Introduction

In open economy, there are international transactions between countries. These transactions involve an exchange in goods, services or assets by government, individuals or business of one country to those of another (Carbaugh, 2002, p. 341). The international transaction, is involved to the international trade, is related to balance of payment. Balance of payment will present and record the economic transactions between Australia and the rest of the world. Current account is one of the four types of economic transactions in the balance of payment. It engages with transaction in goods and services, investment income and unilateral transfer (Carbaugh, 2002, p. 344; Balance of payment, Australia, 2003).

The purpose of this paper is to analyse why Australia has current account deficit. Mainly, it is divided into two parts. Firstly, The situation of Australia current account deficit from 1970's until 2003 is presented, and then the paper focuses on the variety of factors which have influenced Australia current account deficit, such as exchange rate, saving, investment, term of trade, and government policies.

Background of current account deficit in Australia from 1970's

From the late 1970's, Australia began to have real concern about the balance of payment deficit. As was one of the most developed countries in the world, it has a huge amount of foreign debts. To finance these debts the country had recourse to foreign borrowings, as a result of increasing its stock of net foreign liabilities (Cashin, 1996).

During the late 1980s, Australia's current account balance deteriorated very sharply. The Government became alarmed at the deterioration and responded by implementing tight fiscal and monetary policies. The Government introduced four consecutive years of fiscal surplus beginning in 1987/88, and the interest rate on 90-day bank bills rose from 13.15 per cent in 1987/88 to 18.30 per cent in 1988/89. This policy mix succeeded in reducing the current account deficit to $15.4 billion (3.8 per cent of GDP) in 1992/93. But the cost of this was that the policy stance contributed significantly to the depth of the recession that Australia experienced in the early 1990s. The economy is still paying the price for this in terms of continued high levels and duration of unemployment (Kriesler, 1999, p.75).

In January 1990, the current account deficit is the largest deficit ever. The second quarter in year 1993 showed that the flow of import good and the drop of export good created a massive gap in current account (Rees, May 1993). In the same year but in the third quarter, the current account deficit was narrower (Rees, Sep 1993). From 1994 to 1995, the record showed that the current account deficit was 4.6 percent of GDP (Jacques, 1995). This imbalance of the current account has been created many problems to the country for example foreign debt, market failure and etc. It is because when country have current account deficit, private sector and government sector have borrowed form other countries.

The situation of current account deficit since 1996 to 2002

RATIOS

	Units	1996-97	1997-98	1998-99	1999-2000	2000-01	2001-02
Value							
GDP(a)	$m	529,886	561,229	591,592	629,212	672,232	715,973
Ratios to GDP							
Current account	%	-3.3	-4.1	-5.7	-5.1	-2.7	-3.1
Goods and services	%	0.3	-0.8	-2.4	-2.3	0.1	-0.3
Credits	%	19.8	20.3	18.9	20.0	22.8	21.3
Debits	%	-19.5	-21.1	-21.4	-22.3	-22.7	-21.5
Income	%	-3.6	-3.2	-3.1	-2.9	-2.8	-2.8
Net international investment position(b)	%	54.8	52.9	54.4	51.9	53.7	54.5
Net foreign equity	%	15.4	12.3	15.4	7.7	7.1	8.5
Net foreign debt	%	39.4	40.6	39.0	44.2	46.6	46.1
Ratios to good and services credits							
Net investment income	%	-18.3	-15.9	-16.4	-14.3	-12.3	-13.2
Net foreign equity	%	-7.1	-6.2	-7.0	-3.7	-2.7	-4.0
Net foreign debt	%	-11.2	-9.7	-9.4	-10.6	-9.6	-9.2

(a) GDP at current prices.

(b) These ratios are derived by expressing net foreign liabilities at end of year as a percentage of GDP at current prices for that year.

Source: Australian National Accounts: National Income, Expenditure and Product (5206.0); Balance of Payments and International Investment Position, Australia (5302.0).

