



plain-english

economics

2012 TOPIC PAPERS

NO.	TITLE	PAGE
1	Inflation	3
2	External Stability	5
3	Unemployment	7
4	Labour Markets	9
5	Financial Markets	11
6	Economic Growth	13
7	Ecologically Sustainable Development	15
8	Globalisation	17
9	Income Distribution	19
10	Developing Economies	21

Produced by "Plain English Economics Pty Ltd" PO Box 522 Jannali NSW 2226 Email: plain.english@bigpond.com
Disclaimer: While every attempt is made to ensure the accuracy of information contained in this publication, no liability is held by the producers as a result of any use of the contents of this document.



plain-english

economics

Topic one: Inflation

Inflation remains moderate

Inflation has tended to be moderate in recent years, averaging within the Reserve Bank target 2% to 3% range. Measures of underlying inflation, which remove some of the more volatile or outlier movements from the inflation calculation, show an annual inflation rate in the year to March 2012 of between 2.1% and 2.2%.

Some softening in demand in the domestic economy is likely to be a factor that has contributed to inflation being in the lower range of the Reserve Bank's target. Typically, in periods of soft demand, there will be less pressure on the rate of inflation to increase as subdued demand makes it more difficult for producers to raise prices.

For much of the past two years, however, the official or "headline rate" of inflation was above the upper 3% ceiling of the target range. This was largely due to higher food prices as floods around the country and the North Queensland cyclone in early 2011 caused supply shortages of several fruits and vegetables. The most recent inflation data for the March quarter of 2012 has shown a reversal of much of these temporary jumps in prices. The Consumer Price Index (CPI) rose by only 0.1% in the quarter, which brought the annual headline rate of inflation down to just 1.6%. This is the lowest rate since the September quarter of 2009.

Growth Rate %	March 2012 Quarter	Year to March 2012	Year to Mar 2011
Consumer Price Index	0.1%	1.6%	3.3%

It should be noted that the moderate rate of inflation in the Australian economy has come at a time when there was a high Australian currency. This has reduced price growth pressure on imported items and any goods and services that rely heavily on imports as inputs into the production process. Over the year to March 2012, import prices did rise by 2.1%, however this was heavily influenced by a 15% jump in fuel related items. Other categories, such as manufactured goods, have had far lower rates of increase.

Policy response to inflation

Largely in response to concerns over the likelihood of increased inflation in the future, the Reserve Bank embarked on a program of gradually raising interest rates following a period of loose policy in the aftermath of the Global Financial Crisis (GFC). This saw the overnight cash interest rate jump from 3.0% in October 2009 to 4.75% in November 2010. Policy was then loosened again a year later, with the cash rate dropping to 3.5% following 4 reductions between November 2011 and June 2012.

Despite the fact that cash interest rates at 3.5% are at historically low levels, the Reserve Bank describes the current level of interest rates faced by borrowers as only being "a little below their medium-term averages". This assessment takes into account the fact that banks are passing on larger than normal interest rate margins to borrowers. Hence the current monetary policy setting is only mildly expansionary, with the end effect of current interest rate settings aiming to slightly stimulate the level of demand growth.

The Reserve Bank is in a position to implement mildly expansionary monetary policy because inflation is deemed to be at manageable levels. This at least partially reflects the success of the previous period of higher interest in stemming inflationary pressures. In addition, generally weak global economic growth and subdued spending domestically have also detracted from price pressures.

The outlook for inflation

Although the high \$A and subdued demand has kept inflation under control in Australia, there are at least two key potential sources of future inflation. In the short term, the introduction of the carbon pricing regime may result in a temporary spike in price growth. However, from a policy setting perspective, the Reserve Bank has stated that it will “look-through” this affect, as policy shouldn’t be influenced by a temporary jump in price growth rates.

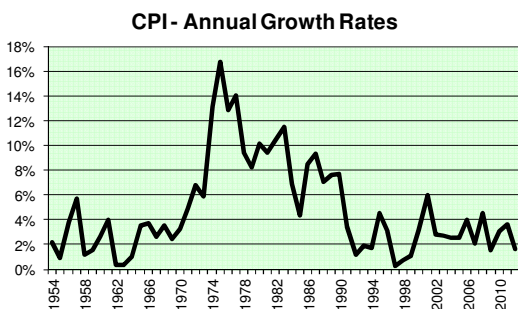
A second source of potential inflationary pressure in the Australian economy is the current tight labour market. When labour is in short supply, wages may be forced higher as firms compete for the scarce supply of workers. Higher wage costs may then flow through to higher price growth. With considerable expansion taking place in the mining sector, there remains a possibility that the direct and indirect demand for labour from this expansion may drive up wage costs.

In its latest Statement on Monetary Policy, the Reserve Bank suggested additional upward pressure on inflation may be forthcoming in the medium term, even though there may some weakness in the labour market in the short term:-

“There is the possibility that in the near term, labour shedding across a range of industries outside of the mining sector accelerates as firms continue to adjust to the high exchange rate, weakness in the property market and the effects of weaker public demand. Over the medium term, however, as mining projects progress into the more labour-intensive phase of construction, there is a risk that labour demand could pick up more than forecast.”

Longer-term comparisons

The “moderate” inflation currently prevailing is significantly lower than that which characterised the 1970s and 1980s. As shown on the chart below, current inflation is more comparable to the prolonged period in the 1950s and 1960s when inflation was maintained at very low levels.



Source: Australian Bureau of Statistics 6401.

The shift to low inflation over the past 20 years has largely been a global phenomenon. There are, however, some Australian specific factors that have assisted in the avoidance of a return to high inflation. Provided below are some reasons as to why Australia has been able to maintain low inflation rates over the past 20 years: -

Cheap imports - The growth in the manufacturing base of China, which is a low cost producer, has led to a lowering in the growth of import prices.

Reform in wage determination - There is now a closer link between the granting of wage increases and improvements in productivity. As such, the rate of wages growth is less likely to directly lead to pressure on prices.

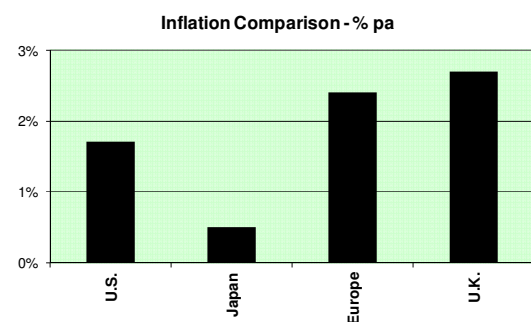
Inflation targeting – Monetary policy settings in recent times have been determined largely by the need to influence the rate of inflation.

Inflationary expectations - Inflation targeting has proved to be a credible commitment to low inflation. This has resulted in the lowering of inflation expectations.

Microeconomic reform- Reforms have driven costs down. Tariffs on imports have been cut and some non-competitive industries have been opened to competition e.g. telecommunications.

International comparison

Despite some fears that depressed demand and low money supply growth would lead to negative inflation, the continued implementation of loose fiscal and monetary policy in several overseas developed economies has seen inflation remain positive. Europe, the United States and the UK now have inflation rates at similar levels to those in Australia. Inflation in some emerging markets, including China, has been higher than the developed market average in recent times, largely due to the stronger levels of economic growth and demand in these economies.



Source: Reserve Bank of Australia. Current annual inflation.



Topic two: External stability

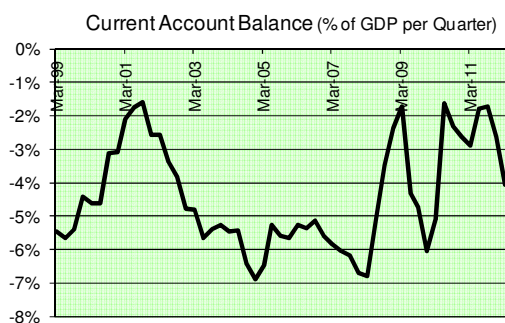
Although Australia has continued to experience positive economic growth and has benefited from improved terms of trade, there has not been uniform improvement across all measures of external stability. A summary of recent trends in these measures is provided below.

1. Current Account deficit

Whilst Australia's Current Account has consistently been in deficit, the size of the deficit has fluctuated significantly with economic cycles. Typically, the deficit has expanded during times of strong economic growth. This is because in times of growth, high overall spending causes import levels to increase by more than exports. The reverse is true when growth is weak.

