An Evaluation of the Government's Balance of Payments Strategy

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AN OVERVIEW OF THE BALANCE OF PAYMENTS STRATEGY

Since 1977 the present Government has been borrowing heavily on external money markets. This programme of borrowing was a response to a major downturn in the balance of payments. The Government perceived the borrowing programme as a transitory exercise until the balance of payments turned around. Such a turn around would come about through the large direct foreign investment in the mining industry, and the subsequent upturn in export earnings. The turn around in the balance of payments would then coincide with the repayment of external debt, which would not, in itself, then be a severe burden.

This, then, has been the plan. It is the contention of this paper that the plan may well fail. And if the plan were to fail, Australia's balance of payments problems would be exacerbated. The reasons for believing that the strategy may well fail are as follows:

(1) currency movements have greatly increased the magnitude of the Government's external debt burden;
(2) there as yet has been no turn about in the balance of payments;
(3) the capital account is becoming increasingly volatile, whilst portfolio investment has increased just as much as direct investment;
(4) the boom in mining investment as yet has not eventuated;
(5) international economic conditions are currently running against the Government's external and domestic policy strategies.

Each of these factors will be examined in turn.

AUSTRALIA'S EXTERNAL DEBT

In a recent article in this journal, Crough[1] critically evaluated the Government's programme of external borrowings. As at the end of June 1979, total official borrowings stood at over A$5.2 billion; and since then the Government has negotiated further external loans.[2]

Treasurer, John Howard, stated in the 1978 Budget Speech that:

> the Government remains committed to a programme of official borrowings from overseas to supplement the temporary depleted levels of private capital inflow and, in the process, to maintain reserves.[3]

The Government then is committed to borrowing to maintain current levels of international reserves with the view that the present balance of payments difficulty is only temporary.

It could be argued that with current high levels of unemployment, the Government should apply such loans to developmental and employment creating programmes. This could be made consistent with the need to establish export industries and to increase export income if the Government itself were to finance projects in the mining and energy areas.

Apart from the application of the loans, the major problem concerns the future debt burden. Firstly, because of adverse currency movements, the debt burden itself has already increased by more than A$500 million.[4] Secondly, as yet, there has been no major turn about in the balance of payments. The second factor reinforces the first. Through weakness in the balance of payments, the Australian dollar has gradually depreciated against most currencies in which the borrowed funds were obtained (see Table 1). If the balance of payments remains weak, then further depreciation will increase the debt burden in the future.[5]

Table 1: Exchange Rate Movements - Units of Foreign Currency per $A 1977-79

At end of	US Dollar	UK Sterling	W.German Mark	Neth. Guilder	Swiss Franc	Japanese Yen
1977						
March	1.103	.641	2.635	2.747	2.805	306.50
June	1.115	.648	2.607	2.764	2.741	298.50
September	1.107	.634	2.568	2.730	2.599	293.33
December	1.141	.596	2.395	2.586	2.287	273.84
1978						
March	1.143	.612	2.316	2.479	2.144	253.65
June	1.147	.616	2.382	2.561	2.128	235.46
September	1.156	.585	2.234	2.441	1.758	218.60
December	1.150	.565	2.098	2.268	1.865	222.83
1979						
March	1.118	.542	2.087	2.250	1.889	233.63
June	1.121	.515	2.068	2.275	1.856	242.83
September	1.129	.510	1.963	2.176	1.747	252.17
December	1.107	.494	1.900	2.110	1.761	265.31

Source: Reserve Bank of Australia, Statistical Bulletin.

THE BALANCE OF PAYMENTS PROBLEM

Australia's balance of payments has in recent times been beset by large and continuous deficits in the invisible and current accounts (see Table 2), and unlike previous years these deficits have more than offset any net capital inflow. Since the mid 1970s there has been a drain on reserves through the balance of payments, but fortunately for the Government this has been more than offset by the revaluation of reserve assets, especially gold (see Table 3). However, the value of reserves dropped considerably with the fall in the price of gold earlier this year.[6]

