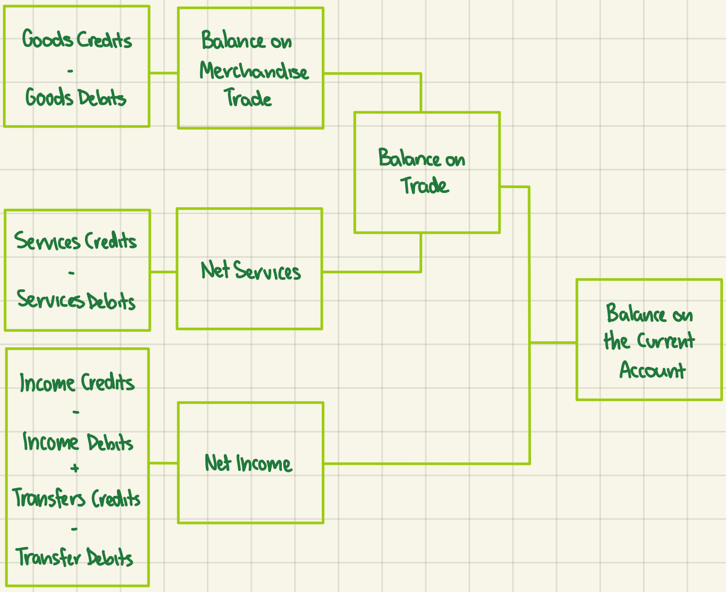
Balance of Payments and Foreign Investment

Current Account - Balance of Payments

• Capital and Financial Account has to off set current account.



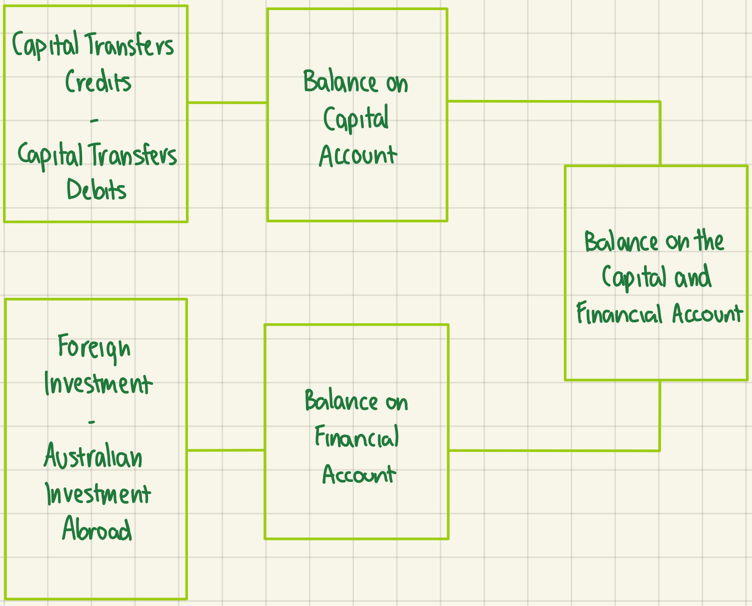
Goods
- Goods credits - the value (quantity * price) of all exports of goods from Australia.
- Goods debits - the value (quantity * price) of all imports of goods into Australia.
- Balance on Merchandise Trade (Net Goods) is the sum of goods credits minus the sum of goods debits.

Services
- Services credits - the value (quantity * price) of all services exports from Australia. (Where money has entered Australia in return for a service, e.g. providing education for overseas students)
- Service debits - the value (quantity * price) of all services imports into Australia. (Where money has left Australia in return for a service, e.g. a holiday)
- Net Services is the sum of services credits minus the sum of services debits.

Income
- Income credits - where money has entered Australia in the form of wages/salaries, rent, interest or profits/dividends.
- Income debits - where money has left Australia in the form of wages/salaries, rent, interest or profits/dividends.
- Net Income is the sum of income and transfer credits minus the sum of income and transfers debits.

Transfers
- Transfers are when money is received but there is no exchange for goods or services, e.g. pension payments
- Transfer credits are when transfer payments enter Australia from overseas residents
- Transfer debits are when transfer payments leave Australia to pay overseas residents

Balance on Current Account
- The Balance on the Current Account is the sum of the balance of trade and net income.
- Balance on trade is the sum of the balance of merchandise trade and net goods.
- The difference between the current account and the capital and financial account is balanced by an exchange rate and hence, always equals to 0.