In recent years, however, dramatic movements in commodity prices have tended to outweigh domestic influences on the trade accounts. Growing global demand for items that Australia exports has seen export receipts increase strongly. Of particular significance has been the increase in the price of commodities (e.g. iron ore, coal). This has led to an improvement in the trade accounts, although there was a brief down turn in export income associated with the Global Financial Crisis.

As the chart below shows, there has been some reversal of the improving trend in the Current Account balance over the past year. This could reflect the impact of the high \$A, which is making exports less competitive and imports cheaper.



Source: Australian Bureau of Statistics 5302

The largest contributor to Australia's Current Account deficit is the high negative balance on the income account. Interest payments on foreign debt make up a significant proportion of the income deficit. Other categories of income payments include profits payable to overseas shareholders of companies trading in Australia, wages to overseas residents and rentals to overseas landowners in Australia.

Current Account Items \$B	Year to March	
	2012	2011
Exports	\$ 264.6	\$ 242.6
Imports	\$ 243.2	\$ 216.9
Balance of Trade	\$ 21.4	\$ 25.8
Services Balance	\$ (10.1)	\$ (5.2)
Balance of Trade in Goods & Services	\$ 11.3	\$ 20.6
Net Income & Transfers	\$ (48.5)	\$ (53.2)
Current Account Balance	\$ (37.2)	\$ (32.6)

Source: Australian Bureau of Statistics 5302

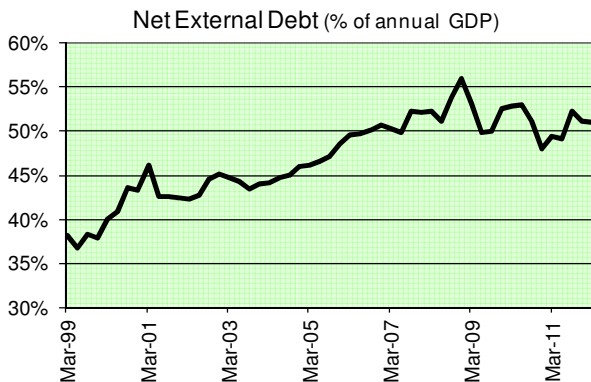
Unlike the Net Incomes account, the Balance of Trade has fluctuated between surplus and deficit in recent periods. Over the past year, exports have increased by less than imports, which has led to the Balance of Trade surplus contracting.

Australia has previously run large deficits on the Services Account, however growth in income from industries such as tourism and education to overseas students, have helped keep the Services Account in modest surplus or small deficit in recent years. Over the past two years, though, the Services deficit has expanded as competitiveness in industries such as tourism has been eroded by the appreciating \$A.

2. Foreign debt

Australia has experienced significant growth in the level of foreign debt over the past 3 decades. In June 1980, the net external debt for Australia was only \$6.9 billion or 5.8% of GDP. Following a period of high trade deficits, foreign debt levels increased markedly over the 1980s before stabilising in the mid 1990s. Foreign debt then reached new highs in 2008 after accelerating again since the year 2000. In March 2012, the value of the net foreign debt was equivalent to 51% of GDP, which is below the peak of 56% reached at the end of 2008.

Hence, as Australia maintains a deficit on the Current Account, there has been an ongoing need to borrow funds to finance the gap between what is earned and spent between Australia and overseas. The strength of the Australian dollar over the past three years has offset some of the natural growth in the debt. A higher \$A reduces the monetary value in \$A terms of any debt domiciled in foreign currencies.



Source: Australian Bureau of Statistics 5302

However, not all the finance coming into Australia is in the form of borrowing. Finance can also be in the form of equity investments (which tend to be purchases of Australian property or shares by overseas entities). Unlike borrowings, equity investments do not add to debt. Currently, only 16% of Australia's net foreign liabilities are in the form of equity, with the remaining 84% in the form of debt. The ratio of equity has increased since late 2008 when it was as low as 2%. Following the Financial Crisis, some companies chose to raise equity (via new share issues) in preference to debt, which had become more expensive to obtain. None-the-less, equity financing, it is still well below the 30% share of total offshore financing it held in the mid 1990s.

Foreign Liabilities	\$ Billion in March 2012	% of Total
Net Foreign Debt	\$677	87%
Net Foreign Equity	\$103	13%
Total Foreign Liabilities	\$781	100%

Source: Australian Bureau of Statistics 5302

External stability outlook

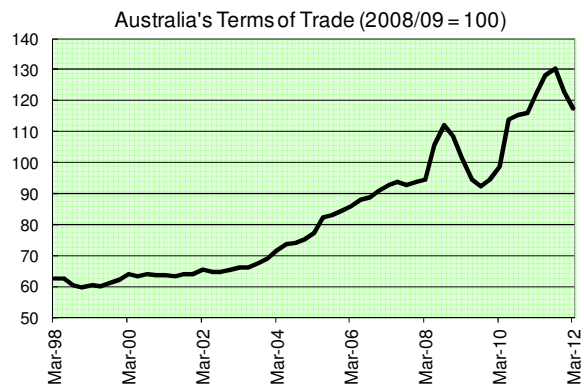
Since the 1990s, Australia's external stability has not been a matter of much concern. The economy has been growing strongly, Government debt has been low and the currency relatively strong. However, discussed below are some factors that could potentially cause future disruption in external stability.

1. The vicious trade deficit – debt circle

Even if Australia experiences some further improvement in its Balance of Trade, the high foreign debt means any significant improvement in the Current Account deficit will be difficult. This is because the high debt creates interest servicing costs which drive the net income outflow on the current account. A "vicious circle" can therefore be created whereby high debt leads to higher interest payments, which leads to a higher Current Account deficit, requiring more debt. A rise in interest rates or a fall in the value of the \$A could exacerbate this vicious circle.

2. A correction in the terms of trade

Since the mid 2000s, there has been a significant improvement in Australia's Terms of Trade. A worldwide boom in commodity prices has seen the price of our exports rise, and a lowering in manufacturing costs has muted growth in import prices. However, with the Terms of Trade now so high, there is an increased vulnerability of some form of downward correction and there has been some weakness over the past year. Commodity prices are historically quite volatile. The chart below shows the extent of improvement in the Terms of Trade since the mid 2000s.



Source: Australian Bureau of Statistics 5206

3. Weak non-mineral exports

A relative decline in non-mining related exports has made Australia's external position more vulnerable to a downturn in the mining sector. Between September 2001 and March 2012, rural items have dropped from representing 25% of exports to just 13%.

Similarly, increasing competition from China and other newly industrialising nations has made it more difficult for Australian manufacturing exporters to compete, further increasing the reliance on mineral exports.



Topic three: Unemployment

With Australia's economy recording a prolonged period of high economic growth up until 2008, unemployment had reached 30-year lows. Even through the period of lower economic growth associated with the Global Financial Crisis (GFC), there was only a minimal lift in unemployment from these lows.

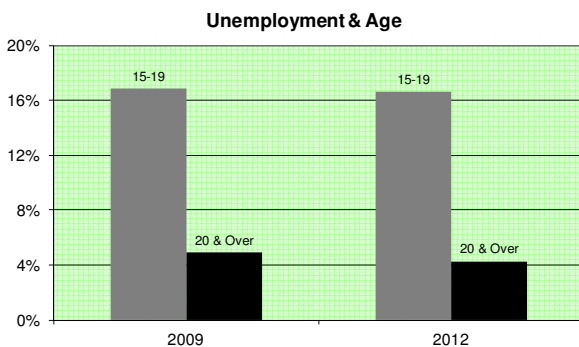
After reaching a low of 4.0% in February 2008, Australia's unemployment rate gradually increased, reaching 5.9% in mid 2009. Since then, the unemployment rate has declined back to be 5.1% in May this year. The table below shows that over the past decade there has been a solid rise in the number of workers employed and a small decline in the number unemployed.

Month - May (000s)	2012	2011	2002
Workers Employed	11,538	11,426	9,224
Workers Unemployed	623	596	624
Unemployment Rate	5.1%	5.0%	6.3%

Source: Australian Bureau of Statistics 6202

Unemployment and age

Unemployment remains considerably higher for younger members of the workforce than for the general workforce population. Of those in the workforce aged between 15 and 19, some 16.6% were unemployed during May 2012. This rate of unemployment is up from 14.9% in May 2011, and much higher than the pre GFC level of 11.4%.



