

★ Australia's reserves of sterling and foreign currencies are at present in excess of £500 millions, but they are little more than what is needed to pay for one year's imports at present prices.

# THE BALANCE OF PAYMENTS

The overseas balance of payments is possibly the most revealing, although not the most fundamental, of all the indicators of economic health and prosperity. It is here that underlying internal weaknesses and instabilities eventually manifest themselves most clearly. This is especially true of those countries in which international trade comprises a large proportion of all trading activities. For instance the final test of the success or failure of Britain's dramatic struggle for economic survival is whether she can balance her overseas accounts by achieving a sufficient volume of exports to pay for the food and raw materials essential to her existence. The attention of governments and economists in Britain has been, therefore, over the last few years, unremittingly focussed on her balance of payments, and particularly on her balance with the dollar countries.

But overseas trade also looms very large in the Australian economic picture, and the trend in the Australian balance of payments should be a matter of live interest and concern to business and trade unions as well as to governments. Relative to its population Australia is a large exporter and importer, selling very big quantities of a very small number of products and purchasing a wide range of raw materials, finished goods and capital equipment needed for home industry and for direct consumption by the people.

## THE BALANCE OF PAYMENTS—WHAT IT IS

The balance of overseas payments is the surplus or deficit remaining after our overseas expenditure on imports and other items have been balanced against our overseas receipts from exports and other sources. Imports and exports are by far the largest entries in our overseas accounts; the difference between them is known as the *balance of trade*, as distinct from the *balance of payments* which covers all receipts and expenditure from overseas transactions—not merely those arising from exports and imports.

In addition to paying for our imports, we have to pay interest on the Australian national debt held abroad, dividends on overseas capital invested in this country, and for such services as shipping and insurance; and in addition to overseas receipts for our exports, we receive funds by way of new capital invested by overseas people in Australia, the expenditure of overseas tourists in this country, and from other sources. When receipts from all sources exceed expenditure the result is reflected in an increase in our overseas funds (these are held almost solely in London and are popularly known as London Funds) which are held mainly by the Commonwealth Bank.\*

Exports are the means by which we pay for our imports. Prosperous times in Australia have usually been associated with a high level of exports, which have meant that we have ample funds to finance the volume of imports necessary to our industrial development and a rising standard of living. On the other hand when exports have been low we have usually been forced by one means or another to contract our imports with unhappy effects on expansion and standards of living within Australia. The classic means of reducing imports, where there has been a decline in exports, is by internal deflation which has reduced spending power in Australia—and thus expenditure on imports—and which has in the past been accompanied by unemployment.

#### RECENT MOVEMENTS

A comparison of trade figures for the financial year, 1948-9 with 1949-50 reveals that whereas imports have increased by £122m., exports have increased only by £74m., a rise of £87m. in wool exports covering declines in other exports. (Exports of wheat and flour have fallen by £10m.). As a consequence of these changes our favourable *balance of trade* (not payments) for the twelve months dropped from £127m. to £79m.

\* The way in which exports increase our overseas funds is as follows:—

The Australian exporter who sells say £100 of goods in the United Kingdom receives in exchange £100 in sterling. As he wants his profit in Australian money, he exchanges this claim on sterling for £125 Australian. The bank which conducts the transaction credits his account with £125 Australian and in return receives the £100 sterling which it holds in London as an addition to its London sterling funds. In this way the transaction both increases deposits and spending power within Australia and also increases the sterling funds held in London by the banking system. The reverse process operates in the case of imports. Australian trade with all foreign countries is mainly financed through London. Transactions may be negotiated in sterling, or in the currency of the countries concerned. In the latter case, surplus holdings—e.g. French francs, may be sold for sterling, or conversely where holdings are inadequate, e.g. American dollars, they are allocated to us under the Dollar Pool arrangement and paid for in sterling.

Whilst the deficit with U.S.A. and Canada was reduced from £12m. to £6m., a favourable balance of trade with the United Kingdom of £20m. has been turned into a deficit of £40m. Our overall favourable balance is being maintained by heavy sales of wheat to India and the Far East, and of wool to the continent of Europe, particularly France and Belgium and to Russia and Japan. Should for any reason these exports fall off in the near future, then the balance of trade would most certainly turn against us.

In addition to this volume of overseas trading, sums of money must constantly be transferred between Australia and other countries in payment for services rendered (or received)—for tourist expenditure, freight and insurance on imports, the transfer of dividends, interest on public loans raised abroad in earlier years and the like. The gross total of these payments and receipts reaches large figures but official estimates are given only on a net basis; the final balance which had to be paid by Australia on account of all these items in 1948-9 was about £80 million. This payment was in addition to that required to meet the cost of actual goods imported amounting to £415 million. As the total value of our exports reached approximately £543 million, Australia had a surplus of a little under £50 million in the 1948-9 financial year.