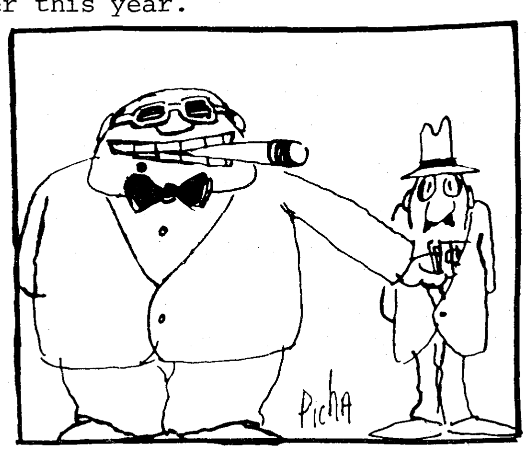


Table 2: Net Invisibles, Current Account Balance, and Net Monetary Movement 1968/69 - 1978/79

Financial Year	Net Invisible	Current A/c	Net monetary movement
1968/69	-1001	-968	148
1969/70	-1109	-698	37
1970/71	-1206	-766	598
1971/72	-1264	-315	1474
1972/73	-1468	734	1071
1973/74	-1744	-810	-435
1974/75	-1784	-946	-464
1975/76	-2592	-1108	-1020
1976/77	-3015	-1961	-491
1977/78	-3395	-2545	-542
1978/79	-3821	-3200	-124

Source: Balance of Payments, Australian Bureau of Statistics, Canberra.

What has been the source of the weakness in Australia's balance of payments? Crough[7] suggests that there are four explanations:

(1) a fall off in the rate of foreign private investment in Australia (see Table 4);
(2) a continued increase in profit and dividend remittances (see Table 4);
(3) a reduced rate of growth of export revenue and corresponding increase in imports (see Table 4); and
(4) increasing invisible deficits (see Table 2).

Table 3: Official Reserve Assets

Financial Year	Changes due to Balance of Payments	Changes due to Revaluation
1968/69	143	26
1969/70	118	6
1970/71	742	-71
1971/72	1544	-108
1972/73	1079	-593
1973/74	-384	-329
1974/75	-460	+393
1975/76	-1053	+646
1976/77	-190	+416
1977/78	-474	+387
1978/79	-167	+827

Source: Balance of Payments, Australian Bureau of Statistics, Canberra.

All factors seriously undermine the Government's external strategy. As can be seen from Table 5, private investment has recently become very volatile and unstable. At the same time, the invisible deficit (largely through profit remittances, transport payments) has greatly increased. Finally, whilst the Government has expected export growth, this has generally been matched by import growth (see Table 3).

Table 4: Growth Rates of Selected Items in the Balance of Payments, 1968/69 - 1978/79

Financial Year	% Commodity Exports	% Commodity Imports	% Remittances to Property Income	% Foreign Private Investment
1968/69	10.4	1.4	11.4	2.7
1969/70	22.6	10.9	8.6	-17.0
1970/71	6.6	6.7	6.0	76.4
1971/72	12.1	0.0	3.7	-11.4
1972/73	28.9	0.4	25.8	-65.8
1973/74	9.6	51.1	13.6	-59.2
1974/75	26.9	33.0	-4.5	305.6
1975/76	10.8	3.6	41.2	-3.6
1976/77	21.2	30.7	11.3	128.9
1977/78	5.6	7.9	8.5	-48.3
1978/79	16.7	20.7	11.3	99.5
9 months ended March 1979 to 9 months ended March 1980	38.8	19.1	n.a.	-70.1

Source: Balance of Payments, Australian Bureau of Statistics, Canberra.

There are no reasons to suggest that in the future either invisible payments or the volume of imports will fall off. Thus, for the Government strategy to succeed, either the private capital inflow or export income must increase substantially.

INCREASING PORTFOLIO INVESTMENT

The capital account, if anything, is becoming increasingly volatile. Table 5 indicates monthly private capital movements for 1979-80.

Table 5: Private Capital Movements, 1979-80

For Month	Private Capital $m
1979 July	117
August	36
September	-176
October	-174
November	71
December	-187
1980 January	556
February	72
March	-28

Source: Balance of Payments, Australian Bureau of Statistics, Canberra

The recent volatility on the capital account reflects the important trend towards portfolio investment.

> The volatility in the capital inflow stemmed in part from the great increase in size and proportion of the capital inflow under the incongruous statistical grouping of portfolio investment and institutional loans.[8]

Increasingly, the behaviour of interest rates, exchange rates, stock market prices, etc., makes short term investment an attractive proposition. There are substantial profits to be made on share markets, currency markets, and money markets. Table 6 indicates that for Australia over the past few years, portfolio investment has increased generally at the same rate as direct investment, although greater publicity has been given to the latter.

