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Welcome

The Economic Society of Australia warmly welcomes you to the Gold Coast, Queensland, Australia for the 37th Australian Conference of Economists.

The Society was formed 83 years ago in 1925. At the time, the Society was opposed to declarations of policy and instead focused on open discussions and encouraging economic debate. Nothing has changed today, with the Society and the conference being at the forefront of encouraging debate.

This year we have a large number of papers dealing with Infrastructure, Central Banking and Trade.

Matters of the greatest global importance invariably boil down to be economic problems. Recent times have seen an explosion of infrastructure spending, after world-wide population growth has seen demand outpace aging supply. The world has become more globalised than at any time since World War I but the benefits of this (and the impact on our climate) has been questioned by some.

At the time of preparing for this conference we could not have known that it would have been held during the largest credit crisis since the Great Depression. The general public and politicians both look to central banks for the answers.

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GPO Box 1170
Brisbane Queensland Australia
ecosocqld@optushome.com.au

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GLOBALIZATION, DEMOGRAPHY, HISTORY, AND THE AUSTRALASIAN INVESTOR

Samanthala Hettihewa¹

School of Business, University of Ballarat, Victoria, Australia

Email: s.hettihewa@ballarat.edu.au

Christopher S. Wright

Accounting Group, Commerce Div., Lincoln University, NZ

Email: profcswright@gmail.com

ABSTRACT

Ever seeking to increase returns at a given or lower risk levels, investors are finding that globalisation and market integration are making it more difficult to achieve their targets by diversifying their portfolios across nations. Australia moved from being a poor investment prospect in the last third of the 20th Century to becoming fourth in world competitiveness. In contrast, the New Zealand economy has become ever more dependent on volatile agricultural commodities and faces serious infrastructure issues that may hinder its efforts to enhance or even retain its competitiveness. This paper projects from the recent history of the Australian and New Zealand economies to consider how they are likely to fare in resolving the early 21st Century challenges of globalization and demography and asks if Australasian investors should consider investing closer to home.

Key Words: Globalization, Risk/Return Trade-off, Demographic Changes, Competitiveness, Commodities.

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Professor Christopher S. Wright is the Director of the Centre of Accounting Education & Research, and Professor of Accounting with the Commerce Division, Lincoln University, New Zealand. Dr. Wright has a PhD in Fisheries Management and Accounting Systems and an MA (Economics) from Simon Fraser University, Canada. His research interests include accounting theory and systems aspects of accounting, governance, economics, resource management and IS/IT/MIS. He has worked as an engineering technician in agriculture and as an internal auditor in forestry. He is a Fellow of the Royal Society of the Arts, a Fellow of CPA Australia, and has a CMA (Society of Management Accountants of Canada).

Dr Samanthala Hettihewa is a Senior Lecturer in the School of Business, University of Ballarat, Victoria, Australia. Dr Hettihewa earned a B.Com (Honours) from Sri Lanka, Post Grad. Dip. in Statistics from Sri Lanka a MA and PhD from USA, and a Post Grad. Dip. in Applied Finance from Australia. Her research interests include financial management, risk management, capital market integration, business ethics and applied macro economics. She is a senior fellow in FINSIA, a Chartered Financial Analyst (CFA), and a Financial Planner Australia (FPA).

¹ Contact author Email address: s.hettihewa@ballarat.edu.au

GLOBALIZATION, DEMOGRAPHY, HISTORY, AND THE AUSTRALASIAN INVESTOR

INTRODUCTION

In response to rampant volatility and insecurity in global markets over the last few decades, investors are increasingly using diversification, in their search for higher returns at a given, or lower risk level. International diversification had been a common theme from 1960 through to the 1980s. However, increasing globalisation and market integration are making it difficult for investors to achieve their targets by diversifying their portfolios across nations.

Global investors are constantly searching for secure capital markets. Australia has become a leader of Asian capital markets—with a rapid growth and becoming the 10th largest share market in the world. New Zealand’s (NZ) much smaller economy has tended to focus on enhancing its performance in such primary sector commodities as dairy, meat, forestry, and various crops with strong forays into processing wines and olive oils.

It is important to analyse the current financial strength of the Australian and NZ economies and to examine the way Australasian investors respond to the ongoing changes and challenges globalization poses. Australia’s remarkable recovery in the last decade (see Table 1) is based on strengthening its competitiveness and its lessons provide essential tools for future policy stances in Australia and other economies that have achieved significant financial strength. In contrast, the 1990s miracle recovery of NZ’s economy (Rankin, 1995) appears to have lost steam and been reversed (Tables 1 and 2 and Figure 1). In counterpoint, strong and currently rising prices for food and other primary-product commodities bode well for both economies.

Table 1: World Competitiveness Scores for Australia and New Zealand

Country	95	96	97	98	99	00	01	02	03	04	05	06	07	08
Australia	16		15	12	11	10	11	10	7	4	9	6	12	7
New Zealand			11	17	17	18	21			18	16	22	19	18
Canada	13		6	8	10	8	9	7	6	3			10	8
Japan	4		17	20	20	21	24	27	25	23			24	22
USA	1			1		1		1	1	1	1	1	1	1

Source: IMD World Competitiveness Yearbook various issues.

