

## Australia – UK bilateral economic relations

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To *Our Shared Future: The UK – Australia Future Leaders Dialogue*,  
Sydney Conservatorium of Music, 16 April 2004.**

### ***Introduction***

My brief today is to talk about Australia-UK bilateral economic relations. I plan to start with the specific, providing a quick overview of some of the key economic flows between the two countries, and then move on to some more general observations.

### ***Quantifying the economic relationship***

I want to begin by looking at the nature of the economic relationship between Australia and the UK, which I want to think about in terms of three flows; flows of goods and services (trade), flows of capital (investment) and flows of people (migration).

Note that I intend to focus mainly on how the relationship looks from an Australian perspective.

### ***Ranking the economic relationship***

The table provides a quick overview and hopefully also delivers the main message of this section; that the bilateral economic relationship remains substantial, especially from an Australian perspective.

1. Last year the UK was Australia's sixth largest export market for goods (about 7% of the total) and its fifth largest source of merchandise imports (a little over 4%). [Incidentally, for the UK the equivalent rankings are 14<sup>th</sup> (1½% of total exports) and 28<sup>th</sup> (1% of total imports) respectively.]
2. The UK is Australia's second largest trading partner for services. Services trade is dominated by tourism, with the UK the second largest source of tourist arrivals (after NZ) in Australia in 2003.
3. Taking overall trade in goods and services together, the UK was Australia's fourth largest trading partner last year.
4. In the same year the UK was both the second largest source of overseas investment in Australia (27% of the total), and the second largest destination for Australian investment overseas (17%). [According to the FCO, the equivalent rankings of Australia's importance for the UK are seventh and fourth, respectively.]
5. Finally, last year the UK was the largest source of migrants to Australia.

Let's look at a couple of these in a little more detail.

## ***Australia-UK trade in historical perspective***

We'll begin with trade, where we have the advantage of some fairly good long run data.

Crudely put, Australia's initial integration into the international trading system took the form of a simple bilateral exchange of Australian primary commodities in return for imports of British manufactured goods; thus in the late nineteenth century roughly three-quarters of all Australian trade took place with the UK. By the start of the 20<sup>th</sup> century the UK continued to account for about half of all Australian trade flows, and by mid-century that share had dropped to about a third, but the UK remained by far the most important of Australia's trading partners.<sup>1</sup>

By the start of the *current* century, however, the UK's relative importance to Australia as a trading partner had declined markedly (although as noted above, in absolute terms it remained important).<sup>2</sup>

Why the major shift in the second half of the 20<sup>th</sup> century? Obviously several factors were at work, but a big part of the explanation has to do with the growth of regional trade. Thus the EU became an increasingly important trading partner for the UK, even as East Asia filled the same role for Australia. The EU now accounts for well over half of all UK trade, while East Asia accounts for almost half of Australian trade.

In large part, this is just a market-driven story – a response to changing patterns of global demand. But presumably it also reflects the *politico*-economic decision of the UK in 1961 to seek membership in the then-European Common Market (in the event, de Gaulle vetoed British membership in January 1963 and the UK finally joined in 1973). Also during this period, Australia began to negotiate a landmark trade deal with Japan.

One interesting question for the future of the bilateral relationship therefore is whether more recent politico-economic decisions, such as the AUSFTA, or the proposed Australia-China trade deal, will have similar implications for the bilateral trading relationship.

## ***Australia-UK investment trends***

The story with regard to international investment makes an interesting contrast to what has happened with trade. I don't have such good long run data here, although clearly the UK would originally dominate investment into Australia in much the same way that it dominated the trading relationship. However, the bilateral investment relationship has shown much less sign of relative decline, with the UK continuing to hold second place (well ahead of the third-placed economies) both as a source of foreign investment in Australia, and as a destination for Australian investment overseas.<sup>3</sup>

Indeed, it is quite striking that while Australian *trade* has been substantially redirected towards East Asia, the same has not happened with investment. As Ian Macfarlane, governor of the Reserve Bank, puts it, Australians have always been more comfortable running businesses in the United States and the United Kingdom than in Asia. Indeed, the share of direct investment going to Asia has actually *fallen* over the past decade.<sup>4</sup>

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<sup>1</sup> Data for 1887-91 taken from Meredith and Dyster, *Australia in the Global Economy*, Cambridge University Press, 1999. Remaining data from *Direction of Trade Time Series 2000-01: One hundred years of trade*. Market Information and Analytical Unit, Department of Foreign Affairs and Trade, February 2002.

