Is Australia a Global Trading Power?

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Introduction

The primary purpose of this paper will be to examine Australia's role in the global trade environment, and to examine current trade policy and determine areas for improvement. In the first section, economic indicators such as real GDP, real GDP per capita, balance of trade, and inflation will be measured to assess the overall health of the Australian economy. Then, the gravity equation will be applied and analyzed for Australia and its trading partners to examine who the nation primarily trades with and if the gravity equation holds for Australia. Next, the country's level immigration and foreign direct investment will be examined. Then, Australia's current and past trade policies will be examined. The final section of this paper will use the findings in the first two sections to recommend improvements for Australia's trade policy in the coming years.

A Summary of Australia's Economy

The Australian Parliamentary Office (2022) describes the Australian political system as ”A representative democracy and a constitutional monarchy. It is also a federation of states”. The Australian political system appears to closely resemble that of the United States, where the Constitution is law and citizens choose their elected officials. This type of economic system should be conducive to a thriving presence in the international trade arena given that trade barriers are low and monopoly power among firms is limited. According to the Federal Reserve Bank of St.Louis, Australia had a real GDP of slightly more than 2 trillion Australian dollars in 2021, and a real GDP of approximately $\$58,780.3$ in U.S. dollars (FRED, 2022). In contrast, the U.S. had a GDP of approximately $\$60,154$ in 2021 (FRED, 2022). Therefore, the average citizen in Australia is nearly as well-off as the average citizen in the United States, as measured by real GDP. The balance of payments for Australia in 2021 was $\$-23,141,244,331.2$, which indicates that the country has a trade deficit and is thus importing more goods and services than it exports (FRED, 2022). It is not surprising that Australia operates with a trade deficit, as, theoretically, it is difficult for a land-locked country to export more than they import. This assumption will be examined in the next section. Additionally, the country experienced an inflation rate of 2.86 % in 2021 as measured by the CPI (FRED, 2022). Overall, the economic indicators for Australia for the year 2021 are not a cause for concern, especially considering many countries are still dealing with the economic impacts of the COVID-19 pandemic. The country has a GDP per capita comparable to the United States, a trade deficit that may be the natural result of the country's geographical location, and a steady and low inflation rate. According to the United Nations Conference on Trade and Development (2022), the main exports of Australia in 2021 consisted of machinery and transportation equipment, manufactured goods, and food and livestock, with revealed comparative advantages in the production of railway construction materials and non-alcoholic beverages. These exports, primarily manufactured goods and food and livestock, tend to be labor-intensive industries. Therefore, using the specific factors model of trade (Feenstra & Taylor, 2021), Australia may be a labor abundant nation, and thus choose to produce products that are labor-intensive. This line of reasoning would indicate that Australia would choose to import relatively more capital-intensive products. Australia's three largest trading partners in 2020 were China, the United States, and Japan (Australian Government: Department of Foreign Affairs, 2021). China and Japan are located near Australia, though the United States is not. Therefore, the gravity equation of trade (Feenstra & Taylor, 2021) appears to hold for trade between Australia and Japan and China, though the relation doesn't hold for trade between Australia and the United States. However, the United States consists of large corporations that do international business, thus they may be a natural exception to the gravity equation. Australia's largest destination of natural resource exports in 2020 was China (Chatham House, The Royal Institute of International Affairs, 2020).

Analysis of Trade Policy

Armstrong (2013) describes Australia's trade policy as "Predicated on keeping markets open and having a robust-non-discriminatory global trading system" (pg. 3). This laissez-faire approach indicates the country intends to keep barriers to trade low, and that they are willing to trade with anyone. Australia can be considered "small country" in the sense that it cannot influence global prices. Thus, this approach to trade policy appears to be optimal for Australia as the implementation of any form of trade barriers would likely result in decreased overall welfare for the country. Building upon Feenstra Taylor's (2021) model of tariffs, Australia faces a horizontal export supply curve, meaning that their choices do not impact the decision of foreign suppliers (pg. 244). Therefore, any form of a trade barrier, such as a tariff or quota, will raise prices for consumers and cause a dead weight loss that offsets any potential gains the country may experience from such a policy tool. Thus, Australia should be willing and eager to enter into trade agreements with other nations. According to the World Trade Organization's (WTO) Regional Trade Agreements Database (2022), Australia is currently involved in 17 regional trade agreements including the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and separate regional trade agreement with the United States and China. These agreements give the country the flexibility to lower trade barriers between member countries, and yet to set their own trade policy with respect to countries outside of the regional trade agreement. Given the assumption that Australia is a "small-country", it makes sense for the nation to be involved in regional trade agreements with two of the world's largest trading nations, the U.S. and China. Recall that these two countries are among the largest destinations for Australian imports and exports.