The structure of the capital and financial account is divided into two sections, capital transfers and financial account.

Capital Transfers
Capital transfers credits are the value of assets bought into Australia from immigration.
Capital transfers debits are the value of assets that leave Australia from emigration.

Balance on the capital account
Balance on the capital account is the value of capital transfers credits minus the value of capital transfers debits

Financial Account
Foreign investment is the value of all money entering Australia from overseas borrowings (foreign debt) or sale of domestic assets (foreign equity)
Australian investment abroad is the value of all money leaving Australia to accumulate overseas assets or lending of money to overseas residents
Balance on Financial Account is the value of foreign investment minus the value of Australian Investment abroad

Balance on the Capital and Financial Account
Balance on the Capital and Financial Account is the sum of the balance on the capital account and balance on the financial account.
The difference between the current account and the capital and financial account is balanced by an exchange rate and hence, always equals to 0.

Influences on the Current Account Balance

Cyclical Factors temporary factors mainly affecting trade balance change is relative to domestic + overseas business cycles.

Domestic Business Cycle: The state of Australias economy (growth in GDP) will impact trade. * If Australian economy is booming with increased imports, this would decrease BOGS and most likely the CA balance, and vice versa (covid-19)

Overseas Business Cycle: If there is an increase in economic growth of trading partners the demand for Australian exports will increase. * Price of exports will increase and the trade balance will increase ∴ causing a decrease in CA deficit.

Exchange Rate: Aus the Australian dollar (AUD) appreciates imports will increase and exports will decrease (vice versa). * If the $AUD appreciates then the CA will have a decreased deficit. The opposite is true for a depreciation of the $AUD

Relative Inflation: If Australias inflation rises, residents will increase their imports from places products are cheaper to purchase. (vice versa) * An increase in imports will lead to a decrease in BOGS, potentially leading to a CA decrease however the CA is still determinate on Y as well.

Commodity Prices (TOT): Terms of Trade = Export Price Index / Import Price Index · CAB = BOGS+Y · BOGS = X-M. The export and import prices will alter BOGS. * A decrease in imports or an increase in exports will result in a BOGS increase, likely leading to a CA balance increase.

Structural Factors → fundamental factors that mainly impact the income balance.

Foreign Investment: (assets) An overseas resident invests either a direct I or portfolio I into a domestic business. (Australia relys on this to meet investment needs as we are a small country (pop. wise) * This leads to an increase in the income account which leads to an increase on the CA.

Foreign Liabilites: Australian residents oweing money to overseas residents. Australias level of borrowings. Eg. Telstra takes a loan from foreign HSBC bank, this is now foreign debt. * This leads to a decrease in the income account and consequently a decrease in the current account.

Investment-Savings Gap: Overseas residents have savings/investment. People invest their savings which leads to interest and dividends going into Australias primary income account. * The increase in income account leads to an increase in the CA balance. Investment leads to Income debits → we pay interest and dividends (vice versa ex)

Significance of the Current Account Deficit

A positive view of the Current Account Deficit

Positive View #1: Allows Australia to acheive a higher rate of investment: Australia has a savings and investment gap, requiring foreign investment to supplement the gap. Foreign investment leads to a higher rate of economic growth. This investment is used to expand Australias production capacity. As FI↑ the CA↑ deficit.

Positive View #2: Foreign Investment is a positive indicator of the economy: Continual flows of foreign investment into Australia means that overseas investors are still confident in the Australian economy and their investment will seek safe and profitable returns.

Positive View #3: Portion of Y generated by Foreign Investment = reinvested into economy: Most Foreign Investment resuts in an outflow of income debits, a portion of gains will be reinvested into the economy, creating new economic growth and employment within Australia.

A negative view of the Current Account Deficit

Negative View #1: Overspending on imports: A CA deficit that is fuelled by a trade deficit could be indictitave of an economy living beyond it's means and that money spent on imports would be better off spent on domestic production. This view states producers > consumers, which is wrong.

Negative View #2: Future generation punishment: An economys reliance on foreign invest could result in a growth of an unsustainable foreign debt that leads to high-interest repayments for future generations. Also ↑ levels of Foreign equity could result in ↑ levels of Foreign ownership of domestic assets.

Negative View #3: Credit rating risk: Too much soverign debt could result in a credit rating risk as the risk of government default on overseas loans increases. However most foreign debt is private debt. Done by 'consenting adults - private sector bases decisions on a profitable outcome.