Although both Australia and NZ have performed well in the competitive world economy (see Tables 1 and 2), prudent global investors still ask of these nations – are:

- ⊕ Their economies a strong, safe market for investors?
- ⊕ The structural problems, which led to a severe recession in the early 1990s, resolved?
- ⊕ They enhancing or at least maintaining competitive positioning with the Asian Tigers?
- ⊕ They advancing the policy options needed to enhance their economic sustainability?

This paper is aimed at addressing the above questions and to provide insight to policy makers, by examining the relative state of these two economies and their record of responding to the challenges of globalization.

Efficient and timely responses to ongoing challenges of globalisation appear to be increasingly more vital to economic success than domestic resources and markets

—which previously were considered to be the most important indicators of economic achievement. Based on a theoretic general-equilibrium model, it is widely thought (Chen, 1991; Fama, 1970, 1990, and 1991; Kwon and Shin, 1999; Pearce and Roley, 1998; Wei and Wong, 1992; Cox, Ingersoll and Ross, 1985) that the income structure of an economy should be related to asset returns and the expected returns are functions of state variables that describe the macro economy including production rates, expected productivity of capital, and uncertainty in the production technology.

The first part of this study, gives an introduction to globalization, a brief discussion on the Australian and NZ economic experience over the last two decades and their structural issues; the second, analyses economic reforms and the relative competitive position of Australia; the third, examines current debates in Australia’s business sector. Investor confidence and the current competitive global environment are discussed in part four and part five concludes with insights for policy makers and investors.

Figure 1: Australia and NZ Wold-Competitiveness Standing (1.0 is Best)

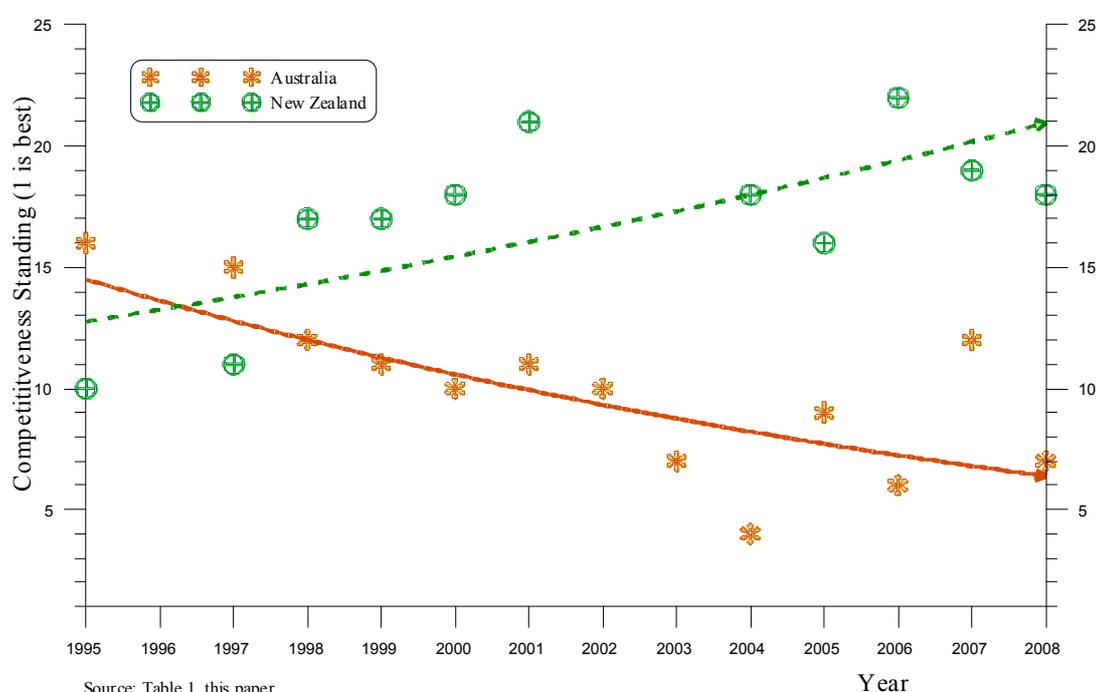


Table 2: Real GDP Growth Rate (annual % change) for Selected Countries

Country	95	96	97	98	99	00	01	02	03	04	05	06	07	08
Australia	3.6	4.3	4.0	5.1	4.4	3.4	2.1	4.1	3.1	3.7	2.8	2.7	2.6	3.3
New Zealand	4.3	4.1	2.1	-0.1	4.3	3.9	2.7	5.2	3.4	4.5	2.8	1.5	3.0	2.0
Singapore	4.3	4.1	2.0	-0.2	4.3	3.6	2.6	4.6	3.2	4.4	2.1	1.5	2.5	2.6
Japan	2.0	2.7	1.6	-2	-0.1	2.9	0.2	0.3	1.4	2.7	1.9	2.2	2.3	1.9
Korea	9.2	7.0	4.7	-6.9	9.5	8.5	3.8	7.0	3.1	4.7	4.2	5.0	4.4	4.4
Canada	2.8	1.6	4.2	4.1	5.5	5.2	1.8	2.9	1.8	3.3	2.9	2.7	2.4	2.9
UK	8.2	7.8	8.3	-1.4	7.2	10.1	-2.4	4.2	3.1	8.8	6.6	7.9	5.5	5.7
USA	2.9	2.8	3.0	3.3	3.0	3.8	2.4	2.1	2.7	3.3	1.9	2.7	2.9	2.7