Table 6: Portfolio Investment and Institutional Loans, 1968/69 - 1978/79

	(1) Portfolio Investment & Institutional Loans	(2) Total Private Capital	(1) / (2)
1968/69	405	980	.413
1969/70	267	813	.328
1970/71	652	1434	.455
1971/72	577	1270	.454
1972/73	94	434	.217
1973/74	-134	177	-.757
1974/75	237	718	.330
1975/76	198	692	.286
1976/77	496	1584	.313
1977/78	268	815	.329
1978/79	661	1626	.407
6 months to Dec. 1979	351	240	1.458

Source: Balance of Payments, Australian Bureau of Statistics, Canberra

In an international investment climate of continuing risk and uncertainty, due to movements in interest rates and exchange rates, especially, short term capital movements will become the norm. If risk and uncertainty do continue, then the capital account can be expected to remain volatile. Yet the Government's expectation is of a stable, long term capital inflow predominantly in the form of direct investment.

DIRECT INVESTMENT IN THE MINING INDUSTRY

Australia's vast mineral resources await development. Investment by international corporations in this sector is seen by the Government as providing a solution to both short and long term balance of payments difficulties.

As yet, the expected surge of foreign investment in the mining sector has not been forthcoming. Reference to Table 7 suggests that direct investment in the mining sector has not grown rapidly in the last few years, especially in relation to Government expectations, despite intensified wooing by Federal and State Governments.[9] It is to be noted that the large-scale projects for which there are plans involve long gestation periods before there can be increases in export revenue. But in any case, one would not expect gestation to begin while current international uncertainty persists; and paradoxically the "sloshing" of the reserves of transnational mining companies and others between short term investments prolongs the uncertainty.

Table 7: Direct Private Investment by Sector, 1968/69 to 1978/79

Financial Year	Mining	Primary+	Manufacturing
1968/69	142	262	201
1969/70	159	259	232
1970/71	262	275	246
1971/72	355	362	185
1972/73	58	70	71
1973/74	93	60	245
1974/75	90	52	283
1975/76	67	26	231
1976/77	-47	-53	485
1977/78	na	57	360
1978/79	na	na	na

\+ includes mining, oil exploration and pastoral

Source: Balance of Payments, Australian Bureau of Statistics, Canberra

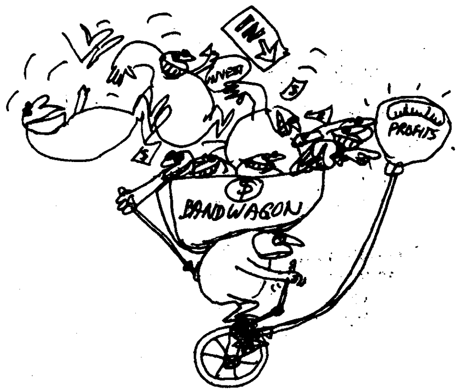
Even if a substantial increase in mining investment were to occur, would that necessarily mean longer term viability and stability in the balance of payments? Whilst export income would undoubtedly increase, so too would the remittances of profit and dividends, resulting in a concomitant increase in the invisibles deficit; and further, the import content of mining investment is large, so that expenditure on visible imports would increase. Also, mineral investments are very lumpy and uneven, with vast amounts being committed over short periods of time.[10] A shift to greater investment in the mining industry, if and when it did eventuate, could be expected to add to the instability of the capital account. So, while the nature of the balance of payments problem would change with increased investment in the mining sector, there would be no less a problem.

INTERNATIONAL UNCERTAINTY AND INSTABILITY

Recent developments in the international economy are likely to place the Government's internal and external strategies under severe pressure.

