

5.5 WHAT ARE THE DIFFERING VIEWS AS TO THE SIGNIFICANCE OF THE CURRENT ACCOUNT DEFICIT (CAD)?

View 1 – The CAD is a sign of economic strength

This view holds that:

- Australia has a CAD because we have an inflow of foreign investment.
- We have an inflow of foreign investment because private sector multinational corporations and other investors believe an investment in Australia will be safe, involve little risk and be profitable.
- The inflow of foreign investment and the exports produced as a result of the foreign investment, support the value of the AUD (which makes it harder for other sectors to export and more attractive to import) and lead to an outflow of interest, dividends and profits recorded as a primary income outflow in the current account.
- The CAD is significant because it is caused by a financial account surplus, financing the expansion of further production and export capacity (it shifts the PPF outwards).

This view is a simplified version of the 'Pitchford Thesis' and the 'consenting adults theory', both of which claim the CAD has little economic significance when it is the result of private sector activity with the aim of reaping the benefits of international trade and investment. The fundamental cause of the CAD is the investment-savings gap created because Australia is 'resource rich and capital starved' (our national savings are insufficient to provide the investment finance required). The CAD is sustainable because:

- Foreign investors will continue to look for profitable investment in the Australian economy.
- Debt servicing ratios are manageable.
- Debt to GDP ratios are low by international standards.
- A relatively small proportion of Australia's foreign debt is sovereign or government debt.

View 2 – The CAD is a sign of economic weakness

This view holds that:

- We are living beyond our means, buying more imports than we can afford given the revenue we earn from exporting.
- Our export performance is poor because Australian producers don't do enough value added or downstream processing (our exports being mainly unprocessed commodities or simple transformed manufactures).
- The lack of competitiveness of Australian products has turned Australian consumers into import junkies, who prefer imported goods to those made in Australia.
- The CAD is significant because it is unsustainable. The more we borrow and the more assets we sell to non-residents the less we are in control of our own economic destiny.

According to this view the fundamental cause of the CAD is an expenditure-production gap created because we spend more than we earn in income. This is unsustainable because:

- It creates a 'debt trap' where a rise in foreign debt leads to a rise in primary income outflows, bigger CADs, and yet more foreign liabilities.
- It makes us vulnerable when global financial markets are not operating normally (e.g. during the global financial crisis).
- We have a limited stock of assets to sell (e.g. agricultural land).