<sup>2</sup> As an aside, it's also worth noting that the nature of goods traded between the two countries has also changed. By last year, for example, wine had replaced more traditional exports such as wool and iron ore as the driving force of Australian exports into the UK. There is also a growing trade in the export of computer parts. *United Kingdom Country Brief*, Department of Foreign Affairs and Trade, March 2004.

<sup>3</sup> Data from Reserve Bank of Australia, *Australian Economic Statistics, 1949-50 to 1984-85*, Occasional Paper, 1986 and Australia Bureau of Statistics *International investment position: supplementary country statistics*, February 2003.

<sup>4</sup> *Asia's role in Australia's economic future*. Speech by I J Macfarlane at the 10<sup>th</sup> Annual Sir Edward "Weary" Dunlop Asialink Lecture, Sydney, 16 October 2003.

Whether or not this split between trade and investment is set to be sustained is another intriguing question for the future of the bilateral relationship.

### ***UK-Australia flows of people***

In terms of migration, the data show that while the UK's share of migrants to Australia is on a declining path, in absolute terms it remains important. According to DFAT, for example, the UK was the largest source of immigration into Australia last year, with 12,510 people migrating in 2003.<sup>5</sup> The UK is also important qualitatively as well as quantitatively, being the largest supplier of skilled migrants.<sup>6</sup>

It's worth noting that people flows in the other direction are also significant. Thus almost one-quarter of the Australian diaspora is to be found in the UK.

I think that the interesting issue for the future here is to what extent people-to-people links that in the past have been supported by traditional migration will be replaced by new forms of linkages such as the growing tendency for professionals to spend parts of their career in different international commercial centres. Many Australian lawyers and accountants, for example, would now expect to spend some time working in London.

### ***Beyond the numbers***

To conclude this session, I'd like to finish by moving away from the numbers, and thinking about three more general issues.

### ***An economic Anglosphere?***

First, is there any sense in which we can say that English-speaking countries like Australia and the UK have a distinctive growth experience? Interestingly, there *does* seem to be some evidence of common trends in economic activity across the English-speaking world; an economic Anglosphere, if you like. This takes the form of empirical correlations between the business cycles of Australia and the UK on the one hand, and the US on the other, which are closer than would be expected in terms of pure economic (trade) linkages. Various explanations have been advanced for this phenomenon, including the similarity of institutional features and the impact of a common language.<sup>7</sup>

Perhaps more intriguingly, the economist Paul Krugman has wondered whether being an English-speaking country is particularly good for economic growth. Krugman was writing in 1999 (before the end of the US IT boom, at the late stages of the East Asian crisis, and with Japan's economy stagnating and continental Europe doing only a little better) and was drawing attention to the relatively strong economic performance of the English-speaking economies. Subsequently, the thesis has been dented somewhat by the bursting of the US tech bubble, not to mention the continuing rise of China. Although the current growth spurt in India may give it new legs. Krugman suggested a couple of explanations, including a greater tendency for economic policy to be run by smart economists with good links to academia (well, he would think that, wouldn't he) along with the move to a more market-friendly policy stance that got underway in the 1980s. He also canvassed a couple of other possibilities, including the suggestion that English has become the language of the global economy and of the internet – once described by current French President Jacques Chirac as an "Anglo-Saxon Network".<sup>8</sup>

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<sup>5</sup> *United Kingdom Country Brief*, Department of Foreign Affairs and Trade, March 2004.

<sup>6</sup> *Australian immigration: consolidated statistics No. 21 1999-2000*. Department of Immigration and Multicultural and Indigenous Affairs. June 2002.

<sup>7</sup> See for example Otto, Voss and Willard *Understanding OECD output correlations*. Reserve Bank of Australia Discussion Paper, 2001.

<sup>8</sup> Paul Krugman. *Want growth? Speak English. That certain je ne sais quoi of les Anglophones*. Fortune Magazine, April 1999.

I think that the recent growth of outsourcing or offshoring provides an interesting spin on all this. If you are a pessimist, then English-speaking countries like Australia and the UK are going to be particularly vulnerable to losing service sector jobs offshore in coming years. But if you are an optimist, and believe that outsourcing is just another example of the competitive advantages that can be reaped by participation in international trade, then this could be the source of another significant productivity boost to the “economic Anglosphere”.

### ***Partners in success / Bubble trouble***

Second, regardless of whether you buy into the “speaking English is good for your economy” thesis, it is certainly the case that Australia and the UK have both been enjoying a particularly good run in terms of GDP growth. Australia is currently in the midst of its longest uninterrupted expansion since the end of the Second World War (and possibly since much earlier), while according to Chancellor Gordon Brown, the UK has been enjoying its longest period of sustained growth for more than 200 years.

