difficult circumstances that Australia sought domestic economic reforms based on the minimal government intervention in the market. With the domestic economy thus increasingly penetrated by the global market/economic forces, the traditional economic strategy of bargaining domestic economic stability in exchange for external liberalisation has come to an end. Australia, through its policy overtures, is currently seeking increasing insertion into the global economy. It is against these transformative changes, an attempt is made in this Unit to focus on the current economic developments in Australia and assess its status in the world economy.

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## **11.2 OBJECTIVES**

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After reading this unit, you should be able to:

- describe the structure of the Australian economy;
- understand the restructuring of the economy since 1980s;

- explain the features of Australia's economic policies and its attempt to insert itself into the world economy; and
- discuss Australia's future economic prospects.

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### **11.3 STRUCTURE OF AUSTRALIAN ECONOMY PRIOR TO 1980**

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From the time of federation up until the decade of 1980, Australia remained largely as a 'dual economy' like most primary source-endowed developing countries, exporting its raw materials and in return importing manufactured goods alongside evolving domestic manufactures totally protected from foreign competition. Such an economy effectively insulated inefficient manufacturing and service sectors from the global economy while the relatively efficient agricultural export sector, joined in the post-Second World War period by the mining industry, met largely Australia's import demands. In fact, until the 1970s Australia enjoyed strong trade growth based on traditional exports of primary commodities initially to Britain, followed by the United States and then to the rapidly developing East Asian economies, especially Japan.

Until after the Second World War, Australia's one-half of trade was with Britain. The British economy, with its apparently insatiable demand for agricultural products and raw materials was more complementary to the Australian economy than were those of the most other industrial countries. But beginning 1960s, there was a notable decline in Australia's trade with Britain reaching to less than 5 per cent today. For, by the 1950s British goods were already uncompetitive in the Australian market and were unable to match the products of other industrial powers such as importantly the US. The special relationship between Australia and Britain brought about by the colonial connections and later as members of the Commonwealth, therefore, began to decline over the decades in terms of trade relations. Attendant on the decline in Australia-Britain economic ties was the perceptible increase in Australia-US trade ties, which reached its peak in 1970s and ever since has remained almost constant. However, since 1960s, Japan started to occupy a meaningful share in Australia's trade. Whereas in late 1940s its share in Australia's trade was negligible, by mid-1960s it increased to almost one-fifth in Australia's trade. Ever since, the quantum of Australian trade expanded in the East Asia region given the rapid growth of other countries in the region. In the process, the relative importance of some of the traditional partners such as Britain and the US declined and East Asian economies have emerged as the new and growing partners in Australia's external trade.

Admittedly, the growth of the domestic economy during the long post Second World War "boom" period had relied on the export growth of primary commodities, and the redistribution of income to other sectors. The policy of protection sheltered the domestic manufacturing and service sectors from international competition. In doing so, Australia was discriminating effectively against much more competitive economic sectors like agriculture and mining. The continuing rewards from the rural and mining industry effectively buffered Australia from having to make some hard decisions earlier towards improving its international competitiveness. However, beginning in the 1970s, Australia found these exports providing diminishing returns.

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### **11.4 RE-STRUCTURING OF THE ECONOMY SINCE 1980s**

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In these circumstances, the initial move from within the government to reorganise the domestic industry protection policy came from the tariff board (later called Industries Commission and now known as the Industry Commission) in the latter half of the 1960s. At the beginning, the tariff

board's main role was to handle the requests from manufacturers for increase in the tariffs and to advise the government how far protection on particular products should be increased. In 1967, however, the tariff board began a systematic review of tariffs on manufacturing industries. Although the reform was supported by primary industry sectors such as agriculture and mining, opposition from manufacturers' organisations and trade unions was vociferous. As a result, the tariff reduction had to wait until 1974.

Accompanying the resources boom in the early 1970s, Australia recorded a large current account surplus in 1972-73. The incoming Labor government wanted to encourage exports to counter the inflationary conditions and as a consequence, the government reduced overall tariffs by 25 per cent. It is argued that this liberalisation measure was a result not of external pressures, but rather internal factors, including importantly — the inputs of advice from the Industries Assistance Commission. However, these moves did not resolve the basic problem of being dependent on the primary goods producing sectors. The economy went into decline in the latter half of the year 1974 as its major trade partners, the United States, Japan and the European Community were pushed into recession by the first oil price hike crisis. Earnings from exports suffered set back with inflation spiralling and the government had to squeeze money supply by increasing interest rates. The timing of the tariff reform admittedly worsened the domestic economic situation. So, for the time being the tariff reform process was suspended.

