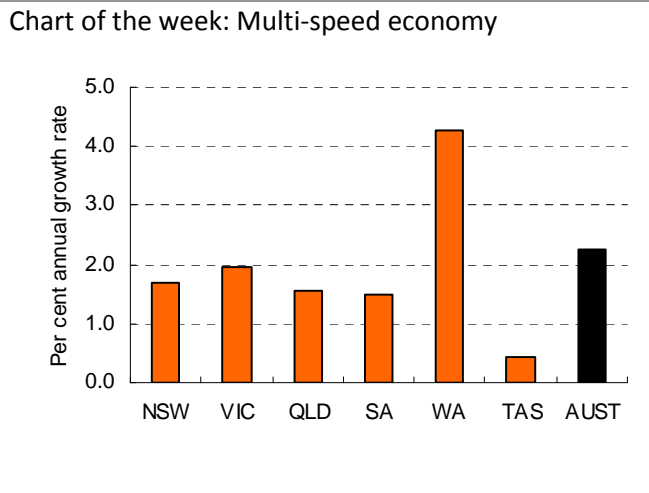


# Current Economic Issues

Observations, ideas and commentary on economic issues

## More evidence of Australia's multi-speed economy....



- The chart shows the real gross state/domestic product growth rates across Australia in 2009-10, released by the ABS last week.

- The chart provides further evidence of the multi-speed economy. **WA is booming, with growth of 4.3 per cent, 2 percentage points higher than the Australian average and 2.3 percentage points higher than Victoria – the second fastest growing State in 2009-10.**

- WA is growing 2.5 times faster than NSW.

- The 2009-10 industry gross value added results further illustrate the multi-speed economy. The table below compares the growth rates of selected Australian industries.

Per cent growth in IGVA in 2009-10	Mining	Manufacturing	Construction	Retail trade	ICT	Finance & insurance
	6.0	1.5	0.5	1.9	1.2	2.9

- The **mining industry's growth rate in 2009-10 was 4 times that of the manufacturing industry.** It was 12 times that of the construction industry. Growth of services industries varied, with the finance & insurance industry growing 2.9 per cent compared to 1.9 per cent for retail trade. ICT grew by 1.2 per cent.
- The manufacturing industry's 2009-10 growth rate of 1.5 per cent was actually above its long-run average (since 1990) of 1.1 per cent.

## Unfinished business: taxation reform....

- A joint report by the World Bank, the International Finance Corporation and PwC that compares the tax systems around the world as they impact business was released last week.
- The report found that **Australia's business tax competitiveness ranking has gradually slipped over recent years**, as other countries have reduced business tax rates and improved or addressed complexity in their own tax systems. That is, Australia has been going backwards in terms of global competitiveness.
- In the report Australia ranks 48<sup>th</sup> (amongst 183 nations surveyed) with regard to (administrative) ease of paying business taxes, 22<sup>nd</sup> in terms of time it takes to comply with tax laws and 148<sup>th</sup> with respect to the total tax rate (i.e. the amount of taxes and mandatory contributions borne by a business in the second year of their operation as a share of profit).
- Research based on data from the report also points to the impact of business taxation on investment. That is, in general **there is a consistent and large adverse effect of corporate income tax on corporate investment.** A 10 per cent increase in the effective corporate tax rate reduces the aggregate investment to gross domestic product ratio by 2.2 percentage points and foreign direct investment by 2.3 percentage points.

### The growing importance of Asia to Australia's economic fortunes....

- The International Monetary Fund has recently released economic modelling on the impact of emerging Asia's growth on Australia. Over the last decade, GDP growth in emerging Asia (i.e. excluding Japan) was approximately twice as fast as average world growth.
- The analysis suggests that approximately **25 per cent of Australia's growth over the last decade has been from emerging Asia's growth differential over that period.**
- The analysis suggests that should emerging Asia continue to grow in a similar fashion over the next decade, Australia's growth dividend could almost double. According to the IMF, the findings have important policy implications for Australia:
  - Adjustment within Australia to the impact of emerging Asia implies significant resource reallocation across sectors and policy can maximise the benefits by facilitating that reallocation.
  - Australia's longer-term growth potential will have a large externally determined component, the magnitude of which will likely be highly uncertain. **Policies focused on long-term objectives will need to factor in this uncertainty.**
  - Policy will also need to be well positioned to respond to the resulting volatility. **For fiscal policy, this could imply allowing larger swings in the fiscal balance than would occur in economies less exposed to large exogenous shocks.** For monetary policy, continuing to fully utilise the flexibility provided in the specification of the inflation target will be important. Ongoing financial sector regulation and supervision would also be prudent.

### Ireland's economic links to Australia....

- As Ireland teeters on a sovereign debt default, it is worth considering Australia's recent economic links and exposure to Ireland.
- Australia has a merchandise trade deficit with Ireland. **In 2009, the value of Australia's total merchandise exports to Ireland amounted to A\$114.8 million while Australia imported A\$2.3 billion from Ireland.** This merchandise trade deficit has increased by an average of 10 per cent since 2006. Key merchandise imports from Ireland include pharmaceuticals or medicines (including veterinary); edible products and preparations (meat, vegetables); and computers (Ireland has a large ICT sector underpinned by foreign multinationals such as Intel). **Key merchandise exports to Ireland include alcoholic beverages; pharmaceuticals or medicines (signifying the two way trade in these commodities); and medical instruments.**
- In 2009, Australia also recorded a services trade deficit of A\$196 million with Ireland, however this only represents 1 per cent of Australia's global services trade. In 2008, foreign direct investment into Australia from Ireland totalled USA\$145 million whereas outward foreign direct investment from Australia to Ireland totalled US\$149 million.
- In terms of migration, in 2008-09 there was an increase in Australia's 'permanent' population of 2384 from persons born in Ireland, whereas there was only 902 'permanent' departures for Ireland. As at 31 December 2009, **there were 3,360 temporary business entry visa holders (457 visa) from Ireland,** representing only 2.8 per cent of temporary business entry visa holders at that time.
- In terms of financial markets, the impact of the Irish debt crisis on the Australian stock market has thus far been relatively moderate. That said, Greece's experience earlier this year suggests that **financial market participants could easily lose confidence in the Irish economy should the adoption of the Irish bailout be obstructed by political processes or if the austerity programs prove to be too onerous.** This could lead to sudden and sharp falls in share prices across global stock markets as investors become significantly more risk averse.