Negative View #4: Limited stock of assets: (to sell). Foreign ownership could reach a point where it's no longer sustainable. Concerns are over future supplies, to which foreign-owned companies could divert all their production to export markets. This can cause supply shock → like in the gas market.

Current Account Balance

$CAB = S - I$ (savings/investment gap)

Countrys that need ↑I = -CAB

Countrys that have ↑S = +CAB

Extra Notes:

#1: Australia is safe to invest in/reliable
↳ 'perfect credit rating' globally

#2: ↑I sign of + economy → have confidence in Aus economy to perform

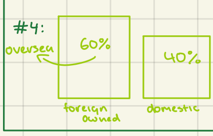
#3: The I leads to Total + ↑ within Aus after paying investors off
↳ Needed help to produce Iron Ore (Now 1.4Tril income)

#1: contradict → provides a better quality of living to people

#2: debt is close to 1 Tril. If we can't pay it off = :(
↳ it's not neccasary to pay this off in one shot → pay it off overtime

#3: not an issue for Aus but if other countries had ↑ unrelicable debt it will lead to a bad credit rating globally. Debt is normal.

#4:



Aus gets 40% due to 60% equity but only has access to 40% when they need 55% → causes gas price to skyrocket to 'meet' demand.

Foreign Investment

- **Australian Investment abroad (AIA)** → Debits on KAFA
  - Foreign Assets (something you own)
    - Australian lending (Australian lending to foreign countries)
    - Australian Equity (Australian ownership of foreign assets)
- **Foreign Investment into Australia (FIA)** → Credits on KAFA
  - Foreign Liabilities (something you owe)
    - Foreign Debt (borrowing from overseas)
    - Foreign Equity (foreign ownership of Australian assets)

interest dividends recieved from AIA $\xrightarrow{\text{credit}}$ CA

Interest/dividends paid for FIA $\xrightarrow{\text{debit}}$ CA

Compensation payments made to compensate resources

CA —— sum to 0 —— KAFA

FIA $\xrightarrow{\text{credits}}$ KAFA

AIA $\xrightarrow{\text{debit}}$ KAFA

Investment Flow
The genuine flow of investment domestic + overseas

Foreign Investment

Benefits of Foreign investment

Increased Government Revenue: FI increases the rate of investment and economic growth. This will increase tax receipts from income, higher employment and higher business profits. As well as from expenditure.

Allows for higher rate of investment: Australia had a savings-investment gap prior to 2018 that meant Aus needed a high portion of investment to encourage economic expansion as Australias small population reduces domestic investment opportunities.

Financial Capital: FI provides finance for industry to purchase more capital stock. A higher level of capital stock will increase aggregate supply, increasing economic growth and lowering price levels. Capital will increase the international competitiveness of Australias exports.

Encourages the transfer of technology: Foreign Direct Investment encourages the transfers of new ideas and technologies, which will increase productivity, aggregate supply and international competitiveness. An increase in aggregate supply will increase economic growth and lower price levels.

Finances 'Economies of Scale': FI provides neccasary finance to achieve economies of scale. Economies of scale are more efficient and internationally competitive. It is the closing of the saving-investment gap within a country.

Costs of Foreign investment

Loss of economic sovereignty: Increases in foreign equity will result in a loss of control of domestic assets. Foreign ownership could dictate domestic assets to go against domestic political or economic agenders. Eg. debate over China owning Darwin port as it's used by Aus Navy → pose National security risk.

Increased vulnerability to external shocks: Portfolio I makes up 56% of all foreign investment. Portfolio investment is highly volatile and could see external shock such as GFC, emphasised in Aus by rapid and sharp movements in foreign investment. (Covid-19, secondary example)

IR rise → Risk of increased servicing costs: Some foreign debt is variable to which it changes according to changes in interest rates. An increase in interest rates could see Australias servicing costs on foreign investment also rise, to unsustainable levels for future generations. (↑ levels of debt, net liability = 2008)

Emergence of housing bubble: A proportion of foreign investment is also invested in the housing market which is an unproductive investment as it does not expand the aggregate supply of an economy. FI could also see demand for Aus property rise until unachievable by first home buyers.

Appreciates the currency: A increase in foreign investment causes an increased demand for the AUD. This decreases the competitiveness of exports and increaces the demand for imports → decreasing the BOGS causing an appreciated dollar will then reduce economic growth.