Source: IMF World Economic Outlook 2003, 2008

Globalisation, Structural Problems and Economic Experiences

Globalisation

Globalisation has changed economic expectations, conditions and environments over the last two decades. Individual economies enjoying high levels of economic and political power at the expense of the international system is a ‘thing in the past’. However the integration of economic blocks has been a common phenomenon over the last two to three decades and has changed the system from individual countries to specific economic blocks such as the European Community (EC), the North American Free Trade Area (NAFTA) and the Association of Southeast Asian Nations (ASEAN). Globalization impacts on macroeconomic performance, living standards; mortality rate, life expectancy, literacy rate and is elevating the living standards of much of population who previously lived in poverty. Globalisation also affects capital markets—e.g. diversification benefits, once thought important, are being diminished as the markets are increasingly heavily integrated (Kruger 2004).²

Step-wise evolution of globalisation goes as far back as the 13th century where nations engaged in commodity related trade transactions. Compared to equity markets, foreign exchange and money markets are heavily globalised. The end of the fixed exchange rate system (1973) heralded the current round of global capital markets—Australia joined this trend in 1983, by floating its currency. In Asian capital markets, Australia has become a leader in creating rapid, steady growth that encourages global investors in their search for high/steady (safe) returns on investments.

Investor Confidence—A Historical Perspective

During 1985–1995 (see Table 3) Australia’s trade performance in the world economy was not considered competitive. Protectionism (a once common practise) isolated Australasia from international trade. Australia and NZ, with other developed economies, shifted toward the ideal of freer markets—with deregulated markets an essential step for competitiveness.

Table 3: Share of World Trade of selected Countries from 1960 – 2003

Country	1960	1985	1990	1995	2000	2003		Δ 85-95	Δ 95-00	Δ 00-03
Australia	2.1	1.32	1.20	1.11	1.05	1.08		-16.08	-5.42	3.41
Canada	4.8	4.66	3.71	3.49	4.03	3.43		-25.11	15.66	-14.98
France	5.0	5.70	6.68	5.48	4.72	4.87		-3.77	-13.86	3.25
Germany	8.1	9.29	11.19	9.56	8.09	8.94		2.94	-15.45	10.56
Hong Kong	0.8	1.62	2.44	3.55	3.21	3.02		118.30	-9.60	-5.92
Italy	3.8	4.46	5.22	4.26	3.70	na		-4.52	-13.22	na
Japan	3.6	8.35	7.74	7.54	6.64	5.66		-9.67	-11.92	-14.78
Korea	0.3	1.67	2.00	2.52	2.57	2.47		51.10	2.19	-4.12
Singapore	1.1	1.33	1.68	2.35	2.11	1.81		76.34	-10.36	-14.08
Taiwan	0.2	1.38	1.80	2.08	2.22	na		51.11	6.79	na
UK	10.4	5.70	6.04	4.91	4.76	4.53		-13.91	-2.98	-4.80
USA	13.0	15.50	13.48	13.12	15.78	13.73		-15.35	20.27	-12.97

Δ = growth rate (growth rates calculated before rounding up the figures).

na = not available.

Source: International Financial Statistics (various issues) Washington D.C.

² Rowe L. ‘Economic discontent at odds with reality’ Financial Review, 10/07/01

However, as a caution, some theorists are now arguing (contrary to classical economic theory) that confining export development to areas of comparative advantage and limiting specialization to those products can stifle growth. This is especially significant as Australian and NZ dependence on foreign supplies of hi-tech capital goods is increasing. Australia and NZ, according to this new theory, by focusing their R&D and manufacturing on areas of extant comparative advantage and confining their trade to primary products, experienced a deteriorating trade situation and worsened its Current Account Deficit (CAD).

Economic recession and the boom:

In the early 1990s, Australasia experienced its worst recession in decades. This adverse experience forced much thinking on appropriate remedial actions to mitigate future major downturns, a search for precise reasons behind the recession and how to resolve it sooner. Economic issues are often aggravated by unstable domestic economic policies—thus, a focus is on enhancing the domestic economy through corrective mechanisms, may be appropriate. Among other structural problems, one of the major issues of concern had been a low rate of savings—savings are essential for domestic investment, R&D (Stone 1982) and, hence, for future growth. Also, the substantial external debt and high level of unemployment appeared to be crucial at that time. Australia's relatively low level of scientific infrastructure prior to the mid 1990s had been considered a significant hindrance in becoming more competitive³. Population growth can be a major stimulus of economic development (Simon, 1981; Kelly 2001). In the 1990s, the migration levels were lower than what they were in the 1980s—the hiatus in population growth may have slowed economic development. Thus, demographic factors must also be considered—as with many other developed nations, Australia and NZ face future growth constraints, arising from their ageing populations (Huyh, Hettihewa and Mallik, 2003). Part two and three of this paper discusses the structural problems in detail, along with how these problems affect the sustainability of economic strength.