Both countries now face similar challenges in managing some of the consequences of that success. For example, the Reserve Bank and the Bank of England have been ahead of the global curve in raising interest rates. Thus while policy rates in Australia now stand at 5¼% and in the UK at 4%, the ECB’s policy rate is just 2%, the US Fed Funds rate is at 1%, and in Japan rates are zero. This in turn has contributed to upward pressure on the A\$ (which has risen against major trading partners in Asia) and sterling (which is up sharply against the euro) with an adverse impact on external competitiveness in both cases.

Moreover, while tightening policy, both central banks have been keeping a close watch on the local property market. Thus another common feature of English-speaking countries in recent years appears to have been a fondness for property speculation. In its survey last year looking at the risks of a property market crash, the *Economist* cited Australia and the UK, along with the US and Ireland, as the countries most likely to see a big correction over the coming year (it also cited the Netherlands and Spain).<sup>9</sup>

### ***Dealing with the neighbourhood***

Finally, both countries are facing some similar challenges in dealing with their neighbourhoods. Thus, even as the UK contemplates its place in a European Union project that has moved from the Single Market of 1993 through the launch of the Euro in 1999, and which in May this year will see the addition of another 10 accession countries, Australia wonders about its future role in East Asia. Here the regional architecture is clearly much less developed than in Europe, but nevertheless there are growing signs of economic co-operation and integration. These include the ASEAN+3 process, which is already bearing some fruit in the form of the currency swap lines of the Chang Mai Initiative and in discussions about regional trade agreements.

These are the challenges thrown up by what are (by and large) economically successful neighbours. At the same time, Australia and the UK also have to contemplate dealing with the regional consequences of economic failure. For Australia, this means the economies of the Southwest Pacific, with PNG and the Solomon Islands to the fore. For the UK – and for the EU more generally – the challenge of failed states rests in Africa and on some of the Union’s Eastern borders.

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<sup>9</sup> Pam Woodall. *House of cards. Survey: Property*. The Economist, 29 May 2003.



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# **The Australia-UK economic relationship**

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# **Quantifying the economic relationship: three themes**

- Flows of goods & services (trade)
- Flows of capital (investment)
- Flows of people (migration)

# Ranking the economic relationship: UK importance to Australia in 2003

Area	Rank	Share
Merchandise exports	#6	6.9%
Merchandise imports	#5	4.2%
Service exports	#2	11.6%
Service imports	#2	11.1%
Investment in Australia	#2	27%
Australian investment overseas	#2	17.3%
Migrants to Australia	#1	-
Australians living overseas	#1	-



# Australia-UK trade in historical perspective

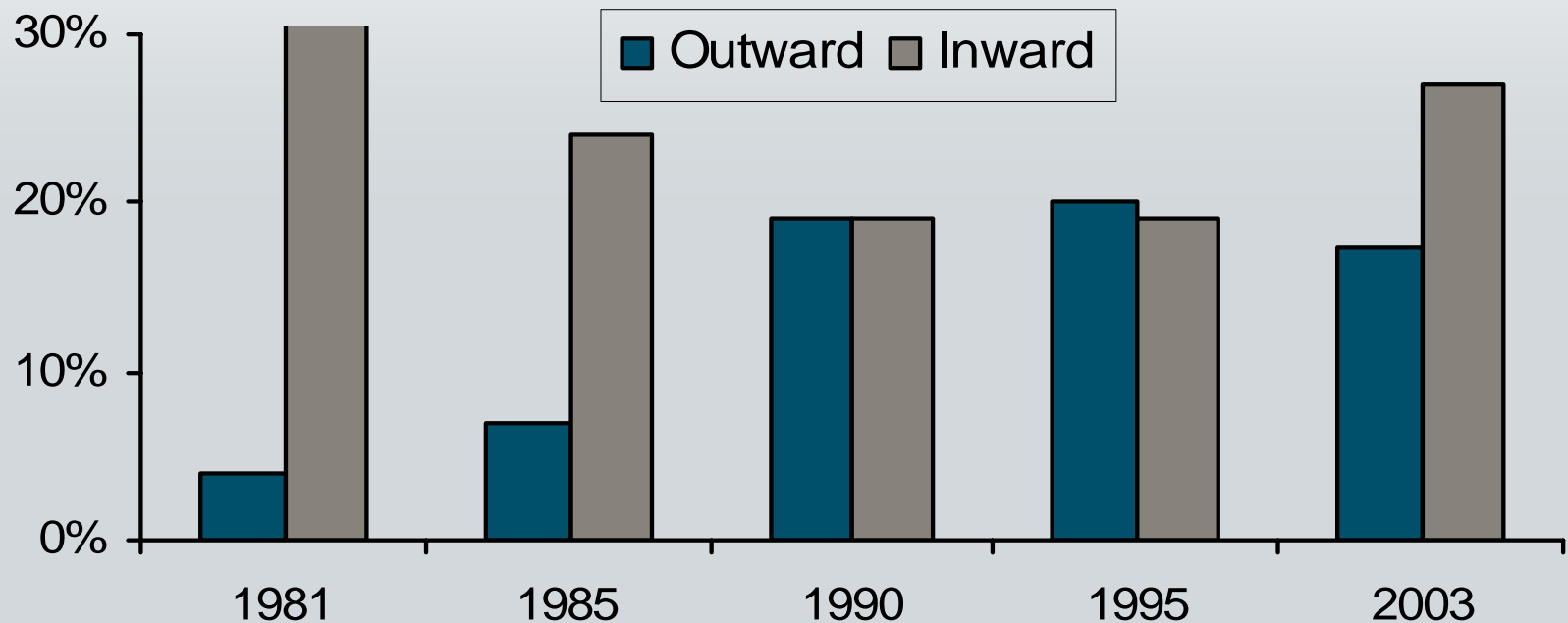
Trade with UK as share of Australian exports & imports, % of total