Source: Australian Bureau of Statistics 6105

Unemployment and location

As the table below shows, unemployment is at similar levels across most of the states of Australia, with the two territories and Western Australia enjoying the lowest rate.

Unemployment by state			
NSW	4.9%	SA	5.2%
VIC	5.5%	TAS	7.3%
QLD	5.5%	ACT	3.4%
WA	3.8%	NT	4.0%

Source: Australian Bureau of Statistics 6202. Trend Series.

Generally, unemployment is lower in the capital cities than in regional areas. The increased employment opportunities in the metropolitan areas have been one factor driving a long term population shift to Australian cities. In recent times, however, there have been large reductions in unemployment in many of the non metropolitan regions in Western Australia and Queensland. More buoyant conditions in the mining industry in these regions have boosted employment prospects.

Long term unemployment

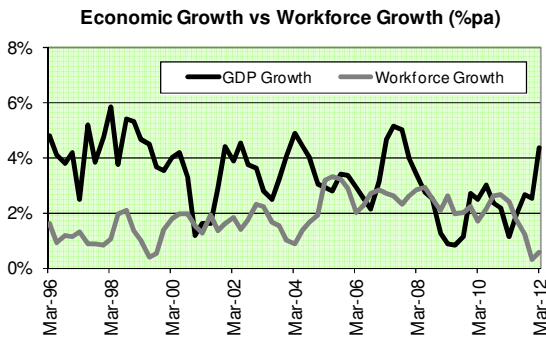
The long-term category of unemployment, covering those out of work for more than one year, is less responsive to shorter term fluctuations in economic cycles. Trends in long term unemployment tend to lag movements in total unemployment. The rate of long term unemployment is currently near its lowest level in two decades at just 1.0%. This compares to a cyclical peak of 3.7% in mid 1993.

Underemployment

Excluded from the unemployment numbers are those workers who are in part-time employment but have a desire to work more hours than is offered by their employer. These workers are referred to as being "underemployed". In May 2012, some 26% of part-time workers desired additional hours. This equates to an "underemployment" rate of 7.2% across the workforce.

Cyclical influences on employment

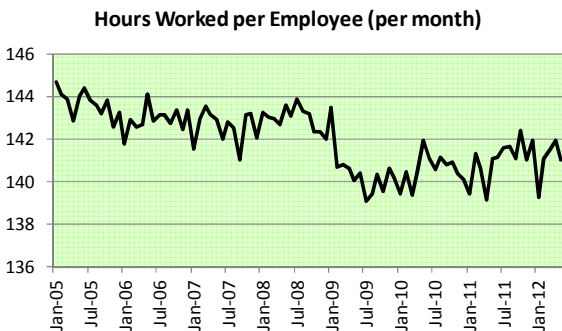
Much of the movement in the rate of unemployment can be explained by changes in the rate of economic growth. Over the past three years, the rate of unemployment has been able to fall back towards its cyclical lows. This is likely to be due to the fact that the rate of economic growth has been above the rate of growth in the workforce population (i.e. those either employed or seeking employment) for much of the past three years, as shown below.



Source: Australian Bureau of Statistics 6202 & 5206

In addition to influencing the actual level of unemployment, changes in the economic cycle can also impact the utilisation of employed workers. As the Australian workplace system is relatively flexible, working hours can fluctuate with the demand for labour. A reduction in hours worked can reflect a fall in the relative share of full time employment and a rise in part time employment. This is typical of a period in which there is a rise in “underemployment.”

During the period of softer economic growth following the Global Financial Crisis, there was a material fall in the number of hours worked, as shown on the chart below. The ability for employers to reduce working hours per employee may have been an important factor in avoiding the need for large scale increases in unemployment during this period.



Source: Australian Bureau of Statistics 6202

Policies to manage unemployment

As unemployment is heavily influenced by economic cycles, it is indirectly managed via the Government’s macro-economic policies. The easing of both fiscal and monetary policy during the Global Financial Crisis period had the indirect aim of reducing the extent of increase in the rate of unemployment. Similarly, the Government’s cash stimulus payments to households are likely to have had quite a direct and immediate impact on employment levels. This is particularly so in the retail sector, which is one of the largest sectors of employment in the Australian economy.

In addition to macro economic policies design to manage cyclical unemployment, various Government policies are also aimed at reducing frictional and structural unemployment. Policies aimed at reducing frictional unemployment are centred on an improvement in the flow of information in the labour market and matching job seekers with vacancies. Structural unemployment is targeted largely via training schemes.

Across the whole Australian economy in May 2012, there was an estimated 174,700 vacant positions. This highlights the possible extent of frictional unemployment; with the number of vacancies being some 28% of the overall number of unemployed workers.

From July 2009, the Commonwealth Government’s initiatives around reducing frictional and structural unemployment have been centred on the “*Job Services Australia*” program. This employment service replaced the previous Job Network program. “*Work for the Dole*” and the Green Corps work programs were enhanced and incorporated into the new program as ways of providing work experience. The new employment service program contains elements of both jobs matching and providing various forms of training and vocational assistance for those not able to move directly into employed positions.

One particular type of “frictional” unemployment in Australia currently is related to the disparity between the geographical location of mining jobs and the location of potential workers. To assist with the movement of labour to areas where employment is available, the Government commenced the “*Connecting People with Jobs*” program in January 2011. The initiative provides assistance to long term unemployed job seekers who relocate for employment, with amounts of up to \$9,000 available for those relocating.

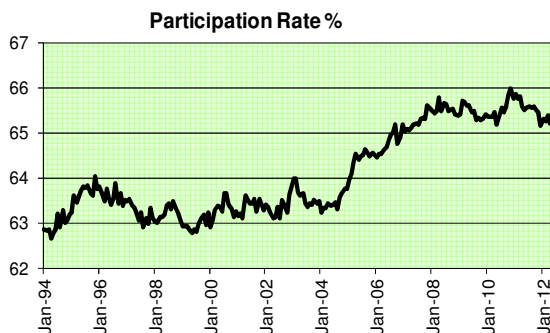


Topic four: Labour markets

Following the change in the Commonwealth Government in late 2007, one of the major policy shifts has been around labour markets and the winding back of various aspects of the previous Government's "WorkChoices" legislation and replacement with Fair Work Australia. Changes in policies combined with changes in the economic climate have impacted on recent trends in various parts of the labour market. These trends are discussed below.

1. Rising labour force participation

The participation rate (i.e. the percentage of the adult population employed or seeking employment) has increased over time as shown in the graph below.



Source: Australian Bureau of Statistics 6202

After a significant rise in workforce participation in the second half of the 1980s, another strong increase took place between 2004 and 2008. There has been some steadying in this trend since the start of 2008. This steadying could be attributable to a lower rate of economic growth, which may discourage entry into the workforce. As the accompanying table would suggest, much of the increase in participation that has taken place since the mid 1980s appears to be as a result of higher female participation, which has jumped from 46% to 59%. Male participation has actually declined by 3.9% over the same period; but at 72%, it still remains well above the female percentage.

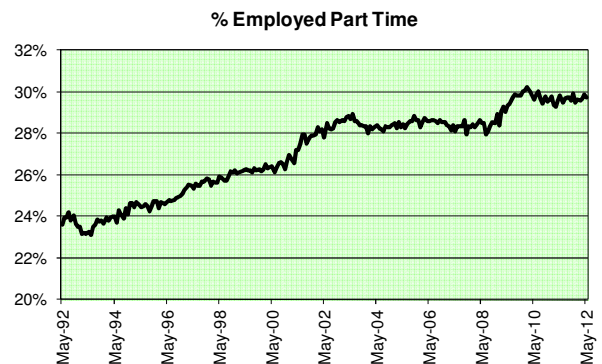
Participation Rate	1985	2012
Males	75.8%	71.9%
Females	46.0%	59.2%
Total	60.7%	65.5%

Source: Australian Bureau of Statistics 6202

The Government has placed greater focus in recent times on increasing the rate of workforce participation as a response to the potential shortage of labour brought about by the ageing of Australia's population. Policies aimed at encouraging participation include attempts to make it more difficult for single parents to remain on welfare once children reach school age; as well as increases made to the age pension retirement age from 65 to 67 (for those born after June 1952). From 2013, those aged 70 to 75 years will also be eligible to have employer funded Superannuation Guarantee contributions made on their behalf for the first time.