Table 1: The ratio of current account and net foreign debt *(Australian Bureau of Statistic, 2003)*

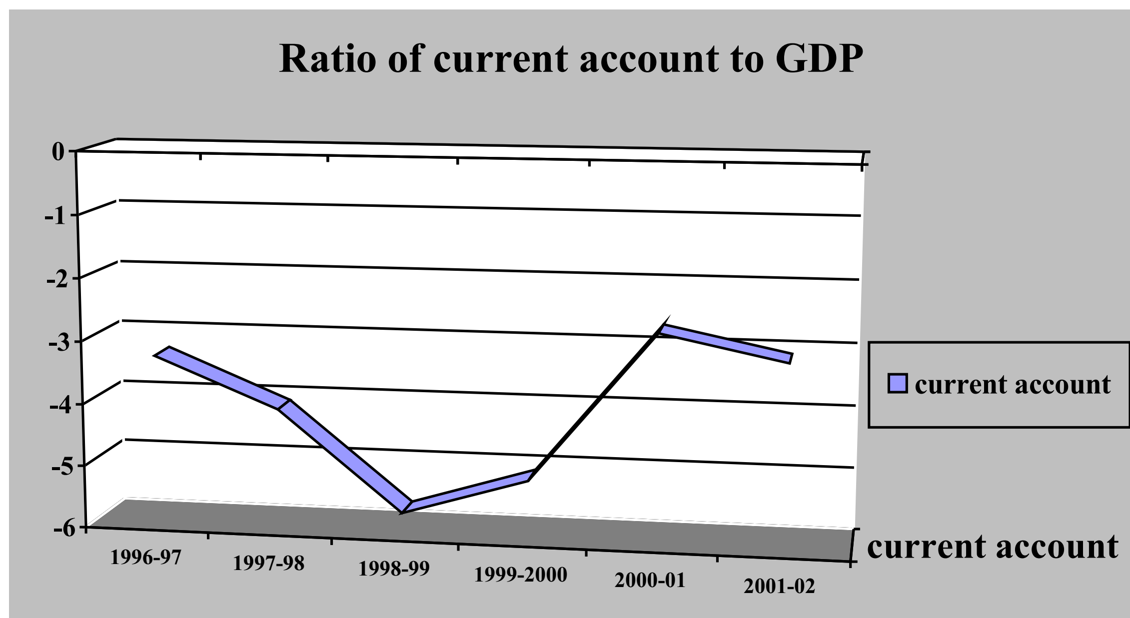

Chart 2: Graph ratio of current account to GDP *(Australian Bureau of Statistic, 2003)*

Table 1 and Chart 2 shows the shift of the current account deficit from year 1996 to 2002. In 1996 to 1997, the current account deficit was 3.3% of GDP and more deficits in next 2 year was 4.1% of GDP. The current account balance was presented in the most deficits in year 1998 and 1999, it was deficit about 5.7% of GDP. After that in 1999 to 2000, the gap of current account was smaller to 5.1% of GDP and narrower in year 2000 to 2001 at around 2.7% of GDP. However, the last statistic shows that in 2002 the current account balance was more deficit than 2001 about 0.4% of GDP.

Balance of Payment from 2002-2003

Table 3 shows that in original terms, the balance on current account for 2002–03 was a deficit of $42.5b, a 94% increase on the deficit of $21.9b recorded for 2001–02. The balance on goods and services deficit of $19.7b was an increase of $18.0b on the deficit of $1.6b recorded in 2001–02. Goods exports decreased $5.2b while goods imports increased $12.3b. The 2002–03 services deficit of $1.5b was an increase of $0.6b on the deficit of $0.9b in 2001–02. For 2002–03, the ratio of Australia's current account deficit to GDP, using the latest available GDP estimate (for the year ended March 2003), was 5.7%, compared with 3.1% for the previous year. (Measuring Australia's Economy,2003)

