Competitiveness and openness

Australia's international competitiveness affects our international trade and hence our national production, employment and income. A fall in our competitiveness implies that goods and services produced in Australia have difficulty finding buyers in both foreign and domestic markets.

Australia's international competitiveness fluctuated quite widely during the past decade. Although the price of labour in Australia (measured by real unit labour costs) remained quite steady there was a fair degree of movement in the value of the Australian dollar against other currencies.

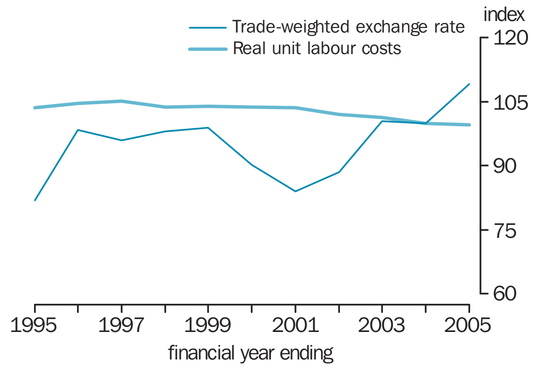
Competitiveness

The competitiveness of a country's goods and services can depend on a variety of factors, but relative price has a major effect, and most statistical indicators of international competitiveness are derived from price measures. Two important influences are a nation's unit labour costs (the pace of wage rises compared to the pace of productivity improvement) and the value of its currency relative to the currencies of its trading partners.

Australia's real unit labour costs showed a moderate decrease between 1994–95 and 2004–05. This was due to productivity gains outstripping increases in real hourly labour costs. This decrease in real unit labour costs is likely to have had a positive effect on Australia's international competitiveness.[1]

In recent years, there have been fairly wide fluctuations in the value of the Australian dollar relative to the currencies of our major trading partners. In 2004–05, the Australian dollar was stronger against the currencies of most of our major trading partners than it had been at any time during the previous ten years, and nearly 9% stronger than it had been in 2003–04. The recent strength of the Australian dollar has reduced the competitiveness of Australia's exports.

Real unit labour costs and the trade-weighted exchange rate



Base year is 2003–04 = 100.

Source: Balance of Payments and International Investment Position, Australia[1] *and Commonwealth Treasury.*[2]

During the decade 1994–95 to 2004–05, there was a rise against the US dollar (up 8%) but a fall relative to the United Kingdom pound of 5%. The Australian dollar appreciated against most of our other major trading partners; in the case of the Japanese yen by almost 40%.

Trade-weighted exchange rate

The trade-weighted exchange rate measures the change of the value of the Australian dollar relative to our major trading partners. As at 1 October 2005, the weights for each exchange rate reflect Australia's two way merchandise trade in 2004–05. The Japanese yen has a weight of about 16%, the Chinese renminbi, about 13%, the European euro, about 13% and the US dollar, about 12%.

The Asia Pacific region accounts for 65%, which reflects the growth of merchandise trade between Australia and the Asia Pacific region.[3]

Measuring competitiveness

A country's international competitiveness can be measured in many ways. Two influences are particularly important.

- Changes in domestic prices relative to prices of competitor countries. All other things being equal, a country becomes more competitive if its prices rise more slowly than those of its competitors.
- Exchange rate movements. All other things being equal, a country becomes more competitive if the value of its currency falls relative to the currencies of its competitors – that is when there is a depreciation in its nominal exchange rate.

Factors influencing change

Changes in a nation's competitiveness are the outcome of many interconnecting influences. Most fundamental in the long run are such factors as technological advance and productivity improvement.

Three factors have an important influence, all of which would ideally be measured.

- Movements in Australian wages relative to the wages in other countries.
- Movements in Australian labour productivity (the amount of output per unit of labour input) relative to productivity in other countries.
- Changes in the exchange rate of the Australian dollar relative to the currencies of other countries.

The first two factors combine to generate shifts in Australian relative unit labour costs – it is the pace of wage rises compared with the pace of productivity improvement that matters, rather than wage rises alone. As discussed in the commentary *Productivity,* Australia exhibited good labour productivity growth during the 1990s relative to earlier periods. Also, Australian wage increases were more modest than in some earlier decades.

Openness – the interaction of Australia's economy with other economies – can provide benefits to Australians. An increased openness to imports means that we have a wider range of goods and services to choose from, often at more competitive prices. Also, international trade and investment flows may give Australian businesses access to newer and more innovative technologies, which can in turn lead to productivity improvements. Competition with overseas suppliers may also prompt greater efficiencies or innovation in Australia.

This commentary considers two aspects of Australia's openness: our imports of goods and services, and foreign investment flows into Australia.

Openness

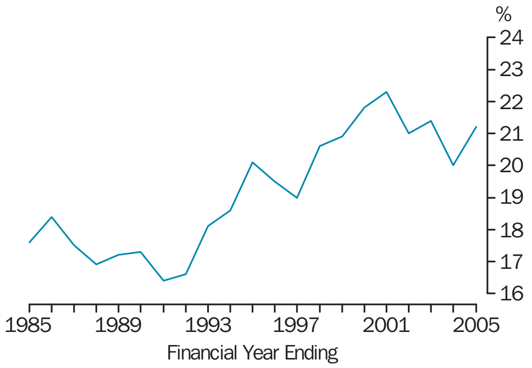
Openness can be assessed from the relative significance of overseas trade and investment flows to the national economy. It can also be assessed from the negotiation of free trade agreements or the barriers that a country places on trade and investment flows across its borders (for example, tariffs and quotas on imports or restrictions on foreign ownership of land or other assets). Ideally, indicators of openness would encapsulate both the size of and the barriers to flows of trade and investment.