2. The growth of part time work

The composition of employment changed significantly in the 1990's. There was a shift away from full-time employment with most job creation being casual and part-time. This may be at least partially explained by the growth in certain service industries such as hospitality and tourism where part-time and casual work is sometimes more suitable.

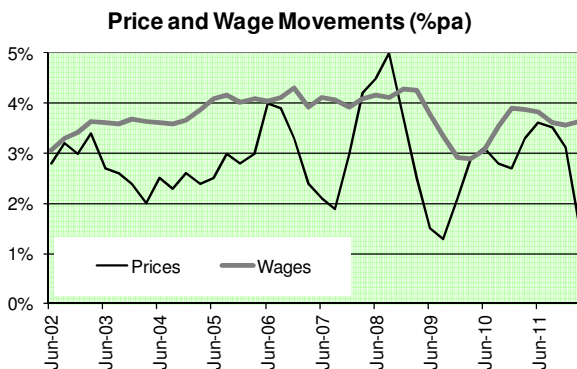


Source: Australian Bureau of Statistics 6202

Between the years 1990 and 2012 the increase in part time employment has been 106%, compared with only 30% in full time employment. Part time workers currently make up 30% of all employees. Some 46% of females work part time compared with just 16% of males.

3. Moderate real wage growth

As can be seen on the chart below, wages growth (as measured by movements in the Wage Price Index) has averaged a slightly higher growth rate than inflation. Some of this gap can be explained by improvements in productivity providing scope for higher wages. Another explanation is that the downward trend in the cost of manufactured imports has pushed inflation down below wages growth.



Source: Australian Bureau of Statistics 6302 & 6401

Although labour costs have been rising by more than inflation, the increase has been moderate. In the year to March 2012 the increase in the Wage Price Index of 3.6% was a little over 1% above the mid-point of the Reserve Bank's target range for inflation.

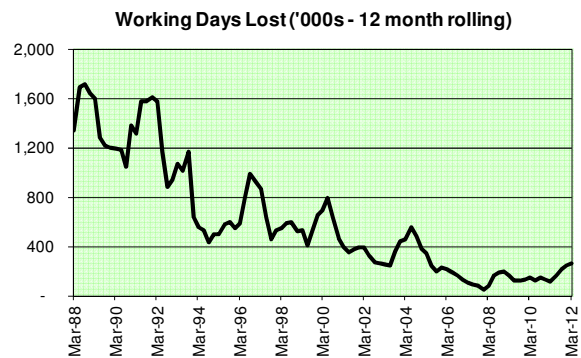
4. Falling trade union membership

Unions are formed to protect the interests of employees in relation to issues such as occupational health and safety, employee entitlements and pay. Unions have the role of representing and aiding employees in the enterprise bargaining process and acting as the employee representative before Fair Work Australia.

In August 2011, 18% of employees were trade union members. This ratio was at the same level one year earlier. There has been a large decline over the longer term, with the rate of union membership in 1990 being 41%.

5. Falling industrial disputes

There has been a significant improvement in the number of work days lost due to industrial disputes (strikes) in recent years. Compared with the 1980s, there has been an 85% drop in days lost due to industrial disputes. The fact that industrial disputes are now a less popular way to resolve disagreements between employees and their employers has positive implications for productivity and business confidence. There has, however, been an increase over the latest year, with days lost rising from 117,500 to 257,600 between the years ended March 2011 and March 2012.



Source: Australian Bureau of Statistics 6321

Workplace system changes

In July 2009, new industrial relations laws came into effect. Known as the Fair Work Bill, the new legislation effectively dismantled the previous Government's Work Choices system.

Included in the new workplace system was the formation of a new single workplace regulator named "Fair Work Australia" (FWA). The new body is responsible for approving changes in workplace agreements and awards between employers and employees or unions; setting minimum wage levels; as well as dispute resolution and arbitration. The FWA body replaced the previous Australian Industrial Relations Commission and the Australian Fair Pay Commission.

The new legislation also provides more support for the notion of collective bargaining (i.e. where employers negotiate workplace conditions with groups of employees or unions, rather than individuals). Under the new arrangements, it is compulsory for employers to recognise and bargain with employee group representatives. This is in contrast to the previous "Work Choices" legislation that gave employers the right not to negotiate on a collective basis.



plain-english

economics

Topic five: Financial Markets

Financial market structure

Few industries have changed as much in structure as has the Finance Industry over the past 25 years. Prior to the 1980s, the financial sector was heavily regulated with fixed exchange rates and controls on virtually all aspects of banking operations, including interest rate levels.

However, international trends, a growing non bank (and less regulated) financial sector and a realisation of structural inefficiencies resulted in the Government embarking on a program of deregulation in financial markets. The result has been one of rapid structural change with the Australian financial sector now regarded internationally as being highly competitive, efficient and stable.

Throughout the last two decades, there have been numerous mergers between financial institutions in response to increased competition. This rise in competition is also evident through a narrowing of bank interest margins. Legislative changes have also removed many of the distinctions between banks and other kinds of financial institutions. This has encouraged the growth of corporations with activities spanning across the fields of banking, insurance and funds management.

The table below shows the share of assets held by the different categories of financial institutions.

Institution Type	% of Industry Assets	
	2002	2012
Banks	47%	61%
Building Societies	1%	0%
Credit Unions	1%	1%
Money Market Corporations	4%	1%
Finance Companies	5%	2%
Life Offices	10%	4%
Super Funds	17%	21%
Other Managed Funds	10%	6%
Securitisation Vehicles	6%	3%
Total Industry	100%	100%

Source: Reserve Bank of Australia

As can be seen from the table, banks have become increasingly dominant over the past decade, with most other categories of institutions and investments declining in relative terms.

Recent trends in financial markets

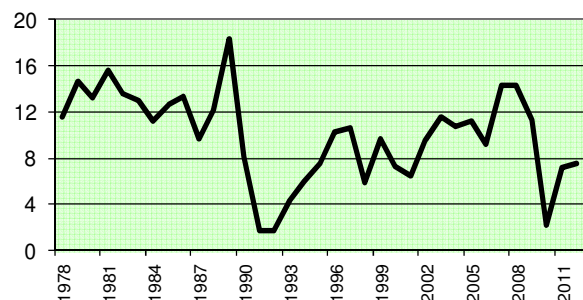
Activity in financial markets has a close relationship with trends in the real economy. Recent trends in a few of the key financial market variables are discussed below.

(i) Money supply movements

With the widespread acceptance of aspects of monetary theory around the globe, central banks in the past tended to adopt specific money supply growth rate targets in an attempt to control the level of inflation. According to monetary theory, it is the growth rate in the money supply (combined with the velocity at which this money supply is circulated) that is a determining factor of the level of output and price growth in the economy.

Increasingly, however, the practice of targeting the money supply growth rate was seen as a very "blunt" policy tool, with long time lags and minimal precision in execution. As a result, the Reserve Bank (RBA) abandoned the practice of targeting money supply growth rates in the mid 1980s.

Broad Money - Annual Growth %



Source: Reserve Bank of Australia. Year ended June (except May in 2012).

Money supply growth, however, remains a useful economic indicator and is still used to assess economic trends. With financial deregulation resulting in more readily available finance for both households and businesses, money supply growth can play an important role in driving

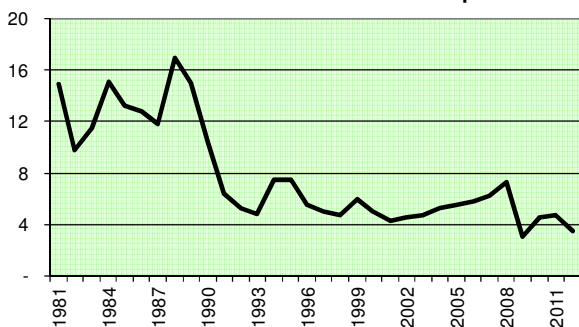
spending and creating demand-pull inflation. The correlation between money supply growth and increases in asset prices (mainly property and shares) has also been particularly strong in recent years.

The above chart shows money supply growth fluctuating significantly. Growth peaked at around the 20% level with the asset price boom of the late 1980s before falling to less than 2% in the recession of the 1990s. In the year to May 2012, the rate of growth in the Broad Money measure has been 7.5%, which is a pick up from lows of the post GFC period but well below the growth rates in excess of 18% that were recorded early in 2008. The slowdown in the rate of growth of the money supply is consistent with a lower rate of economic growth, a more constrained supply of funds available on global financial markets and a more conservative attitude to borrowing by businesses and consumers following the GFC.