Year	Merchandise Trade balance	Service Balance	Goods and Services Balance	Income Balance	Current Transfer	Current Account Balance
2000-2001($m)	**-30**	**905**	**875**	**-19,241**	**32**	**-18,334**
2001-2002($m)	**-792**	**-856**	**-1,648**	**-20,273**	**-17**	**-21,938**
2002-2003($m)	**-18,236**	**-1,452**	**-19,668**	**-22,555**	**-220**	**-42,463**
Mar Qtr 2002 ($m)	**-340**	**930**	**590**	**-5,199**	**35**	**-4,574**
Jun Qtr 2002 ($m)	**-1,318**	**-812**	**-2,130**	**-5,224**	**-63**	**-7,417**
Sep Qtr 2002 ($m)	**-3,056**	**-924**	**-3,980**	**-6,001**	**6**	**-9,975**
Dec Qtr 2002 ($m)	**-5,067**	**-375**	**-5,442**	**-5,149**	**-91**	**-10,682**
Mar Qtr 2003 ($m)	**-4,261**	**719**	**-3,542**	**-5,697**	**-13**	**-9,252**
Jun Qtr 2003 ($m)	**-5,852**	**-872**	**-6,724**	**-5,708**	**-122**	**-12,554**

Table 3: Source: Balance of Payments and International Investment Position, Australia, September quarter 2003 (Cat. No. 5302.0)

The factors which influence current account deficit

There are several factors which can establish the current account deficit, for example exchange rate, saving, investment, term of trade, government policies.

The currency issue is one of all factors, which can shape the current account deficit. The depreciation and appreciation of currency can control the magnitude of current account deficit for instance, Lingle (1999) explained that the rapidly depreciation of the currency in South East Asian countries created the higher cost of Australian produce goods, a decreasing in export and an increasing in Australian import consumption on those countries. Thus, from this situation, it can be seen that weak exchange rate in other countries made Australian dollar more strength and it generated the current account more deficit. Other economists also supported that the impact of Asian Crisis was the major impact which made current account deficit worsen (Anonymous, third quarter 1998).

On the other hand, Australian dollar has fallen since 1996, the statistic showed that current account deficit in Australia was fallen as well from almost 6 percent of GDP to 2.7 percent of GDP in year 2001 as in figure 1 and 2 (The Economist, 2002). It can be supported from other statistics that exchange rate in Australia was A$1.8: US$1 for 2001 and its exchange rate in 2002 was A$1.7: US$1. The current account deficit was wider from 2.7 of GDP to 3.1 of GDP as in figure 1 and 2 (Australian Bureau of Statistic, 2003).

The affect of currency can be seen in export and import in current account matter. There are some evidence that proves relationship between currency, export, import and current account deficit. Lifton (2002) stated that current account deficit increased in the second quarter of year 2002 because of strengthen in Australia dollar, it made exports depressed and import increased. Some economists urged that decreased in export market can increase current account deficit (Anonymous, Jun 1999). In contrast, it was pointed out that in lower exchange rate and optimistic world trade can boost the exports (Anonymous, Dec 2000).

In addition, the major factor which makes worsen in current account deficit is term of trade (Pitchford, 1989). Supporting Pitchford, a sharp fell in term of trade and depressing in export market created the current account deficit about 5.7 of GDP in year 1998 as in figure 1 and 2 (Anonymous, Jun 1999). On the other hand, it was argued that the current account deficit will reduce when export markets improving and term of trade rising, for example, in 1999 the term of trade was more stable that built the current account deficit situation better (Anonymous, Dec 1999). Mccoll idea was supporting in Bennett (1999) that the problem in current account deficit depends on the volatility of its export and vulnerability to changes in the terms of trade.

Additionally, the crisis situation like Asian financial crisis, the export markets of Australia are mostly in Asia, it was very difficult for the country to avoid the affect of the crisis (Lorrimer, 1999). In addition, the insistent promotion of China in export goods made the competitive advantage to Australia (Lingle, 1999). All these problems led the current account deficit wider. Australian exporters responded by changing the market competitiveness to Europe and North America, even though it was not good enough to prevent the current account deficit (Anonymous, Dec 1998; Lorrimer, 1999).

In addition, It was asserted by Pitchford (1990) that increasing in import-competitor sector is one of the factors that can reduce the current account deficit (cited in Cashin and Dermott, 1998).