Measures of effective rates of assistance to industry are available, but only cover barriers to trade.[4] Barriers to investment are more difficult to encapsulate in a single indicator. Moreover, even if such an indicator were available, a somewhat arbitrary decision would have to be made about the importance, or weight, that should be assigned to the various restrictions.[5]

The goods and services that international trade make available to Australian residents are indicators of openness. This section focuses on how Australia's openness to imports provides Australians with wider choices of goods and services. The graph below shows the ratio of imports of goods and services to GDP from 1984–85 to 2004–05. The ratio generally rose over the period, from 18% in 1984–85 to peak at 22% in 2000–01. In 2004–05 the ratio was 21%.

This indicator is affected by a range of factors aside from the openness of the economy. For instance,

Ratio of imports to GDP



Source: Balance of Payments and International Investment Position, cat.no. 5302.0[6]

Foreign ownership of Australian enterprise

Source: Balance of Payments and International Investment Position, cat.no 5302.0[6]

fluctuations in the exchange rate of the Australian dollar and changes in world commodity prices can result in changes in the prices of Australia's imports relative to GDP.

Investment flows into and out of Australia are another important aspect of openness. Outward investment builds up Australia's income-generating assets abroad. Inward investment can provide opportunities for local businesses to access new technologies and management skills, as well as funds for capital formation.[7] To measure this aspect of openness, a relevant indicator is the proportion of foreign ownership of equity in Australian enterprises, shown in the graph above. The volatility in the graph can be seen as a further indicator of openness, as it reflects the ease with which equity can be invested or withdrawn.

Factors influencing change

The increased openness of Australia's economy has been brought about by a combination of factors. For some years now, Australia has been lowering the level of barriers to the imports of goods and services and capital inflows. This is shown in part by the decrease in the average tariff rates applied by Australia, which fell from almost 16% in 1988 to around 5% a decade later.[8] Multilateral, regional and bilateral trade negotiations have played an important part in this gradual dismantling of border protection.

Another way in which economic policy has led to an increase in openness in Australia is through the liberalisation of capital flows. Since the mid-1980s and the deregulation of the financial system, capital transactions, including foreign investment in Australia, have greatly increased.

Links to other dimensions of progress

Enhanced international competitiveness in both foreign and domestic markets tends to improve Australia's international trade balance and increase national income.

Reduced rates of inflation (including wage inflation) relative to Australia's trading partners

Types of foreign investment in Australia

There are various ways in which foreign residents and companies can invest funds in the Australian economy:

- direct investment – when a foreign investor has an equity interest of 10% or more in an Australian enterprise, and so has influence over its operations
- portfolio investment – refers to equity and debt transactions which, unlike direct investment, do not offer the investor any influence over the operation of the enterprise
- other investment – transactions not included as direct or portfolio investment, such as trade credits.[9]

In June 2005, portfolio investment accounted for 58% of total foreign investment levels in Australia. Direct investment made up another 25%.

The industries recording the highest levels of foreign liability at the end of June 2005 were Finance and insurance, and Manufacturing.[6]

Australian imports of goods and services

Imports can be separated into goods and services. Imported goods can in turn be classified according to their end use; for example household items and non-industrial transport are classed as consumption goods, whereas machinery and industrial transport are classed as capital goods.

Over the last decade, one of the fastest growing areas of capital imports was telecommunications equipment. The nominal value of imports of these goods almost tripled between 1994–95 and 2004–05 despite general falls in prices. Imported services also increased throughout the decade. Expenditure on transportation and travel services in particular, which includes spending by Australians on travel abroad as well as their purchases overseas, almost doubled between 1994–95 and 2004–05.

and productivity improvements tend to enhance Australia's international competitiveness.

Increased openness to imports can be linked with greater competitiveness, and can affect consumption patterns here. Improvements in productivity can also be associated with greater openness to foreign investment.

See also the commentaries *National income*, *Productivity* and *Inflation*.

Endnotes

1 Data supplied by the Treasury. The data were derived from the Australian Bureau of Statistics, *Australian System of National Accounts 2004–05*, cat. no. 5204.0, ABS, Canberra.

2 Commonwealth Treasury data and *Balance of Payments and International Investment Position, Australia* September 2004, cat. no. 5302.0, ABS, Canberra.

3 Reserve Bank of Australia Media release – Trade-weighted index, 30 September 2005 <http://www.rba.gov.au/MediaReleases/2005/mr_05_12.html

4 Productivity Commission 2001, Trade and Assistance Review 2000–01, Annual Report Series 2000–01, AusInfo, Canberra.

5 Lloyd, P.J. and MacLaren, D. 1998, Measures of Trade Openness Using CGE Analysis, Research Paper No. 659, The University of Melbourne, Melbourne.

6 Australian Bureau of Statistics 2005, Balance of Payments and International Investment Position, cat. no. 5302.0, ABS, Canberra.

7 Australian Department of Foreign Affairs and Trade 2001, Exploding the Myths – Facts about Trade and International Investment, Canberra <http://www.dfat.gov.au/publications/exploding_myths/index.html> last viewed 13 March 2002.

8 Australian Department of Foreign Affairs and Trade 1999, Regional trends in tariffs, Canberra <http://www.dfat.gov.au/apec/meetings/apec1999/regional_trends.html> last viewed 24 April 2006.

9 Australian Bureau of Statistics 1998, Balance of Payments and International Investment Position: Concepts, Sources and Methods, cat. no. 5331.0, ABS, Canberra.