(ii) Interest rate movements

With low inflation in place for several years, Australia has been able to maintain low and stable interest rates. This was not the case in the 1980s however, when high inflation and periods of weak currency meant that interest rates were consistently above 10%. Rates peaked at around 17% in 1989 following a period of monetary policy tightening, which was aimed at slowing economic activity in order to bring about stability in the Current Account and inflation.

Official Cash Interest Rates % pa



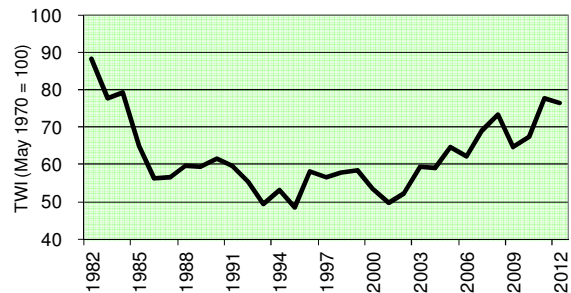
Source: Reserve Bank of Australia

From a cyclical peak of 7.25% in September 2008, the Reserve Bank progressively lowered cash interest rates to 3.0%. As was the case with central banks around the globe, the Reserve Bank eased policy quickly over this period in an attempt to protect economic growth and avoid any deflation pressures stemming from the Global Financial Crisis. Interest rates were then lifted to a peak of 4.75% at the end of 2010 as the economy recovered, before being reduced again to their current level of 3.5%.

(iii) Exchange rate movements

Following the floating of the Australian dollar in 1983, the value of the exchange rate has been determined by the supply and demand for \$As on international currency markets. The RBA will still buy and sell \$As in foreign exchange markets to help stabilise the value of the \$A in certain periods. None-the-less, the \$A has experienced several periods of instability since deregulation.

Trade Weighted Index



Source: Reserve Bank of Australia

As shown on the above chart, the 1980s was a period of sharp decline for the Australian currency. For much this period, Australia had higher inflation rates than its trading partners. This meant there was a natural devaluation occurring to adjust for changes in the purchasing power of the currency. In addition, periods of concern over the nation's trade deficit acted as a catalyst for some sudden loss of market support for the dollar, causing it to fall in value rapidly.

In contrast, from 2001 onwards, the \$A jumped by some 54% as strong support has come from a rise in the Terms of Trade. This rise was temporarily brought to an end with another period of sharp decline with the GFC in the second half of 2008 – although this decline was quickly reversed in 2009. As at June 2012, the \$A was valued at 76.5 points on the Trade Weighted Index. Over the past year, the \$A has pulled back slightly from cyclical highs due to some weakening in commodity prices and a narrowing of the positive interest rate differential between Australia and overseas.

(iv) Pressure for re-regulation

With the activities of financial institutions being central to the events surrounding the Global Financial Crisis and with many financial institutions facing substantial losses, there have been new regulations introduced for the financial institutions around the globe. A component of this renewed focus on regulation has been a global requirement for banks to increase their level of capital reserves.



plain-english

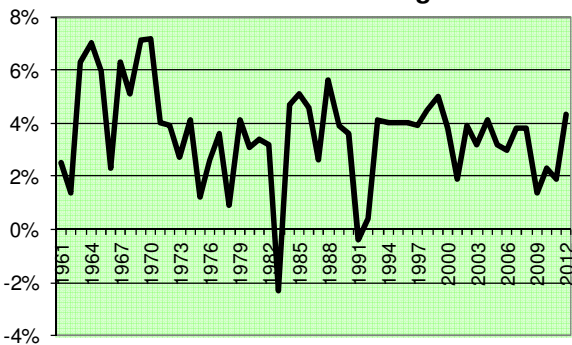
economics

Topic six: Economic growth

The chart below shows the annual growth rate of GDP (Gross Domestic Product) recorded for the Australian economy each year since 1961. Growth rates shown are real rates i.e. adjusted for inflation.

The chart highlights that economic growth rates are far from being steady over time, and are highly cyclical in nature. Since the early 1960s, average annual growth has been 3.5%. The latest growth rate for the 12 months to March 2012 is above this longer term average at 4.3%. The value of GDP over the year to March was \$1,367 billion.

G.D.P. - Annual % Change



Source: ABS 5206. Note: Data is for years ended June, except for 2012 which is the 12 months to Mar 2012.

It can be seen from the above chart, that there have been periods of distinct weakness in growth. Downturns have taken place in the early 1960s, the mid 1970s, the early 1980s and the early 1990s and most recently in the late 2000's.

A variety of factors have contributed to these downturns. External shocks such as the oil prices rise in the 1970s have played a role, as did the drought in the early 1980s. An extreme tightening of monetary policy in the early 1990s, in response to an escalating current account deficit, was a significant influence on growth rates during this period. The GFC also triggered a drop in growth in the 2008/09 period.

Outside of the down turns and the abnormally high rate of expansion in 1960s, growth in other periods has tended to hover between 3% and 4%.

The decade between the mid 1990s and mid 2000s was notable for the consistency of economic growth, which generally prevailed at higher and steadier rates in Australia than occurred globally.

External influences have been highly variable with events such as the Asian economic crisis in 1998, generally weak global economic growth between 2002 and 2004, a commodities boom between 2004 and 2008, and most recently the GFC all providing external shocks to the Australian economy. However, growth in Australia has been relatively well insulated from external shocks. The role of the floating Australian dollar has helped "cushion" the impact of variations in global economic growth whilst relatively stable inflation and low government debt have also assisted.

Components of economic growth

Of the items making up aggregate demand, consumption expenditure by households is by far the largest item and has also been the biggest contributor to economic growth in recent times. The table below provides an overview of the size of the components of aggregate demand.

Aggregate Demand	\$ Billions	% of Total
Household Consumption	786	54%
Government	331	23%
Business Investment	249	17%
Dwelling Construction	72	5%
Inventories	7	0%
Exports	315	22%
Imports	(303)	-21%
GDP	1,456	0.7%

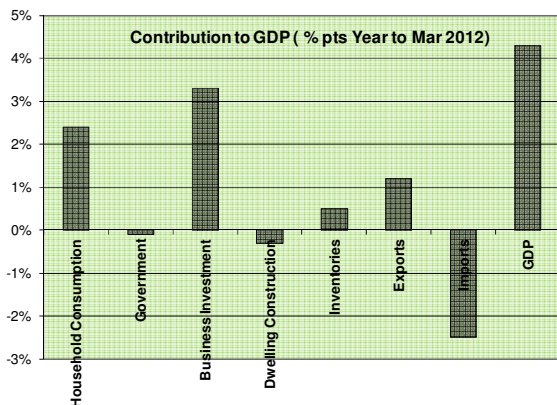
Source: ABS 5206. Year to March 2012

In addition to being the largest item, consumption spending tends to be the most stable item over time. Despite being smaller in aggregate size, variations in the other more volatile items such as exports and investment spending can still have a significant impact on the rate of economic growth.

Notwithstanding its stability, consumption has provided the main impetus to growth for much of the past decade. Consumption has made up around 63% of the increase in the size of the aggregate demand over the past 10 years, with business investment accounting for 40%.

The growth in spending on consumption and investment has not been matched by domestic production. As a result, imports have risen significantly. Growth in imports far outstrips growth in exports in volume terms, producing a net negative contribution to growth from the external sector over the past decade.

Over the past two years, the growth in the mining boom and more conservative consumption patterns by households has resulted in investment spending becoming an increasingly important source of demand growth. The chart below shows the relative contribution to growth that has come from each component of aggregate demand to make up the 4.3% expansion that has taken place in the Australian economy in the 12 months to March 2012.



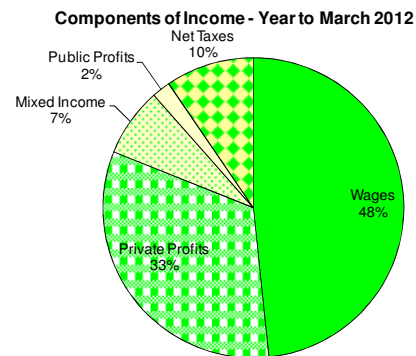
Source: Australian Bureau of Statistics 5206 (a rise in imports is shown as a negative contribution to GDP)

Hence over the past year, business investment growth has been more important than consumption in its contribution to incremental demand in the economy. However, a significant component of this demand has been directed at imports, with the higher \$A stimulating new demand. Hence not all the additional spending has generated a rise in domestic production.