Moreover, the current account balance can be manipulated by monetary policy and Fiscal policy. First, the monetary policy will be discussed. Monetary policy will involve with the interest rate, exchange rate, money supply and etc. Carbaugh (2000) explained that monetary policy refers to change in the money supply in country by the nation's central bank. Usually, the monetary authorities will intervene in foreign exchange rate (Pitchford, 1989). According to MacFarlane (1999), monetary policy has a large number of variables to setting the policy. Not only one but also a wide rage of indicators should be looked in this policy. Some tighten monetary policies intend to reduce the current

account deficit. These are the monetary policies which limit demand and reduce imports (Pitchford, 1989). Tighten monetary policy in short term can reduce domestic demand and increase saving in the long term (Anonymous, Nov 1995).

Another policy is fiscal policy, Carbaugh (2002) and Pitchford (1989) explained that the policy refers to the government expenditure and taxation through the indirect effects on private expenditure. The fiscal policy that Australian government used is national saving policy. The higher government saving makes national saving higher and also recover the current account balance. However, there are some critical issues whether increasing in public saving may lead to reduce in private saving (Robinson, 2002). There are some economists urged that corporate trading enterprise, financial institutions and also government have invested more than their saving, at same time households have saved more than invested. As a result, the government and corporation need to borrow from the household but it is not enough, thus they have to borrow from oversea which will create the foreign indebtedness (Bora and Lewis, 1997). Fiscal policy has become more stimulate in budget which intended in affect on expenditure (Anonymous, Sep 2001). From the evidence of observation showed that over a last decade to ensure net national saving should have been about one percent of GDP, then there was a balance in current account,. Increasing in net national saving can eliminate the current account deficit, (Cashin and McDermott, 1998).

Nevertheless, some economist stated that some government policies like monetary policy might not have only the positive affect. Sometimes, using inappropriate policy to control the current account deficit can make the situation worsen (Quiggin, 2000).

Indirect factor which affects the current account deficit is the wage restraint. The policy of wage restraint seems to make changing in current account balance. It can help in decreasing in import demand and increasing in supply of import competition and export goods. The effective of the wage restraint will effect to the wage and then have impact to the spending and investing. It was believed by Bennett (1999) that if standard of living in

Australia is too high, the consumption should be deducted. To reduce the wage will create changing in positive way for current account deficit. Unemployment rate fallen under 7 percent and unit labour costs very low created current account deficit narrower in year 1999 and 2000 (Anonymous, Jun 2000). In the forth quarter of the year 2000, the number of employment dropped continually which made the current account deficit reduce (Anonymous, first quarter 2001).

Furthermore, in the last decade the current account deficit in Australia has been influenced by international capital flow (Cashin and McDermott, 2002). Robinson (2002) also urged that capital account surplus will drive current account deficit. Lingle (1999) affirmed that current account deficit is pushed by the net capital inflow. With limited in international capital mobility can create an action in current account balance in the borrowing process. Capital flow should be increased because of the high degree of capital mobility, an absence of capital market imperfection and consumption behavior. Consequences of capital flow will shape the current account deficit (Cashin and McDermott, 1998). Swann (2003) proposed that some strategists stated that the reduction of the international capital flow, which determines the current account deficit in Australia, was from the political uncertainty. Increasing in interest rate, which desires to oppose inflation by using monetary policy in reducing money supply, can attack short term capital movement (Arndt, 2000).

Conclusion

Australia has been involved in the current account deficit for a long time. The current account deficit in Australia has been fluctuated depending on many factors. Some of the factors are internal and external factor. Mostly external factors like Asian crisis or other catastrophes in the world cannot be controlled by Australian government, but some internal factor like drought cannot be controlled either. On the other hand, some internal factors can control by monetary policy and fiscal policy, for example, the exchange rate, wage restraint and saving. These factors can create both direct and indirect consequence to the current account deficit. Some factors can effect direct to export, import goods and services namely exchange rate. In both of these factors should be consider especially the factors which can be managed by the government policy. It is because these factors can make the affect to each other like chain reaction, which will create a wider in current account deficit.

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