This surplus comes to us in the form of additional reserves of sterling—or other foreign currencies—and was partly responsible for the rise in the grand total of these reserves from £A274 millions in June, 1948, to £A452 millions in June, 1949. The remainder of the increase presumably arose from a substantial inflow of private capital into Australia from abroad; from the pre-payment for some goods exported from Australia; and from delays in the payment by us for quite a range of commodities purchased from abroad. A large addition to overseas currency reserves of this kind exerts a strong inflationary effect inside Australia for it represents the acquisition of a substantial volume of money by Australians unaccompanied by any corresponding inflow of goods.

#### AN UNFAVOURABLE BALANCE ?

On the basis of this year's figures it appears that we will have an unfavourable balance of payments on current account for the first time since the abnormal conditions of World War II. Total exports for the year have attained the record level of £615m., but imports also reached an all-time high

with £536m. The net payment to be made by Australia on account of all the "invisible" items will probably rise to £90m. because of higher costs and prices. This would mean that Australia would have to meet a total expenditure on current account of £626m. with a total income from exports amounting to £615m. If these figures prove to be reasonably accurate, there will be a deficit of about £10m. to be met from our reserves of sterling and foreign currencies. Our reserves would continue to rise, however, if there is a continuance of capital inflow, from investment.

This position is no cause for alarm; it would be wrong to think that we can or should achieve a surplus on our current overseas payments at the end of every twelve months. But there is need for caution. The export industries are on the whole not well equipped to expand production to meet any decline in prices, particularly wool prices. Because of public works programmes we have heavy commitments for imports, and we will still need large quantities of rubber, cotton and motor vehicles, petrol, tobacco, and other products essential to the Australian economy.

#### HIGH STERLING RESERVES A DELUSION?

By editorial comment and as a result of expressions of opinion by public men from time to time, the press has given considerable prominence to the size of Australia's reserves of sterling and foreign currencies, which at present stand in excess of £500 millions. Often this figure is compared with the pre-war average level of around £60 millions and, perhaps naturally enough, it is concluded that the increase which has taken place means that our position is now secure beyond possible doubt.

This is a mistaken view.

It needs to be remembered that in the pre-war years we were importing at the rate of only a little over £100 millions a year, whereas today goods are flowing in at a rate exceeding £500 millions a year; also the pre-war level of our sterling reserves was uncomfortably low for they were not sufficient even to meet the costs of one year's imports. But today the position is not greatly different for these reserves are still not much above the total value of one year's imports. Because of dollar restrictions imports of some items, particularly cotton and newsprint, are lower than last year, but, great increases

have taken place in imports of other raw materials such as steel and coal, machinery and in everything associated with motor transport—motor vehicles, petrol and rubber tyres. Imports of tobacco and tea and cocoa are also on the upgrade with the result—indicated above—that the 1949-50 trade year will almost certainly see the elimination of the surplus on account of current transactions. Incidentally, it is a thousand pities that overseas funds are now being adversely affected by the importation of large supplies of coal and steel when such vital commodities could and should be produced at home in adequate quantities. Imports of iron and steel have risen from £10m. in the twelve months ended June, 1949 to £25m. for the twelve months ended June, 1950.

A most important aspect of the whole balance of payments position is that at present our sterling reserves are being considerably augmented by large transfers of private capital into Australia, associated both with British monetary investment here and with the stream of immigrants entering the country. These cannot be expected to continue on the present scale; in fact a change in Australia's economic circumstances might put in process an embarrassing movement in the opposite direction. The terms of trade which have tended in favour of Australia over the post-war years must now be expected to move against us. A recession in Australia, brought about by a decline in export income following a fall in overseas prices, would probably reduce inflows of capital from investors and immigrants, just as in the early 1930's. Considerable sums of "hot money" which were transferred here in expectation of an appreciation of the exchange rate, as means of obtaining "easy profits" for speculators, would no doubt be repatriated. It is difficult to estimate the effects of these influences on the Australian balance of payments position, but the last report of the Commonwealth Bank indicated that overseas reserves might easily be reduced by £100 million by the resumption of normal arrangements for the payment for exports and imports.

#### IF EXPORT INCOME SHOULD DECLINE

And apart altogether from the unfavourable reactions on our overseas reserves of these indirect influences, what would be the direct effects on the balance of payments should export prices, and therefore export income, decline? Exports

of wool, wheat and flour for the financial year ending June, 1950, totalling £410m. are nearly twice the value for the same period in 1947-8. Prices in 1947-8 were high and so were export volumes. It is not being needlessly alarmist to say that £100m. could be clipped from our export income in the not far distant future as the result of quite a moderate decline in export prices. Failing a similar decline in import prices some adjustment to our import programme and other overseas expenditure would almost certainly become necessary, for our London Funds could not continue for long to support an unfavourable balance of payments.