Growth in profits

The production of goods and services generates income for the factors of that production. Therefore the overall level of income is equivalent to the value of production in the economy (which is also equal to the level of aggregate demand). Wages/salaries and private sector profits are by far the largest components of income. In recent years there has been an increase in the size of profits relative to wages. Over the past two decades, profits have increased in their share of total factor income from 28% to 33%.

The chart below provides the current split between categories of income in Australia: -



Source: Australian Bureau of Statistics 5206

A rebound in household savings

After falling significantly earlier this decade, the rate of household saving has bounced back strongly in recent times. Between the year to March 2006 and the year to March 2012, the level of household disposable income has increased 53%. Over the same period, the level of consumption spending has only increased 42%, implying that there has been a swing in the allocation of income to saving rather than spending.

The household savings ratio represents the percentage of household disposable income that is saved rather than spent. For the year to March 2012, the savings ratio has averaged 10%. This ratio was negative or very low for much of the period between 2002 and 2004.

Productivity growth

For economic growth to be sustainable over the long term there needs to be an improvement in the level of productivity i.e. an increase in the level of output from a given set of inputs (factors of production). This productivity growth will often result from past investment expenditure. A common measure of productivity is based around dividing the level of output by the number of hours worked by the labour force.

In 2010/11, labour productivity declined by 1.2%, with hours worked rising at a faster rate than production. Over a longer term perspective, productivity growth in recent years has slowed down, with the improvement in output per unit of labour averaging an annual growth of 0.6% over the 5 years to 2011. This compares to a 2.5% p.a. improvement in the second half of the 1990s.



plain-english

economics

Topic seven: Ecologically sustainable development

In the last two decades, there has been a growing recognition by Governments around the globe that economic progress must be ecologically sustainable. Reflecting this recognition, various initiatives have been put in place both locally and globally to support sustainable development. Some recent initiatives are discussed below.

A global focus

In June this year, the United Nations held its largest conference ever when 30,000 people met in Rio de Janeiro for the “Rio+20” Sustainable Development conference. Attendees at the conference included Australia’s Prime Minister and around 100 other world leaders. The Rio+20 conference continued a series of attempts by governments around the globe to make economic development more sustainable, following on from the initial “Earth Summit” held in 1992.

Amongst the outcomes of the Rio+20 conference was an agreement to develop a set of global sustainable development goals. In addition it was agreed that measures would be pursued that promote corporate sustainability reporting; whilst there will also be attempts to go beyond GDP as a way to make an assessment of the well-being of a country.

Much of the primary global concern in recent years has been that of global warming as a result of the emission of “greenhouse” gases. International efforts to slow global warming culminated in the Kyoto Protocol coming into force in February 2005. The protocol set targets for greenhouse gas emissions between 2008 and 2012 to be an average of 5% less than the level recorded in each participating nation in 1990.

In a conference in Durban, South Africa, in November 2011 there was broad agreement to develop a post Kyoto agreement on carbon reduction that would include developing countries. Negotiations on this agreement are to be finalised by 2015 with the new targets coming into effect in 2020.

A focus within Australia

In 1992, the same year as the Earth Summit, all levels of Australian Governments signed a “National Strategy for Ecologically Sustainable Development”. According to the Australian Government’s Department of Heritage and the Environment, the National Strategy for Ecologically Sustainable Development (ESD) provides:-

“Broad strategic directions and framework for governments to direct policy and decision-making. The Strategy facilitates a coordinated and co-operative approach to ecologically sustainable development and encourages long-term benefits for Australia over short-term gains.”

The National Strategy was followed in 1999 by the *Environment Protection and Biodiversity Conservation Act*, which aims to encourage sustainable development through the conservation and ecologically sustainable use of natural resources. A copy of this Act and the National Strategy for Ecologically Sustainable Development can be found at the web address:-

www.environment.gov.au/esd/index.html

The Australian Bureau of Statistics has published a document that “describes the concept of environmental-economic accounting as a means of linking the environment and economy”. This document can be found at abs.gov.au (catalogue no. 4655.0.55.001).

Much of the political and community activity within Australia around sustainable development is focused on greenhouse gas management and water conservation initiatives. These are discussed below.

Greenhouse gas management

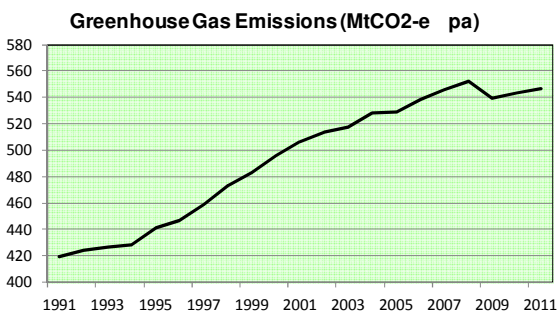
The first official act of the Australian Government when elected in 2007 was to sign the Kyoto agreement. After signing the agreement in December 2007, the then Prime Minister, Mr. Rudd, described the Kyoto Protocol as “*the most far-reaching agreement on environment and sustainable development ever adopted.*”

For Australia the treaty created a legally binding restriction of greenhouse gas emissions to a level equivalent to 108% of our 1990 levels.

Australia was also a party to the *Copenhagen Accord*. In line with the Accord's requirement to set voluntary targets for greenhouse gas emissions for the year 2020, the Australian Government re-affirmed its commitment to a 5% decrease in carbon emissions from year 2000 levels by 2020. A larger decrease of up to 25% may be committed to if there is global agreement on carbon targets.

In addition to the obligations of the *Kyoto Protocol* and the *Copenhagen Accord*, Australia introduced a carbon price mechanism on 1 July 2012. This fixed price carbon scheme will be in place for 3 years with the initial price being \$23 a tonne. The fixed price will then be replaced by a "cap-and-trade" scheme, which is ultimately expected to be linked to a wider international carbon market.

The "cap-and-trade" scheme that will replace the fixed carbon price is the preferred long term carbon pricing scheme of the Government. A "cap-and-trade" scheme involves the Government setting an overall limit on emissions and then issuing permits to produce emissions up to this level. Permits would effectively become the right to produce emissions of a specified quantity and holders of permits could trade these permits at a market determined price. Emission volumes could then be reduced over time by a lowering of the allowable quantity of emissions attached to each permit, or by the Government buying back permits.



Source: Department of Climate Change. Excludes emissions from land use, land use change and forestry.

As indicated on the chart above, emissions have been on a general upward trend in Australia. Australia's rate of emissions also remains high on an international scale. This reflects a high proportion of power being generated from burning fossil fuels, with electricity generation the largest single contributor to greenhouse gas emissions.

However, a **Renewable Energy Target Scheme** that was introduced in 2009 will require that 20% of electricity is generated from renewable sources by 2020. Over the past two years there has been some small reduction in emissions from electricity in Australia. This largely reflects a reduction in demand, with higher prices and relatively mild winters and summers in some regions having an impact on electricity consumption.

Water initiatives

Perhaps of a higher importance to Australia's environmental agenda than in many other nations, water management has received considerable focus in Australia.

In 2004, the Commonwealth Government agreed with the majority of State Governments on a new "National Water Initiative" agreement. The initiative aims to increase the "productivity and efficiency of Australia's water use and the health of the river and ground water systems." The National Water Initiative includes the development of a system of water access entitlements to provide entitlement owners with a tradable right to use a specified share of water.

By strengthening the system of water entitlements for heavy users, it is expected that a more efficient allocation of the scarce water resource will be created. If there is a robust and efficient market in place for heavy users, those users and potential users who have the most productive use for water will be in a position to pay the highest price for the entitlement to use that water. This should ensure that water entitlements will be sold to those users who are in a position to create the most value from water.

Of particular concern in terms of Australia's water management is the health of the Murray-Darling river system, on which a large proportion of Australia's food production is dependent. In July 2008, the Council of Australian Governments signed an *Intergovernmental Agreement on Murray-Darling Basin Reform*. The agreement establishes centralised governance of the basin.