Following another massive deterioration of the terms of trade in the early 1980s triggered largely by the second oil price hike of 1979, again the Labor government in power in 1983 initiated domestic economic reform whereby the government surrendered official control of the exchange rate, deregulated interest rates and allowed the entry of foreign banks. These reform measures represented the most fundamental means by which Australia sought to globalise its economy. Australia's departure from its previously closed or insulated foreign economic policies was most marked in the deregulation of the finance sector. Through the floating of the dollar and the deregulation of the banking sector, the government acted to expose Australia to the global economy as well as facilitating the government's plans for liberalisation and economic restructuring. In many ways, the financial deregulation prompted other 'microeconomic reform' measures including tariff reform and restructuring of the machinery of the state.

While these initiatives were inevitable especially with the demise of the Bretton Woods' fixed exchange rate system, these policy shifts were reflective of the developments elsewhere in the global economy and revealed the growing influence of neo-liberalism as a number of right-wing think tanks and important big business interests were pushing for the deregulation of Australia's finance market. Not only the policy of financial deregulation was the most dramatic, but it was also the earliest paving the way for further neoliberal reforms in Australia. It was also the most significant in narrowing the policy options available to the government. Importantly, opening Australia's financial markets served to make every economic policy subject to the scrutiny and approval of the international financial community.

By the end of 1988, the exchange rate had depreciated by one fourth of the level prevailing in 1980. What was expected, as an outcome of the currency depreciation did not materialise. Neither did it contribute to an increase in exports nor any decrease in current account deficit and foreign debt. Rather, the economic situation worsened with the current account deficit increasing to 4.5 per cent of GDP and foreign debt was also increasing still. In fact, much of the current account deficit was on account spending by both public and private sectors and the lack of competitiveness in manufacturing industries. It was in these circumstances that, unilaterally, the government decided to expose the domestic industry to the world market industry through an industry policy that set out a gradual reduction of tariff levels.

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## 11.5 TRADE LIBERALISATION THROUGH MULTILATERALISM

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Parallel to its unilateral policy change in restructuring the domestic economy, Australia became quite active to promote multilateral free trade in such international forums such as General Agreement on Tariffs and Trade (GATT) and Asia-Pacific Economic Cooperation (APEC). Admittedly, these were the two principal innovatory trade policy measures that Australia spearheaded in the 1980s. The first of these was Australia's leadership of the Cairns Group of Fair Agricultural Trading Nations established in 1986 with as many as thirteen other countries spanning five continents — Argentina, Brazil, Chile Colombia and Uruguay in Latin America; Indonesia, Malaysia, Thailand and the Philippines from Asia; Australia, New Zealand and Fiji; Canada; and Hungary. The objective of the Cairns Group was to push for the inclusion of agriculture on GATT's agenda for the Uruguay Round and the subsequent reform of agricultural policies, especially those of the major industrialised economies in respect of three contested areas such as export subsidies, import access and internal support. By way of bargaining, the Cairns Group led by Australia demanded reform of agriculture trade in return for its support for the other items in the Uruguay Round. Such a diplomatic exercise yielded positive results. With agriculture on the Uruguay Round's agenda, Australia's principal cause of concern with the GATT had been met. Undoubtedly, it helped the Australian government to show its domestic producers that it was fighting to provide gains to compensate for the pain experienced by them from liberalisation and deregulation. More than these gains, for Australia the Cairns Group represented a creative and effective multilateral diplomacy bringing into fold a disparate group of members and to hold them together for a very complex process of negotiation in the Uruguay Round.

As well as this Cairns Group exercise in coalition-building, Australia addressed another concern, that of the formation of regional blocs, through its initiative in founding the Asia Pacific Economic Cooperation (APEC) grouping in 1989. The genesis of the APEC at the behest of Australia, in a sense, could be traced to the Uruguay Round. For, when the Uruguay Round was deadlocked through the late 1980s and early 1990s, the United States opted for the creation of free trade areas (FTAs) with Canada first and subsequently with Mexico to form the North American Free Trade Area (NAFTA) as one of the measures to complement the results of the Uruguay Round. At the same time, the member countries of the European Community integrated their markets to establish the European Union. As a reaction to these moves by the Western industrialised countries, countries in the Asia-Pacific, with Australia and Japan taking the lead, too moved towards freer trade within the region. Building further on their earlier initiatives to form economic cooperation forums such as Pacific Free Trade Area (PAFTA), Organisation for Pacific Trade and Development (OPTAD), Pacific Economic Cooperation Conference (PECC), these overtures culminated in the establishment of the Asia Pacific Economic Cooperation in 1989. Australia's interest in the formation of APEC is quite obvious. For one, Australia until then was not a member of any comprehensive trade agreement except the Australia-New Zealand Closer Economic Relations Agreement (CER). But CER by no means could fulfil Australia's growing needs in the region. Further, important trade and investment partners of Australia are located on both sides of the Pacific-East Asia and the United States. Finally, it provided a great opportunity to promote economic liberalisation and unite members into one region at the same time.