The rising of interest rates to record levels in both Europe and the USA [11] has led to a flood of funds to those countries with high interest rates, and pressure for higher interest rates in the rest of the world. Australia is now faced with increasing interest rates, much to the Government's displeasure. The implications domestically and internationally point to recession. In the view of the Commonwealth Bank:

> the high level of international interest rates could bring about a significant contraction in global money supply and hence a squeeze on investment and consumer activity. With inflationary expectations also adding to uncertainty, the possibility of relatively severe recession in the major economies in 1980/81 has become stronger.[12]



Apart from increasing interest rates throughout the world, there are other factors adding to the climate of uncertainty for international trade and investment. Among them are the following: (1) Inflation problems are generated by rising international oil prices; (2) the political instability in the Middle East areas not only adds to the above problem, but has wider implications. For example, Australia's exports will be severely affected by any trading embargo placed on both Iran and the U.S.S.R.; (3) the recession in the U.S.A. is worsening , and will have effects on world trade and payments. Already there is the spectre of a move towards increasing protectionism.[13]

AUSTRALIA IN THE GLOBAL ECONOMY

The sum of all these developments is that the Government's external strategy is not coming to fruition; and indeed there are doubts if it will ever do so.

Australia has already been forced to accept an increase in interest rates as being the price of greater international economic integration. With current increasing inflation rates and unemployment in the U.S.A., Australia can expect to be in receipt of the same pressures at a time when domestic unemployment is already at post war record levels.

The Government's present strategy of borrowing abroad while awaiting a foreign-investment-led recovery has further integrated Australia into the world economy and limited the sovereignty of not only its own domestic policies, but in all probability the domestic policies of future governments.

The strategy is a very risky one. Australia could be heading down the same path as many third world countries who have foreseen foreign capital and external debt as a basis for future prosperity.[14]

FOOTNOTES

* Useful comments were provided by Gavan Butler and Stuart Rosewarne. Fay Shaw probided valuable help in the completion of the paper. All errors and omissions are the sole responsibility of the author.

1 G.J. Crough, 'Digging Deeper into National Debt: Australian Government's Foreign Borrowings', Journal of Australian Political Economy, No.5, July 1979.

2 The Government is currently negotiating a loan in West Germany. Already this financial year A$272m. of loans have been raised in Japan.

3 The Australian, 16 August 1978

4 Between 1977 and 1979 the debt burden increased by A$252m because of adverse currency movements. See R. Barton, 'The Hidden Loss of Overseas Loans', Sydney Morning Herald, 3 September 1979.

5 Many of the loans have been in those currencies which have considerably appreciated against the Australian dollar - Dutch guilders, Deutsch marks, Swiss francs. For a break-up of the borrowings, see G.J. Crough, op.cit., Table 1, p.49.

6 January saw a revaluation of reserves by A$151m coinciding with the rapid increase in the price of gold. However, as the gold price dropped in March, so did the valuation of reserves, by A$781m.

7 G.J. Crough, op.cit., pp 50-52.

8 By November 1979 the prime lending rate in the U.S.A. was pushed up to a record 17%. According to Ross Gittens this broke the record "that has stood since the election of Abraham Lincoln on the eve of the Civil War". See R. Gittens, 'What the American Squeeze will mean to Australia', National Times, 1 December 1979.

9 'The External Debt and the Balance of Payments', Bank of N.S.W. Review, No 28, February 1979, p.4.

10 Earlier this year, the Prime Minister was reported as telling U.S. businessmen "that 50 per cent Australian equity in resource projects was no longer mandatory and that in Australia profit is an honourable term", Australian Financial Review, 31 January 1980.

11 As the Bank of N.S.W. commented on this development, "the concentration of private investment towards a few big projects, with long lead times in their assessment and preparation, means that the inflow will be of a jerky nature, long periods of dearth alternating with periods of exceptionally heavy infusion of overseas capital", Bank of N.S.W. Review, op.cit., p.9.

12 Commonwealth Banking Corporation, Economic Newsletter, 4 April 1980.

13 As recession hits U.S. and European industries - especially steel and automobiles - the moves towards increasing protection gather momentum. See 'Skirmishing Over Imports', Newsweek, 10 March 1980.

14 The following comments on foreign capital and external debt in Latin America are equally applicable to Australia: "the country whose leaders think or act as if they believed that development depends on what others may do for it will have no destiny as an economically independent country". Richard M. Ffrench-Davis and S. Arancibia, 'Notes on Foreign Capital and Latin Maerica', in International Economics and Development: Essays in Honour of Raul Prebisch, Academic Press, New York, 1972. For further discussion of the external debt problems of third world countries, see C. Payer, The Debt Trap, Penguin, Ringwood, 1974 and G.M. Meier, The International Economies of Development, Harper and Row, New York, 1968, chapter 5.