In April 2009, the Commonwealth Government made an additional commitment of \$12.9 billion over 10 years as part of the new *Water for the Future* program. This program aims to secure the water supply of all Australians in response to water shortages believed to be being produced by climate change. As part of this program, the Government has purchased some water rights from existing holders as a means to reduce water usage from the Murray Darling river system.



plain-english

economics

Topic eight: Globalisation

Notwithstanding the fact that economies around the globe have always been linked in some form, it is apparent now, more than ever before, that the nature and process of production is not confined within national boundaries. Increasingly, firms operate with a global perspective, not only in selling products to multiple nations, but also shifting production to locations around the globe that offer the best prospects for cost minimisation and productivity. The growing dominance of multi-national corporations and the corresponding decline of locally based firms is one of the most observable impacts of globalisation.

Undoubtedly technology has played a strong role in the acceleration of globalisation. Enhanced communication and travel has made it possible for economic agents to be managed regardless of physical location. The same technology has facilitated a convergence of consumer preferences and trends, and has made the quick replication of worldwide best practice production techniques between firms possible.

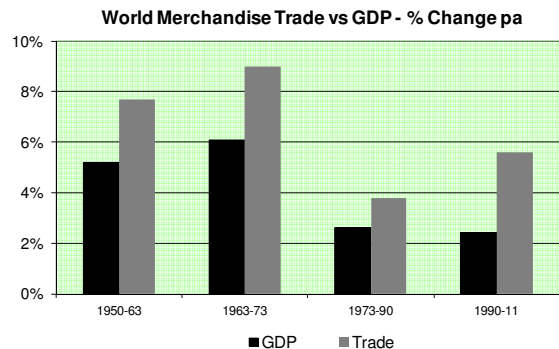
The global shift to free trade

In addition to the role played by technology, another significant driver of globalisation has been the ongoing shift towards free trade. The economic rationale for free trade is well documented and has support from Governments around the globe. However, there is not necessarily a benefit if a nation removes trade protection measures itself without reciprocal removal of trade barriers by others. Therefore the shift to free trade is often performed under agreements that are bi-lateral (between two nations) or multi lateral (between many nations).

The body that co-ordinates and enforces multi-lateral agreements is the World Trade Organisation (WTO). Any country having full autonomy in the conduct of its trade policies may become a member of the WTO, subject to the agreement of the member nations. The inclusion of communist ruled China as a member in 2001 was significant not only due to the size of the Chinese economy, but also because it is indicative of the widespread support for free trade principles across the political spectrum. There are

currently 155 nations being members of the WTO. Russia was accepted for full membership in December 2011 and is in the process of having this membership fully ratified.

Free trade has encouraged the growth of trade volumes between nations. The WTO reports that in 2011, some \$US 18,200 billion in merchandise exports were sold across the globe. The volume of trade has grown at an average rate of 5.4% per annum in the decade since 2001. Over the same period, growth in global production volumes has been just 2.6%. The chart below shows that merchandise trade has consistently risen at a faster rate than overall economic output.



Source: WTO

The WTO has reported that the volume of world trade rose by 5% in 2011. This was below the growth rate of 14% in the previous year when trade was recovering from a downturn associated with the GFC that saw trade volumes drop 12% in 2009. This was the biggest fall in trade volumes for more than 70 years.

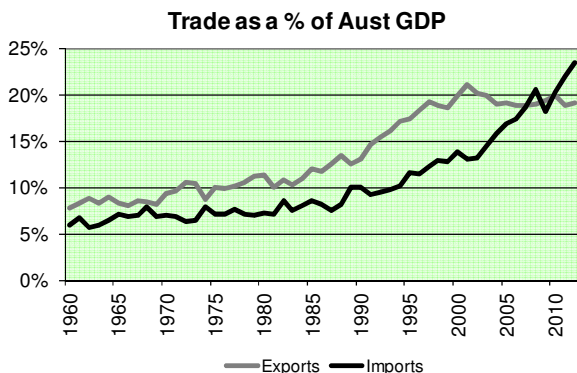
Members of the WTO have for some time been in the process of negotiating the "Doha" agenda of free trade initiatives. The Doha agenda covers agreements in agriculture, manufacturing (where there is a target for zero tariffs) and for the first time there is a significant focus on trade in services. However, progress on the agreement has stalled and the lack of any convergence of views has caused slippage in the negotiation timetable. There remains a commitment by the G20 Group of Nations to complete the negotiations. However, in June, the Director-General of the WTO described the rise in the use of trade restrictions since the GFC as a cause for "serious concern". This suggests that in difficult economic times the commitment to free trade may have waived somewhat.

Growth in Australian free trade

Australia has long been an active supporter of free trade. Over the past three decades Australia has reduced and removed many forms of industry protection as well as being a key participant in bilateral and multi lateral trade agreements. One of the more significant changes in protection levels has been in the manufacturing industry. In 1972/73 the typical tariff imposed on manufacturing imports was 22%. In 1973/74 this fell to 17% and has continued to progressively decline. In many cases these tariffs have now been removed.

Some industries remain protected with the Textile, Clothing and Footwear (TCF), and Motor Vehicle industries accounting for two-thirds of all tariffs. Following a program of tariff rate reductions in the TCF industry, there remained a 25% tariff applying to imports. These tariffs fell to 17.5% in 2005 with a further reduction to 10% in 2010. In the Motor Vehicle industry, tariffs were previously in excess of 50%. However these have also been phased down, with the latest reduction from 10% to 5% coming in January 2010.

Consistent with the trend internationally, the size of overseas trade in the Australian economy has risen at a faster rate than the economy generally. The chart below shows how the ratio of exports and imports of goods to GDP has increased over the past few decades. In volume terms, the rise in imports has been faster than the rise in exports in recent years; however both trade variables have significantly increased since the 1980s.



Source: Australian Bureau of Statistics 5206 (March quarters)

It is interesting to note that at the time of Federation, Australian export volumes exceeded 25% of GDP. Hence, recent increases in the propensity to trade have taken the economy back to near the levels that prevailed a century ago. It could be argued therefore that the Australian economy has a long history of being well integrated into the global economy.

Bilateral Arrangements

In addition to its involvement in the WTO, Australia has been active in negotiating bilateral and regionally based trade arrangements. A summary of the key initiatives is provided below: -

- **APEC:** is an example of a regional trade and economic development initiative and stands for Asia-Pacific Economic Co-operation (APEC) forum. This agreement, amongst 21 countries, aims to *“collaborate to promote regional economic cooperation and to build on the growing interdependence of Asia-Pacific economies.”*
- **ASEAN Australia-New Zealand Free Trade Area:** The Association of South East Asian Nations (ASEAN) and New Zealand together account for 21% of Australia's total trade in goods and services. The Free Trade Agreement between these nations is the most significant for Australia in terms of trade volume. The agreement came into force in January 2010.
- **CERTA:** Is a bilateral trade agreement with New Zealand. Known as the Closer Economic Relations Trade Agreement (CERTA), it was formed in 1983 to promote free trade between the two countries.
- **FTA:** The Free Trade Agreement between Australia and the United States came into effect in January 2005. The deal aims to give both Nations greater access to each other's markets. For Australia, the largest benefit is likely to be increased exports of agricultural goods. In return, Australia will remove various restrictions and tariffs on imports from the U.S.A. and also remove some of the Government screening on proposed takeovers of Australian companies by U.S. interests.
- **Others:** Free trade agreements have also been made with Singapore, Chile and Thailand. Negotiations are taking place on potential new free trade deals with Japan, Malaysia, Korea, and China. In May 2011 Australia formally launched negotiations for a free trade agreement with India.

Offshoring

One feature of the increasingly globalised economy has been the trend by firms to shift production to locations where labour is cheaper than in Australia. This has been particularly common in the information technology industry. The high \$A has contributed to the trend, by reducing the cost in \$A's of work conducted offshore. Some firms undertaking a shift to offshore resourcing have been criticised due to the potential impact that the practice could have on domestic employment opportunities.



plain-english

economics

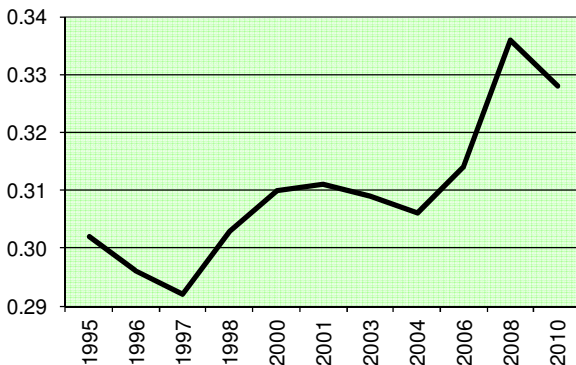
Topic nine: Income distribution

Over time, the average level of material well being in Australia has gradually improved as economic growth has delivered higher and higher levels of real income and wealth per household. However, it is the appropriateness of the distribution of this wealth that often creates debate and policy consideration for the Government.