Sources: Meredith and Dyster (1999); Department of Foreign Affairs and Trade (2002)

# Australia-UK investment trends

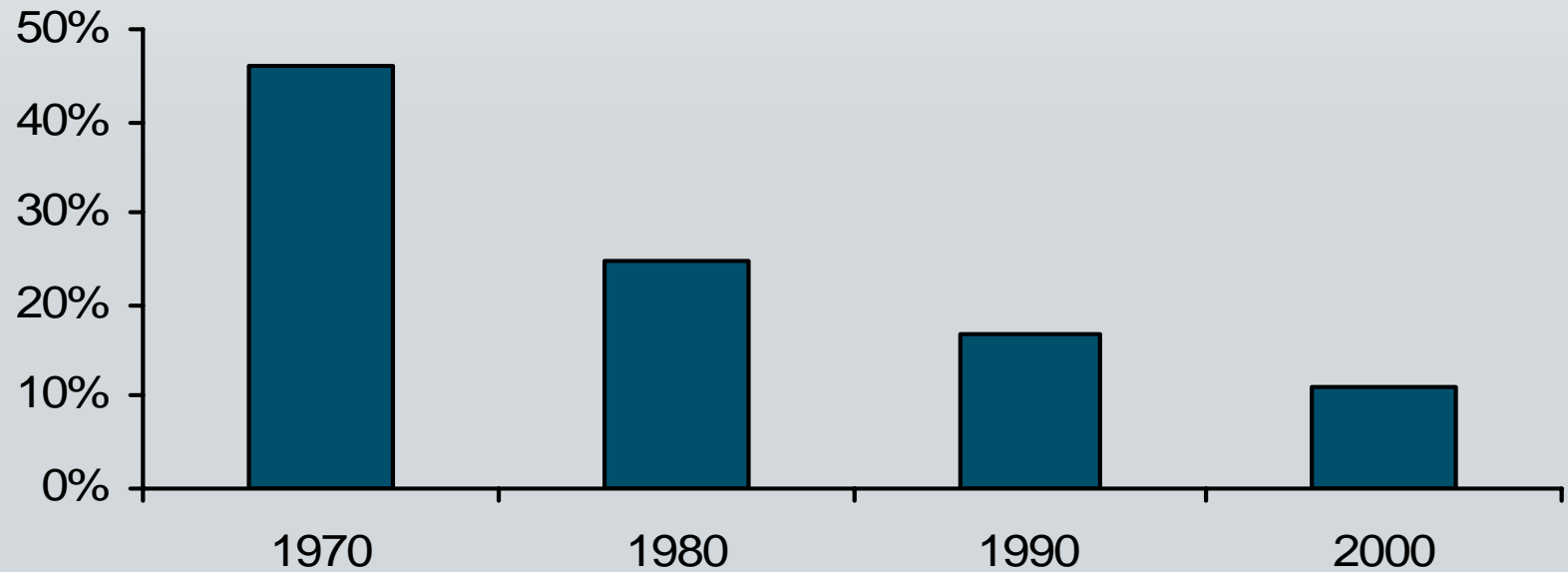
Australian investment into and from the UK, % of total



Sources: RBA (1996) and ABS

# UK - Australia flows of people

Proportion of Australian settlers coming from UK, % of total



Source: ABS

# Beyond the numbers

- An economic Anglosphere?
- Partners in success / Bubble trouble
- Dealing with the neighbourhood

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