Structural problems

Well-known structural issues, like geographical isolation, Australasia's relatively small domestic markets, natural resource endowments, low productivity and lack of competitiveness, were once thought to be insuperable, but globalization has reduced their importance (Stevens, 2007, p.1).

Geographical location

During the first industrial revolution, Australasia's geographical isolation and distance to the large markets of Europe and N. America were seen as a disadvantage and hindrance in achieving scale-economies and in becoming globally competitive. However, the advantages of proximity to dynamic markets (never proven decisively strong) are currently deteriorating in importance.

World experience in strong economic performance has shown that performance of trade can be achieved with the utilisation of intellectual capital, relative-low-unit-labour costs, superior science and technology, infrastructure and resulting high productivity. Australasia was relatively disadvantaged by geographical location until the 1960s. However, its proximity to the new growth centre of the Asia-Pacific market is now, at least over the last two decades, decidedly in

³ [http: IMD World Competitiveness.com](http://IMD World Competitiveness.com)

Australasia's favour. In the 1990s, increased globalisation super-charged Australasia with increased intellectual capital and higher productivity—allowing it to become more competitive in the world economy.

Relative Size of the Economy

Large domestic markets, early in industrialisation, are seen as enhancing economic dynamism and wealth accumulation (e.g. Canada and the USA) and high domestic demand is often viewed as a prerequisite for an accelerated growth rate. However, large domestic markets like India and Brazil have not achieved high levels of competitiveness. When a large domestic economy is combined with other desirable economic variables such as better infrastructure, efficient usage of capital, and the appropriate application of research and development (R&D), such an economy is in a relatively better position to accelerate its growth. Over the last three decades, newly industrialised countries (Singapore, Hong Kong, Taiwan, Korea, etc.) have proven that relative disadvantages stemming from geographical isolation and small domestic economies can be overcome. Thus, the structural problems that Australasia faces with its relatively small size and location in the global economy, is becoming a *thing-of-the-past* in terms of economic competitiveness.

Resource Endowment, Resource Utilisation and Market Improvements

Availability of natural resources is often seen as being crucial at the early stages of economic development (e.g. the USA and Canada). However, Australasia's severe economic down-turn in 1991 and Japan's experience of economic upturn after WW II do not support such a proposition. Garelli and Hoover (1990), show that economic dynamism requires more than access to natural resources. Daniels (1989) and Camdessus (1998) note that nations relying heavily on natural endowments (eg. Australia's dependency on primary products in the 1950s and 1960s) are slow to adjust their trade situations even when changes in global markets and/or technology erode the comparative advantages they once enjoyed. Australasia's heavy emphasis on natural resources resulted a high labour costs in major primary exports (eg. wool, mutton, lumber, coal) and booms and busts as those industries waxed and waned in response to external forces.

At the current level of globalisation, the supply of natural resources in the domestic economy is becoming less important to enhancing trade performance than the relevant application of the available resources. Understanding the nature of export dynamism and directing resources to the relevant path in timely manner, has become essential in improving competitiveness in the present global economy. However Australasia's failure to apply resource endowments to the needs of changed global market kept Australia and NZ behind many other OECD countries over the last two decades. World trade now includes and depends on more technology intensive (TI) exports (see Table 4-6). Daniel (1989) states that technology competitiveness appears to be more closely linked to the direct application of human skill in the R&D process showing that higher levels of resources directed towards general education and the supply of potential scientists, engineers and technical staff does not guarantee better performance in trade in technology intensive products. He, also, asserts that the commercial application of increased levels of R&D enhances trade competitiveness. Mayer, Butkevicius and Kadri (2002) note there are dynamic products in all categories and exports of products from the high skill and technology intensive category and from the science based category grew most rapidly in the 1980s and 1990s (e.g.

electrical and electronic goods, goods needing high R&D expenditure, and labour intensive products)—see Tables 4 through 6

Table 4: Share in Total OCED High-and Medium-high Technology Exports 1992-2001 Percentage in Market Share, Over the Period.

Country	Percentage change
Australia	0.4
Canada	4.6
Japan	12.8
USA	19.9
UK	7.4
Korea	3.7

Source: OECD STAN database May 2003

Table 5: R&D Intensity as a % of GDP

Country	2001
Australia	1.53
Canada	1.94
Japan	3.09
UK	1.90
USA	2.82

Source: OECD Science, Technology and Industry Scoreboard

Table 6: Science and Technology Trade Coverage Ratios*-- A Comparison with Selected OECD Countries 1990 & 2003

	High-Tech Industry Goods	Medium-Tech Industry Goods	Low-Tech Industry Goods
Australia	.09	.49	.95
Germany	1.26	2.30	.93
Ireland	1.59	.78	1.27
Japan	5.15	4.23	.92
Switzerland	1.46	1.10	.52
U.K.	.93	.67	7.25
U.S.A.	.86	.52	.35

* (exports of S&T/imports of S&T)

Source: OECD Statistics for Member Countries . 1991

Economic Reforms and the Relative Economic Position of Australasia

It is necessary to compare developments with those of the preceding years, when reviewing the current financial strength of the economy, which include, taking away barriers to foreign trade, financial deregulation, privatisation of government sector business and labour market reforms. Financial market deregulation benefits included a fall in the interest-rate margin (charged on house mortgage loans) from 4.00 percentage points (early in the 1990s) to 1.75 percentage points (by the end of the 1990s) and a decline in commissions charged to retail investors for financial asset transactions from 2 percent in the 1990s to 0.10 percent in 2000 (Gruen, 2000). Researchers, while recognizing the benefits derived from these reforms, are divided on the exact contribution of the macroeconomic and microeconomic reforms —many consider the increased productivity to be attributable mostly to the range of microeconomic reforms (Gruen and Steven, 2000).