Admittedly, the APEC initiative provided an opportunity for Australia to exercise leadership as a self-professed middle power in the region and at the same time score a victory in foreign economic diplomacy. For, whereas other countries in the region, in particular, the ASEAN countries supported the APEC forum more as a means to attract foreign direct investment from Japan and newly

industrialised countries such as Korea and Taiwan, it was Australia which viewed justifiably that the formation of the EU and NAFTA would be detrimental to the interests of the Asia-Pacific region as these formations had the potential to look inwards and promote protectionist policies vis-à-vis external traders.

Both the Cairns Group and APEC are considered by Australia to be vehicles for trade liberalisation. The value of the Cairns Group is beyond doubt, given its useful role in helping to have the European Commission (EC) and the United States address agricultural trade reform in a meaningful way in the Uruguay Round while hope remains that the commitments will be implemented. However, the same cannot be said for APEC for while its flexibility and voluntarism, once seen as signs of strength, is now viewed as lack of commitment to liberalisation from many of its members. Australia has been forced into recognising that the trade facilitation role (principally conducted through APEC working parties) now looks to be more important than its trade liberalisation one.

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## **11.6 AUSTRALIA'S ENGAGEMENT WITH THE WORLD ECONOMY**

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The change of government in 1996 led by a coalition of National-Liberal parties under the stewardship of John Howard has only further intensified Australia's insertion into the world economy. By and large, the present government's record reveals a continuation of the foreign economic policies of its predecessors, despite much rhetoric to the contrary from both sides of the political spectrum. Finance and foreign investment policies have been identical while in respect of trade policy, the government's early statements promoting an enhanced bilateral approach produced nothing of substance. Equally, the predecessor Labor government's warnings that the Howard government would turn away from Asia, reflecting Howard's own predisposition, did not come to pass.

Domestically, the picture is slightly different with political debate raging over the government's extension of the domestic neoliberal reform agenda of the Labor government through increased deregulation (in particular tax and labour market reforms) and privatisation, as well as the further restructuring of the state. The government's foreign economic policies, predicated on an economic theory of unilateral liberalisation and deregulation and linked to these neoliberal domestic reforms, remain essentially ideologically driven as they choose to ignore a global and trading environment of many barriers and distortions.

The essential features of the present government's economic policies are as follows: (1) continuation of microeconomic reform policies focussed on the labour market by way of reducing the power and involvement of the trade unions in the workplace; (2) deregulation of several industries in the communication and telecommunication sectors and privatisation of the pre-existing monopolies; and (3) accelerate the process of trade liberalisation through multilateral and bilateral trade arrangements.

By most accounts, Australian economy seems buoyant. Since the recession of the early 1990s, the Australian economy has not suffered a recession in over fifteen years. As of September 2005, unemployment has fallen to a level of 5.0 per cent, the lowest level since the late 1970s. The price of Australian shares listed on the stock exchange has also grown significantly since the early 1990s. Many raw materials (including resources postulated to exist but yet to be discovered) remain mostly unexploited. The agricultural and mining sectors contribute significantly to the GDP, both directly and indirectly, through associated services like road and rail networks, which in some areas exist entirely based on an industrial need, and supporting rural economies. In



recent years the Australian government has been focusing on the development of tourism, education and technology markets.

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## **11.7 PROSPECTS OF AUSTRALIA IN THE WORLD ECONOMY**

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Admittedly, Australia's ultimate goal is to become a competitive producer and exporter, not just of traditional farm and mineral commodities, but of a diversified mix of value added manufactured products, services, and technologies. While progress has been made on this economic reform agenda-such as in opening the telecommunications market to competition-much remains to be done, particularly in the domestic arena. While the near-term outlook is for continued economic expansion, Australia's longer term prospects depend heavily on continued fundamental economic reform. There is a general consensus among the major political parties, management, and labour on the necessary features of this reform but significant divergence of views on the methods, pace, and degree of change required.