Of course, imports can always be reduced (at the cost of a temporary reduction in real living standards) and if the internal deflationary process which would accompany such a reduction in export income were allowed to run its course, no doubt they would be reduced following curtailment of the purchasing power of the people. But if, as would seem more likely, internal purchasing power were artificially supported, the demand for imports might remain high, throwing additional strain upon the balance of payments. It has been suggested in the White Paper on Full Employment that a situation of this kind might be met by straight-out quantitative restriction of imports. Apart from whether action of this nature would be consistent with our obligations under the post-war trading agreements, it would almost certainly invite reprisals from other countries, which would lead to a vicious spiral of contracting demand.

The next question is how far and in what manner is Australia dependent upon imports at present?

Table II printed at the end of this article clearly indicates that over the last twenty years the composition of imports has changed; materials and capital equipment for use by domestic industry have come to occupy, relatively, a much more important place while the importance of consumers' goods has steadily decreased. And, lest anyone think that the Australian economy has become more independent of the production of other overseas countries, the proportion of imports to national income has risen steeply from 14% in 1938-9 to over 21% last financial year. It was 18% in 1928-9. Table I reveals at least one important fact; that the burden of overseas interest payments on our balance of payments is now almost

insignificant as compared with what it was in 1928-9, or even ten years ago.

Gathering together this evidence, the general conclusion emerges that any marked impairment of our financial capacity to pay for imports would be under today's conditions more than usually hurtful to the nation. A forced curtailment of imports on any scale would threaten the ability of Australian secondary industry to maintain production even at present levels and would undoubtedly end (for a time) possibilities of industrial expansion at anything like the rate experienced over recent years. It could react severely upon industrial employment and would place a most awkward obstacle in the way of the national immigration policy. And, though there would be no embarrassment as a result of the annual interest bill payable by Australia on account of government and other public authority loans raised abroad in earlier years, this problem, which caused such heartaches and bitter recriminations in the days of the last depression, might very well be replaced by another.

The new problem would be a dilemma associated with the effort to provide—in circumstances of a marked decline in our export income—domestic employment which would require, of course, that the people's purchasing power should not be allowed to fall, or at least not allowed to fall far. Any such action would keep up the demand for imports so, maybe, the interesting position will one day be reached where domestic credit expansion will replace overseas interest payments as the "villian of the piece" in any balance of payments difficulty which might confront this country.

Table I.

	COMPOSITION OF AUSTRALIA'S OVERSEAS EXPENDITURE		
	1928-9	1938-9	1948-9
	%	%	%
Imports .....	69	61	79
Freight and Insurance .....	9	9	8
Interest on Public Debt .....	15	15	4
Public Expenditure .....	1	2	4
Net Company Dividends .....	4	8	4
Net Expenditure—tourists, migrants, and other services .....	2	5	1
	100	100	100

Source: National Income Estimates, 1948-9. Compendium of Australian Statistics, December, 1949. Roland Wilson, Economic Record Supplement, October, 1932.

*THE BALANCE OF PAYMENTS (continued)*

Table II.

**COMPOSITION OF AUSTRALIA'S IMPORTS.**

	1928-9	1938-9	1948-9
Producers' Materials .....	45.5%	44.1%	43.6%
Capital Equipment* .....	23.4	27.4	29.5
	<u>68.9</u>	<u>71.5</u>	<u>73.1</u>
Consumers' Goods .....	24.1	19.8	17.4
Fuels and Lubricants .....	6.7	7.8	8.8
Munitions and War Stores .....	.3	.9	.7
	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

\* Includes small item classified in Official Statistics as "Auxiliary Aids to Production."

Source: Monthly Reviews of Business Statistics.

Table III.

**EXPORTS OF AUSTRALIAN MERCHANDISE—PRINCIPAL COMMODITIES.**

Australian Currency F.O.B. Prices.

	1928-9 £ mil.	1938-9 £ mil.	1948-9(a) £ mil.
Wool .....	61.6	42.7	231.7
Wheat and Flour .....	26.3	13.3	98.2
Butter .....	7.2	12.9	23.8
Sugar .....	2.4	4.2	13.3
Meats .....	6.3	11.8	29.8
Hides and Skins .....	9.3	4.1	12.2
Lead .....	3.2	4.3	22.1
Dried Fruits .....	2.3	2.9	3.4
Fresh Fruits .....	0.9	2.0	3.1
All Other .....	19.1	24.3	105.0
Total Exports (excluding Gold) .....	<u>138.6</u>	<u>122.5</u>	<u>542.6</u>

(a) Subject to revision.

Source: Monthly Reviews of Business Statistics.

Table IV.

**RATIO OF IMPORTS AND EXPORTS TO NATIONAL INCOME OF BRITISH COMMONWEALTH COUNTRIES AND THE UNITED STATES OF AMERICA, 1929 and 1948.**

	Imports		Exports	
	1929 %	1948 %	1929 %	1948 %
Australia .....	18	21	13	28
New Zealand .....	22	28	33	35
Canada .....	28	21	25	25
United Kingdom .....	29	22	20	17
United States .....	5	3	6	6

Source: United Nations Department of Economic Affairs, Division of Economic Stability and Development.