Money, finance, and inflation were critical policy issues in the 1980s (Fahrer and Myatt, 1990). Inflation, averaging 8.0 percent, was well over the previous experiences of most developed countries. Financial deregulation remained a focus of macroeconomic reforms through the 1990s and into the start of the 21st Century. Australia and NZ still experience some long-term structural issues, in their currently strong economies. For example, price levels are relatively high, compared to similar OECD countries—making it essential that improved technology be focused on reducing prices (Table 7). Also, the dismally low national savings rate and increasing Current Account Deficit (CAD) make it essential for Australasia to formulate policies to mitigate those effects in the rapidly changing global economy (Gruen and Stevens, 2000).

Table 7: Consumer Price Index

Country	1989-90 = 100		2000 = 100			
	1988/89	1992/93	2001	2002	2003	2004*
Australia	93.7	113.5	104.4	107.5	110.5	112.8
USA	95.5	114.8	102.8	104.5	106.8	109.7
Japan	97.2	106.8	99.3	98.4	98.1	98.0
Germany	97.5	113.9	102	103.4	104.5	106.1
Canada	95.4	112.1	102.5	104.8	107.7	109.8
UK	94.5	118.6	101.8	103.5	106.5	109.4

*2nd quarter Source: OECD Statistics 2004

Productivity, competitiveness and trade performances

It is essential to consider competitiveness at both macroeconomic and microeconomic levels. Competitiveness, in *Classical Economic Thought*, emphasises comparative advantage; while *Economic Historians* emphasise the role of government and socio-political environments. Based on experiences in the US economy from 1948–1982, Robert Solos asserts that technological innovation and increased know-how were more important in improving competitiveness (i.e. contributed 50% of economic growth) than additional labour and capital (i.e. contributed only 20% of economic growth; Carelli and Hover, 1990). Resolving such issues as: over-protected industries, inappropriate economic structure, over-reliance on rural products, high labour costs, poor management culture, low adoption rates of new technologies in local companies, low rates of capacity utilisation, low levels of commercial application of R&D and a culture that did not stress the workplace and exports, were important focuses in pre1990s policy reforms. Low productivity and a lack of competition were critical issues in the 1990s and were rectified with enhanced levels of R&D and its application to the TI export trade.

Australia and NZ have CAD issues:

- ∞ Australia's CAD increased by an annual average of 11.68 and 7.4 percent during the periods, respectively, 1985–1995 and 1995–2003. Australia's poor trade performance in 1980s and 1990s has been the focus of many academic studies (Hughes, 1989; Pappas, Carter, Evans, and Kooper, 1991; Schedvin, 1987). The failure of exports to keep pace with growing imports, declining terms-of-trade and growth in the net-income-deficit resulted in this poor performance. Australia's low savings rate contributes to the problem, but concentrating on low savings rates is to focus on symptoms rather than the cause. Continuous national spending over-and-above-savings results in an ever increasing external debt. At the beginning of the 20th Century, Australia's exports to Gross-Domestic-Product (GDP) ratio stood at 20% while in 1985 it was 9.96% and in 1990, 10.57%. This ratio was 10.95% and 9.55% in, respectively,

1995 and 2003 (OECD Economic Outlook, 1998).

- ∞ New Zealand's CAD "...has been persistently in deficit since the early 1970s and increased markedly during the late 1990s" (Kim, et al., 2001)—the CAD as a percent of GDP of 7 to 9 percent in the mid- to late-1980s (up from 4 percent in 1984) and 5 to 7 percent in the late 1990s (up from 1 percent) but were considered to be consistent with the experiences of Australia and the USA and were not expected to create economic disruption as they fell-back to lower levels. However, in 2007 the NZ CAD as a percent of GDP was again at 7.9 percent—indicating persistent structural issues.

While the level of merchandise-exports-to-GDP ratio in Australia/NZ stood at 12.6%/29% in 1988/89, most of the OECD countries have a much higher level, with Canada and South Africa having ratios that are twice as high as Australia's, for the same period. Aggravated economic problems over an extended period have resulted in a continuously deteriorating CAD, a relatively high external debt, high inflation, high unemployment in early 1990s and subdued savings for the current level of investments—to ensure a competitive edge, Australia and NZ may have to formulate and apply remedial measures for past-policy *sins* and omissions.

Contribution by the service sector

The service sector's importance to non-tradable exports must be considered in policy decisions—statistics indicate that, although 70% of Australia's GDP came from the service sector in 1980s, that sector's direct contribution to total exports was a mere 17%. However, its indirect effects may be much more significant. Specifically, a cost-factor analysis indicates that service inputs make up 28% of agriculture inputs, 35% of mining inputs, and 42% of manufacturing inputs⁴. Productivity levels in Australia's service sector are well below the international best and are likely impacting the exports potential of the other sectors—concerted effort to improve services is an important part of any reform.