Additionally, Australia's recent trade policy indicates that the country is interesting in expanding preferential trade agreements (PTAs) with outside nations (Capling, 2008). These PTAs give the country the ability to develop personalized and comprehensive trading agreements with outside nations. Australia's current tariffs are imposed mainly on food products and transport equipment (WTO Trade Profiles, 2022). Recall that these are among the product groups in which Australia has a revealed comparative advantage. However, given the "small country" assumption, these tariffs necessarily result in deadweight loss through increased prices for consumers. Australia may be protecting domestic industries through these tariffs, given that they are among the country's largest exports. However, if the country truly had a comparative advantage in the production of these product groups, these products would sell at a domestic price that is lower than the world price, thus causing the domestic firms to export these product groups at the higher world price. Alternatively, this would imply that other countries would have a domestic price that is higher than the world price, and would thus choose to import these products from Australia. The fact that Australia imposes import tariffs on these product groups indicates that other countries are exporting these product groups as well, and thus other countries must also have a comparative advantage in the production of these product groups. Alternatively, Australia may impose these tariffs with the intention of protecting domestic firms from subsidies given to foreign firms from other nations. As Capling (2008) notes, however, that Australia lacks the bargaining power to persuade foreign countries to reduce these subsidies through trade agreements (pg. 4). Therefore, imposing tariffs on these product groups may be the only method for Australia to protect its largest export groups from unfair global competition. Given the large scale of global agricultural subsidies, the reduction of such subsidies will likely be the result of the WTO or other trade organizations rather than a single nation, such as Australia.

Policy Recommendations and Conclusion

Given that Australia cannot influence world prices, the first place the country should start in improving its trade position is in increasing the pressure on countries to reduce subsidies to the agricultural sector through trade organizations such as the WTO. Once these subsidies are eliminated, Australia can remove its tariffs on these product groups and allow its domestic firms to compete in fair competition with global firms. The removal of these tariffs will increase overall welfare in the country due to the decreased prices of imports for consumers. Additionally, the country should continue to be involved in regional and multilateral trade agreements, specifically with the largest trading nations in the world. These trade agreements will ensure that Australia can freely export its goods and services to large consumer markets without import tariffs or quotas. Unrestricted access to large international markets, such as in the U.S., China, and Japan, will allow Australian firms to increase the value of their exports. Additionally, the country may work on reducing its trade deficit. Given that the country is landlocked with limited natural resources, it will inevitably rely on imports of numerous resources. However, the country can still make attempts at increasing its terms of trade by increasing the value of its exports through trade agreements that eliminate barriers to trade or by paying less for its imports. Additionally, given the global trend towards automating labor-intensive positions, Australia should start transition labor-intensive production processes in the food and transport equipment industries towards using more capital and new technology. In making this transition, the country would be well-equipped to ensure it retains its comparative advantage in these industries moving forward. Making these investments should be the result of national savings, as opposed to being financed by foreign debt. Increasing the national savings rate also relies on reducing the trade deficit. In transitioning away from labor-intensive production processes, Australia should take steps to increase the human capital of its citizens to operate the high-technology capital that will be relied on in the future. This could entail increased government spending on education programs, or incentives to attract foreign exchange students to attend Australian universities.

Overall, Australia appears to have a strong economic outlook. Domestic economic indicators suggest the Australian economy is healthy, with a low inflation rate and a modest GDP per capita. Internationally, the country has trade policy conducive to the limiting of trade barriers and the promotion of trade agreements to increase its reach to global markets. The largest area of improvement lies in the country's ability to increase its international bargaining power. This would require the country to continue to increase its GDP and exports to other nations. However, as Kunkel (2002) notes regarding Australia's ambitions to increase imports and exports, ”As long as its exchange rate is competitive, its macroeconomic management is competent and its internal markets are flexible, there is no optimal target share of world trade” (pg. 238). Perhaps countries such as Australia are content with their global economic standing and their level of global trade given steady and healthy domestic macroeconomic conditions.

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