In recent years, the influence of China's economic growth has also fuelled Australia's export growth in mineral and energy resources, with the recent Western Australian Liquefied Natural Gas (LNG) contract worth potentially \$25 billion over the life of the project. China's industrialisation has resulted in an export boom for resource corporations, and thus contributed to increasing the Australian federal government's revenue stream from increased corporate taxes. Australia's trade with China is currently the fastest growing in the past decade, to become the third largest trading partner overall.

Recent changes by the coalition government on industrial relations reform with particular regard to new laws for liberalising workplace contracts for small businesses under 100 employees, has resulted in some discontent among union groups and employee advocates. Critics argue that the laws will result in reduced worker entitlements in return for nominal financial compensation, which will thus impact on the social needs of individuals. Furthermore, it is argued that there is no economic evidence to support the government's claims that the changes will stimulate productivity and raise wages. Nevertheless, business sectors welcome attempts to improve productivity, and believe such reforms will benefit the Australian economic output as a whole.

The privatisation of telecommunication will also be a major agenda for the government, potentially worth AUD\$30 billion, as it seeks to retire public debt and build upon successive federal surpluses for a future capital reserve.

Overall, during the last two decades, the Australian economy has become increasingly internationalised with both exports and imports of goods and services rising considerably as a proportion of the GDP. Also, Australia has made great strides in diversifying its export structure away from its traditional commodity baskets to the extent that manufactures and services constitute nearly one-half of the total export receipts. Growing emphasis on exports to the dynamic East Asian economies has helped to sustain export growth. Distinctly, small and medium sized industries involved in manufactures and technologically superior services are making headway in the region.

Notwithstanding the encouraging trends, it is acknowledged that continued efforts are necessary to maintain the current momentum at least at two levels-international and national. At the international level, Australia has to strive hard to gain access for its goods and services in the overseas markets. At the national level, in order to seek a place in the world economy, Australia's mineral, agricultural and manufacturing sectors have to become competitive which calls for nothing less the

modernisation of the economy which among others require further deregulation so as to help encourage the inflow of international capital, stimulating skill training and above all pressurising the industry to make competitive investments.

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## 11.8 SUMMARY

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The Unit explored the recent developments in the Australian economy arising out of the far-reaching changes in the international scenario and highlighted the global penetration of the domestic economy. The shift in Australia's foreign economic policy for the past two decades has formed part of efforts by the state to bind the national economy closer to the global one thereby increasingly taking its signals from the global market. This appears to have been based on two premises-first, there is no other viable alternative for the continued growth of the national economy; and the second, linked to domestic reform, is that such policies gave credibility to Australia's foreign economic diplomacy directed at encouraging players with structural power in the global economy to open up their economies. The adoption of these policies, generally described as neo-liberal, amounted to a scrapping of the post-war bargain of domestic stability in exchange for external liberalisation.

In the process, the recent shift in the policy orientation has led Australia to change gradually its traditional economic policy of inward-looking protectionism towards market and export orientation. In the process, like most industrialised countries, Australia too opened its economy, liberalising foreign trade and payments, deregulating its financial system, promoting competition and a more flexible labour market, privatising state enterprises and encouraging foreign direct investment-all of which resulted in an increase in the relative importance of foreign trade and capital movements, creating thereby a degree of internationalisation of the national economy. It is in these difficult circumstances that Australia sought domestic economic reforms based on minimal governmental intervention in the market. With the domestic economy increasingly penetrated thus by the global market/economic forces, the traditional economic strategy of bargaining domestic economic stability in exchange for external liberalisation came to an end. Ever since, Australia — through its policy overtures- is seeking increasing engagement with the global economy

Parallel to its unilateral policy change in restructuring the domestic economy, Australia actively promoted multilateral free trade in such international forums such as General Agreement on Tariffs and Trade (GATT) and Asia-Pacific Economic Cooperation (APEC). Admittedly, these were the two principal innovatory trade policy measures that Australia spearheaded in the 1980s. The government's foreign economic policies, predicated on an economic theory of unilateral liberalisation and deregulation and linked to these neo-liberal domestic reforms, remain essentially ideologically driven as they choose to ignore a global and trading environment of many barriers and distortions. They are seeking to accelerate the process of trade liberalisation through multilateral and bilateral trade arrangements. By most accounts, Australia has achieved some positive results in the short-run as the economy appears buoyant.

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## 11.9 EXERCISES

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- 1) In what way did the structure of the Australian economy and trade change in the 1980s from that of the post Second World War years?
- 2) Why did Australia decide to go in for domestic economic liberalisation in the 1980s? What steps did it take in this direction?

- 3) How has Australia's multilateralism aided trade liberalisation?
- 4) What are the current challenges Australia faces in order to maintain its place in the world economy?

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## SUGGESTED READINGS

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