An idea of what infrastructure levels may be hampering economic performance is needed before excessive, inadequate or inefficient infrastructure can be re-engineered—e.g. international airport gateways in Adelaide, Townsville and Cairns, and inefficiency was rife in railways and ports (Cox, Forsyth and Ross, 1985). Causal factors identified for poor performance in the service sector are:

- i) Infrastructure projects not being clearly defined.
- ii) Inflexibility of infrastructure projects to accommodate changes in financial and institutional sectors, and
- iii) Failures to encourage private sector participation/competition on infrastructure projects.

Low Level of R&D⁵

In the last two decades, Australasia's level of R&D had been low by world standards (Dwyer and Alchin, 1986; Lodewijks, 1990; Table 8). Australasia's trading and technological strengths traditionally have been directly linked to natural resources—as a result, R&D remained weak, compared to Japan or the US. It is encouraging to note that since late 1990s Australia has markedly improved in the areas of chemical, electrical and electronic equipment, agricultural chemicals and

⁴ Sydney Morning Herald 27/2/91

⁵ For details see Butlin (1973) and Schedvin (1987)

bioengineering development—NZ is still focused on expanding its commodity exports of primary products and/or value-adding to commodity primary products (e.g. dairy).

Table 8: Researchers per 10,000 Labour-Force Workers (selected OECD countries)

Country	1985	1991	1995	2001
Australia	41	50	64	72
Canada	40	46	54	61*
Japan	64	75	83	102
UK	47	45	51	55*
USA	68	75		86 *

*1999

Source: OECD Science, Technology and Industry Scoreboard 1999 and 2003

Australia and NZ have relied on the processing and export of gold and/or other primary commodities since the mid-1800 for export earnings. High tariff protection discouraged trade competitiveness during and after World War II. Even after the wool industry was threatened by synthetics and blends, rather than embracing highly beneficial TI exports, Australasia, again, diversified by expanding to other primary products. Even at this stage, Australasia needs to accelerate R&D in areas other than primary products.

Studies suggest that a lack of trained personnel weakened the effect of R&D in the workplace in Australasia, during the 1980s and 1990s (Dwyer, 1986; Table 9). Relatively high interest rates in the late 1980s and early 1990s combined with high unit labour costs (Table 10) to further discourage private sector R&D.

Table 9: Expenditure on R&D, in % of GDP, by Business & Government Sectors

Country	1988/89		1990/91		1994/95		2000/01	
	Bus	Govt	Bus	Govt	Bus	Govt	Bus	Govt
Australia	0.41	0.56	0.57	0.44	0.74	0.43	0.72	0.35
USA	0.49	0.49	1.90	0.34	1.80	0.27	2.04	0.18
Japan	0.71	0.20	2.15	0.23	1.96	0.26		
Germany	0.64	0.34	2.02	0.37	1.54	0.36	1.75	0.34
Canada	.41	.44	0.77	0.27	0.91	0.25	1.09	0.22
UK	.51	.37	1.36	0.34	1.43	0.30	1.21	0.22

Source: OECD

Table 10: Unit Labour Costs in Manufacturing (Annual % Change)

	Ten Year Average 1984 - 1993	1995	2000	2003
Australia				
Canada	1.9	0.9	-0.7	0.9
Japan	1.4	-2.1	-6.3	-1.6
United Kingdom	3.4	4.9	-0.9	2.0
USA	1.9	-1.7	3.2	0.9

Source: IMF World Economic Outlook 2003

Government Stimulus

The Government sector is the main source of R&D in the primary industries—possibly because of the public good nature of much of that research. However, most innovations in the present economic climate have come from the private sector. There was no significant encouragement of the private sector R&D efforts, on the part of the

Government, until Australia introduced a 150% tax concession in 1985. There is still room for tax initiatives to improve productivity. Relief on losses and exemption from corporate tax for a limited period would be a welcome stimulus to essential industries. Attractive remuneration packages to stimulate employees can encourage them towards improved productivity—the Australasian corporate sector has much to learn from Japan’s industrial experience.

Knowledge-based Economy

While Australasia was slow in embracing a knowledge-based economy, it is now focusing on science and education with great enthusiasm—it is at the top of the political agenda.

In 2001 Australia occupied the 13th place in World Competitiveness Scoreboard and Singapore was second. The 2001 Australian Government Innovation Action Plan promised \$ 2.9 billion for R&D over five years.

Risk Tolerance

In the 1980s, Australasia’s inability to fund high-risk, high-return, innovative investments caused Australia and NZ to function well below other advanced nations. Specifically, Australasians were happy to invest in low-risk, well-secured investments. (Macfarlane 2002). Further, Trade Union discouragement of new capital investments on re-engineering and automation, were detrimental to the labour force in the long run. Advanced training for high-ranking, decision-making personnel, in-house projects and relevant training for lower-rung personnel will also be useful in overcoming productivity hurdles.

