

AUSTRALIA'S TRADE AND FINANCIAL FLOWS

4

MULTIPLE CHOICE

- | | | | |
|------|-------|-------|-------|
| 1. B | 6. D | 11. A | 16. A |
| 2. B | 7. D | 12. A | 17. B |
| 3. B | 8. A | 13. D | 18. D |
| 4. A | 9. D | 14. B | 19. B |
| 5. C | 10. C | 15. B | 20. A |

SHORT ANSWER QUESTIONS

Question 1

- (a) The balance of payments is the record of all transactions between Australia and the rest of the world over a period of time, consisting of the current account and the capital and financial account.
- (b) An answer to this question may include any two of the following:
- Australia's current account has been persistently in deficit, fluctuating between 3% and 6% of GDP.
 - The balance on goods and services has fluctuated between small surpluses and larger deficits.
 - The net incomes account has been persistently in deficit, with this deficit widening in recent years.
 - Net current transfers tend to make an insignificant contribution to Australia's current account deficit, ranging from small surpluses to small deficits.
- (c) Expressing the current account as a proportion of GDP provides an indication of the size of the CAD relative to the size of an economy. This allows for comparison between countries and over a period of time.
- (d) An answer to this question may include any two of the following:
- An increased reliance on imports of elaborately transformed manufactures (ETMs) has consistently added to the size of the goods and services deficit, a significant component of the current account deficit.
 - Australia tends to export low value-added agricultural goods and volatile commodities, leading to low export revenue when compared with Australia's high cost, high value-added imports. This adds to the Balance on Goods and Services component of the CAD.
 - Australia's low level of national savings means that Australian firms and government must borrow from overseas or sell domestic assets to finance investment, adding to Australia's foreign liabilities inflows.
 - Australia's high level of foreign liabilities incurs servicing costs such as interest repayments on debt and dividends on shares. These costs are recorded as outflows on the net incomes account, adding to persistent current account deficits.

Question 2

- (a)** An answer to this question may include any one of the following causes:
- Australia's persistent and increasing current account deficits, which have created a dependence on financial inflows to fund the deficit.
 - Australia's declining national savings rate, which has created a need for foreign financial inflows where the domestic pool of savings is not sufficient to fund domestic investment.
 - Lower international interest rates in comparison with Australian interest rates, making investing in Australia relatively attractive.
 - The deregulation of the financial sector in 1983, which provided foreign investors with greater access to Australian financial markets.
- (b)** Direct investment is a substantial long-term investment in a company, involving a purchase of more than 10 per cent of its shares. Portfolio investment refers to a short term, smaller purchase of a financial asset, generally less than 10 per cent of a company's shares.
- (c)** Increased financial flows into the Australian economy provide funds for investment that contributes to Australia's productive capacity, increasing employment and economic growth. Financial inflows, especially foreign direct investment, are often associated with the transfer of skills and technology from other countries, which can help improve labour productivity as Australian workers and firms adopt efficient work practices.
- (d)** Foreign liabilities incur servicing payments, in the form of interest on foreign debt and profits returned to foreign equity. These servicing costs are recorded in the net incomes component of the current account. An increase in foreign liabilities thus adds to the size of future current account deficits. To finance these current account deficits, it is necessary to borrow from overseas or sell assets to foreigners, further increasing the size of foreign liabilities.

Question 3

- (a)** An answer to this question may include any two of the following changes:
- Australia has seen an increase in exports to South-East Asia and China due to the region's strong economic growth, fuelling demand for Australian commodity exports.
 - Australia has decreased its exports to the European Union due to its discriminatory trade policies, which disadvantage Australian exporters.
 - Australia's imports from ASEAN nations have increased due to the emergence of low-cost manufacturing export industries in these nations.
 - Australian imports from the United States have fallen, as imports increasingly come from Asian nations.
- (b)** An answer to this question may include any two of the following changes:
- The share of agricultural goods in Australia's exports has declined in recent years as the Australian economy has diversified into resource and service exports.
 - Service exports, particularly tourism and financial services, have increased as a proportion of total exports as globalisation has facilitated the international movement of people and finance.
 - Australia imports a greater proportion of finished goods today than in the past, reflecting the abundance of low-cost manufactured goods produced in East Asian economies.

- (c)** The terms of trade is the ratio of export prices to import prices. An improvement in the terms of trade means that Australia can buy a greater quantity of imports with the same quantity of exports, which would benefit the balance on goods and services component of the current account.
- (d)** The government may introduce export incentives (such as tax concessions) to encourage firms to export more broadly, which would improve the BOGS. To broaden Australia's export base to include higher value-added goods and services, the government may invest in research and development. To address Australia's dependence on foreign funds, it may implement policies that encourage savings, such as compulsory superannuation. Through maintaining a budget surplus, the government aims to reduce the public sector's contribution to foreign debt, hence reducing the size of future servicing cost outflows on the current account.