Inadequacy in Funding

Providing Venture Capital (VC) for young entrepreneurs with innovative projects plays a crucial role in promoting new technology-based firms in the world, with Ireland and the US recording the largest investments (at 0.5% of GDP) in 1998–2001. Australia is still slow in channelling venture capital to small industry. Canada and Ireland have recorded a high investment of 4/5 VC for high-technology ventures, while Australia records 25% of VC for high-tech firms. Overseas entrepreneurs with viable projects are growing while the investment from Australasian business sector is poor. Australia and NZ should provide wide publicity and incentive packages to encourage more venture capital for R&D projects in small businesses.

World Economic Outlook

Acceleration in US productivity and unexpected economic growth enhanced performance in Australia’s economy in the late 1990s. Australia recorded economic growth rates of 3.5 to 4.0 percent after it’s recession in 1991 and a strong worldwide recovery is forecast for 2005 (Cotis, 2004). Japan and Korea are taking advantage of the Asian economic boom in China and India by investing in those emerging economies. In contrast, NZ’s growth rates have been more variable with one year of negative growth. The following risks are clearly identifiable:

- i. Adverse economic growth in the world economy,
- ii. High risk of increases in long-term interest rates, and
- iii. Geo-political instability/risk.

In spite of a global downturn, Australia has maintained relatively high rates of economic growth over the last few years. Australia registered a steady level of growth during 2001-03, when other OECD countries were suffering an economic downturn. However, an ageing population (e.g. the baby-boom demography) encouraged the undertaking of policies that negatively impact the financial sector (Huynh, Hettihewa, and Mallik, 2003) and lower investor confidence. One response to demography issues is to encourage older workers to maintain a high rate of continued participation in the workforce. (Government Intergenerational Report)⁶.

Financial Strength of the Economy

While Australia ranks 10th in the most desirable destinations for foreign investment and has a growing strength in the global market, the Heckschev-Ohlin Samuelson model has not satisfactorily explained relative trade advantages in terms of intra-industry trade (Peters and Vaal, 2003). The implication of the comparative advantages theory has been questioned by researchers (Kearney, 1990). Australia's trade directions have changed recently in that Australia is seeking markets where its manufacturing products are more competitive. In the first half of the last century, 60% of Australia's overall trade was with European countries and only 20% went to the Asia-Pacific market. Recent data indicate that the US and Japan are Australia's largest trading partners (see Table 11)⁷. In 1988/89, the Pacific basin accounted to 70.9% of total Australian exports—highlighting the importance of Australia seeking a higher market share in the Asia-Pacific (Healy 1990). The rate of growth of Australia's trade in the recent past shows a rapid increase with the Asian market.

Table 11: Australia's Main Export/imports, by Destination, in 2003

Country	Exports %	Imports %
Japan	18.2	15.8
United States	8.8	12.5
China	8.4	11.0
New Zealand	7.6	6.1
Republic of Korea	7.5	4.2

Source: <http://www.dfat.gov.au/geo/fs/aust.pdf>

Australia and NZ should diversify from traditional exports and seek value-added exports to enhance export income. A recent study (Athukorale, 2004) on trade patterns indicates that international product fragmentation and cross-border dispersion of component production over vertically-integrated-production processes will harm Australia's economy if these trends and developments cannot be ameliorated.

Japan remains among Australia's largest export destinations—accounting for almost 20% of total exports during 2001–02 and contributed much to Australia's economic development during the mid to late 20th Century. In that same period, Australian exports to N. America and the EU, increased by 4%.⁸ A sustainable positive image with strong growth is evident in the following information: i) non-Japan East Asia will continue strong growth over the next decade; ii) China and India will continue strong growth for next couple of years; iii) Emerging markets will

⁶ <http://www.ceda.com.au/ResearchNews/PressReleases/IMDWorldCompetitiveness.html>

⁷ For details see http://www.dfat.gov.au/trade/negotiations/us_bkg.html

⁸ Composition of Trade Australia, 2001-2002

remain more open to financial market shocks⁹. According to the economic forecast for 2010 Japan will grow annually at a little over 2 percent, while China will grow at 8 percent and other Asian economies around 5–7 percent (Dept. of Foreign Affairs and Trade 1999).

Australia and NZ continue to maintain historical trade links with the EU, but must stay highly competitive to offset costs imposed by the long shipping distances between Australasia and EU nations. The EU on the other hand looks to Australian and NZ macro-economic policies, ongoing reforms, and microeconomic reforms (e.g. tariff reduction and reform of the labour market) as an indicator of Australasia's ability to retain its high level of productivity (Trade Route Australia, 2003).

According to forecasts (OECD Economic Outlook, 2004), Australian and NZ domestic demand is expected to grow slowly. Increasing strength in the global economy and the breaking of a long-lasting drought should improve production and exports and in turn increase the GDP growth rate in Australia's near future. It is advisable for Australia and NZ to continue small budget surpluses to improve the financial market confidence in the macroeconomic side. However, the Reserve Bank of Australia (RBA, 2000) suggests that relative slow growth in fulltime employment, rises in fraction of the community on welfare, and increasing inequality in earnings need to be addressed so as to improve investor confidence.

Institutional Factors and the Investor Confidence

Along with macroeconomic measures, some important microeconomic issues need resolution to increase and sustain investor confidence. There is a wide array of important institutional factors that affect the economic strength. Specifically: i) Behaviour of the corporate sector; ii) Identification of critical competitive factors in companies, industries, and the economy.

No one environment is good for all industries. For example, while IT thrives in flexible environments with good communication networks, pharmaceutical firms need stable well-regulated environments. National-Industrial-Portfolio-Competitiveness measures can be developed by comparing the growth of Australasian industries against world exports in those or equivalent industries. Performance of Australasia's international portfolio is indicative of its strength in providing quality investments.

Investor confidence is built on strength in the business sector. Important issues in the ongoing debates in the corporate sector include the branch office concept—the issue of the foreign takeover of major firms and local firms moving offshore (Kitney, 2002). Although Tingle (2002) notes there is a new trend with increases in foreign investment inflows, the survey results of a London-based Business Planning and Research firm suggest that Australasia is not capitalising sufficiently.¹⁰ Policy constraints can create conditions where the business sector seeks overseas tax havens. Taxation, merger and labour laws encourage domestic firms to expand or even shift operations overseas (Smith, 2001). Larger firms within Australia are of the opinion that there should be more incentives to grow into local giants enhancing the strength of the economy (Marris2002), whereas the culture of NZ discourages the formation of

⁹ <http://www.dfat.gov.au/publicatins/newmillennium/australia-trade>

¹⁰ <http://cpds.brisbane.apana.org.au/Teams/Articles/global-economy.htm>

local, home-grown giants. According to Wood (2001) and Durie (2002), a local perspective and lack of understanding of scale of operation resulted in Australian fund managers under-valuing their asset portfolios which in turn resulted in Australia losing control of Australian mining. The overseas relocation of local giants could be arrested or even reversed via tax incentives, encouragement of retirement-fund pools (e.g. compulsory superannuation) and government emphasis on re-examination of the Trade Practices Act.

In the microeconomic sector, the following factors are important, and should be addressed to improve the strength of the business sector:

- i) Poor management of reputed brands,
- ii) Disorganised marketing management,
- iii) Fear of unprecedented growth results in a ‘silo’ culture that keeps firms within their cocoons (Gottleibsen, 2001a), and
- iv) Australian financial institutions undervalue Australian companies—thereby, creating cheap takeover targets (e.g. BHP) and making further investment costly to extant shareholders (Gottleibsen, 2001b).

Australasia gives inconsistent exposure to investors in terms of diversification. While institutions investing in Australasia face a high exposure to mining industry, their exposure to high technology and pharmaceuticals is low due to the incompatibility of those industries with global bench marks (Uren, 2001). According to Kelly (2001), the most important issues for Australasian firms for overseas relocation are:

- i) Australian Competition and Consumer Commission’s competition policy focuses on domestic policies—ignoring global competition,
- ii) Lack of Government stimulus,
- iii) Thin local markets,
- iv) Relatively high wages in Australia, and
- v) Inability to compete with on the basis of wages with newly industrialised nations.

Conclusion and Policy Implications:

In 1980’s the economic performance of Australia and NZ were poor. A severe economic downturn in the early 1990s was due to deep-seated structural problems, mainly arising from natural factors. Today Australia and NZ are much better situated to achieve a higher share of world trade (e.g. close proximity to the high growth areas of the Asia-Pacific centre and declining transportation/communication costs).

Table 12: Evaluation of Investor Issues -- Likert Scale (1-5, 5 being best)

Investor Issue:	Australia	New Zealand
Strong Safe Market for Investors – Short-run	4	4
– Intermediate-run	4	3
– Long-run	3	2
Structural Issues Resolved	4	2
Maintaining Competitive Position with Asian Tigers	3	2
Advancing Policy Options Needed to Maintain Competitiveness	4	1

The greatest source of investor concern should arise from Figure 1—it appears that, in focusing on domestic issues, NZ has overlooked much of its economic miracle of the mid-1990s—its world-competitiveness trajectory is less than encouraging. The current wobble in Australia’s world-competitiveness (Figure 1) may resolve itself or

may herald more troubles to come. Australia and NZ need to consider the following policy options:

- ❖ Products and manufacturing competitiveness should properly be analysed and addressed in policy formation to eliminate deep rooted problems (external debt, CAD, low domestic savings rates, etc.). Australasia must encourage R&D in all areas of the industry on a commercial basis. Products with comparative advantages should be identified along with the implications of the changing nature of the world exports and evolving trade flows.
- ❖ The essential ingredients of a strong economy include: increased human capital, a high level of infrastructure facilities, improved R&D, value-added manufacturing from available resources, and high levels of productivity. Workplace culture should be improved with good workplace relations through education and workplace training. Policies should encourage venture capitalist.
- ❖ A consistent export diversification and world-export growth will enhance global investor benchmarks. Sustaining economic growth and investor confidence requires sound economic policies, political stability, strong and high quality labour force, trade linkages, foreign investment, a commitment to R&D, and technological advances from the macro- and micro-economic aspects. Assessment and analysis of challenges posed by rapid globalisation, implementation of policies should result in increased investor confidence and upward movement of Australia in the global arena.

A sound political and economical status minimizes risks and, thus, reduces investor vulnerability. Global investors are concerned with whether Australasia's economies can sustain their current economic growth. Sustainability of current economic prosperity depends upon an ongoing identification and implementation of timely and appropriate remedial measures and the recognition that investors are continually searching for strong, low-risk economies, to offset eroding opportunities elsewhere.

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