Changes in income distribution

Over the past decade there has been a slight decline in equality of income distribution according to some measures. One way to measure the distribution of income is via the Gini Coefficient, which is shown on the chart below. The Gini Coefficient measures the extent to which the actual income distribution in an economy varies from a situation of perfect equality (where a coefficient of zero implies all households have the same income. A coefficient of one implies all the income is with one household). In 2010 the Gini coefficient for income distribution in Australia was 0.33.

Gini Co-efficient



Source: Australian Bureau of Statistics 6523

Another way to view the range of distribution of income is to look at what proportion of total income is earned by each quintile i.e. how much share of income the top 20% of income earners receive, and then the next 20% etc. This quintile view of income distribution for Australian households can be seen in the table below.

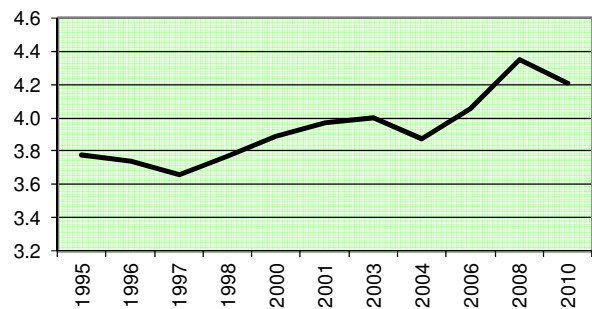
Selected Quintile	2000	2010
Highest (top 20%)	38.4%	40.2%
Middle (40% to 60%)	17.7%	17.0%
Low (10% to 30%)	10.5%	10.1%

Source: Australian Bureau of Statistics 6523

Hence the top 20% of income earners account for 40.2% of total income in the Australian economy. As the table suggests, there has been a slight increase in the share of income going to the top earners over the past decade.

A third way in which income distribution can be measured over time is to compare the earnings of high income earners to low income earners. In 2010, households in the top 10% of income earners generated 4.3 times more income than those in the bottom 10%. The chart below traces this ratio over time.

Ratio - High to Low Income Levels



Source: Australian Bureau of Statistics 6523

As is the case with the two other measures of income distribution, there has been some decline in income distribution equality across households over the past decade – although this has partially reversed during the last two years.

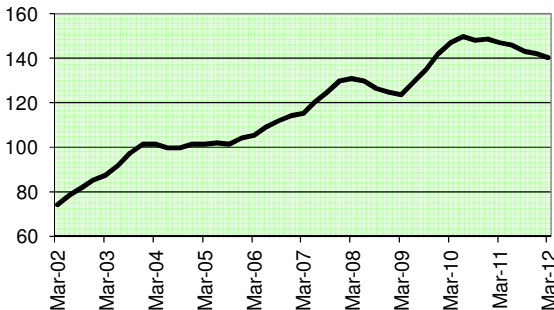
Rising asset wealth

Due to ease of measurement, indicators of inequality are typically focused on measures of income distribution. However wealth levels and changes in the prices of the assets within which households typically hold their wealth (e.g. property and shares), can have a significant impact on inequality. It is possible for very wealthy households to have low, or zero, income; whilst it is also possible for high income earners to hold no net wealth.

One factor that is particularly important in determining wealth is the movement in the price of residential housing. Not only do higher housing prices directly increase the wealth of home

owners, the rise in housing values will ultimately lead to higher rents being paid by those who don't own their own homes. This exacerbates the size of the inequality between home owners and non home owners.

House Prices Australia (Index June 2004 = 100)



Source: Australian Bureau of Statistics 6416

The Australian Bureau of Statistics data on wealth and income distribution highlights a strong positive correlation between home ownership and wealth. According to the Bureau (cat. no. 6523) *“net worth in renter households was on average only about 13% of the net worth in owner households with no mortgage, and about 21% of the net worth of owner households with a mortgage.”*

As is the case with income distribution, much of the wealth in Australia is held within a relatively small group of households. Some 62% of wealth is held by the top 20% wealthiest households.

Another factor impacting on the distribution of wealth has been a shift in the share of income across the economy from wages to profits (see Topic Paper number 6). Over time this change could lead to shareholders, who receive company profits, gaining a greater share of wealth than non shareholders.

User pays for “essential” services

Longer-term solutions to bring about equality of opportunity to earn income (not necessarily bringing about equality of income in itself) require open access to services such as education and health. In the case of higher education, the Australian Government announced that public universities will not accept full fee paying local students from 2009. It is argued that allowing access to university on the basis of fee affordability can lead to higher inequality of opportunity, as those with existing access to income have superior access to the service.

Similarly in the case of medical services, the co-existence of private and public facilities provides greater choice and service levels to those with sufficient income to fund private payment of health expenses. Whilst this too represents an unequal distribution of an essential service, many argue that without the private funding of health services it would be impossible to provide sufficient government funding to support reasonable health standards across the community. This would be to the disadvantage of all. Hence, there is often a need to trade-off the desire for equality with overall objectives around living standards and economic growth.

Taxation changes

The primary method through which income inequality is reduced is the system of taxation and subsequent payment of welfare. Australia has a progressive taxation system, whereby individuals on higher incomes are charged higher tax rates. This system leads to a significant increase in income equality compared to that which would exist if there was a total reliance on private income only. Some 58% of households in the bottom income quintile (the lowest 20% in terms of income) have more than 90% of their income coming in the form of government transfer payments.

It could be argued that the Minerals Resource Rent Tax (MRRT), introduced in July 2012, is consistent with the policy of improved wealth distribution in Australia. As per the statement below from the 2010/11 Budget Papers, a resource tax aims to spread the benefits of resource sector wealth wider:-

“Tax reform that better charges for the use of Australia’s mineral resources will increase national income, and allow a better distribution of the benefits of resource wealth across the community.”

The impact of cyclical changes

Cyclical changes in the economy can impact on income inequality, most notably via changes in unemployment. Whilst there was some rise in unemployment in the economic downturn around the time of the GFC, policy changes bringing lower interest rates and increased Government transfer payments provided some compensating impact on the overall equality of disposable income distribution. In addition, the fall in share market prices over the Global Financial Crisis period would have also brought about some increase in measures of equality of wealth distribution.



plain-english

economics

Topic ten: Developing economies

Despite the continuous process of economic development around the globe since industrialisation, there remains widespread inequality of income and vast regions of economic underdevelopment. The gap that exists between the industrialised and underdeveloped economies presents a stark contrast - both in terms of wealth and general living standards.

Development progress

Over recent years there has been progress in increasing the level of output of developing economies. Despite a short set-back in progress associated with the GFC, ongoing increases in economic output have contributed to a reduction in poverty in some regions of the world, particularly in East Asia.

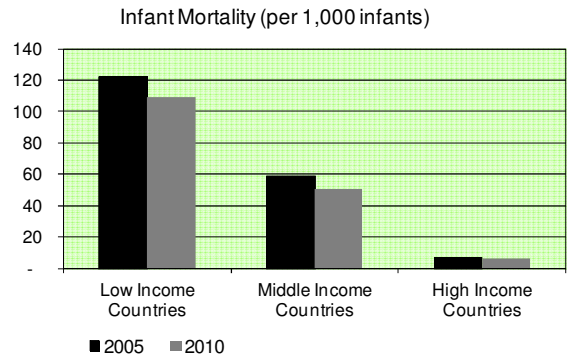
In the year 2000, some 189 countries committed to achieve the United Nations “*Millennium Development Goals*” (MDGs) by the year 2015. These goals consisted of targets to achieve the following:-

- 1 - Eradicate extreme poverty and hunger
- 2 - Achieve universal primary education
- 3 - Promote gender equality and empower women
- 4 - Reduce child mortality
- 5 - Improve maternal health
- 6 - Combat HIV / AIDS, malaria and other diseases
- 7 - Ensure environmental sustainability
- 8 - Develop a global partnership for development

The United Nations has reported the following progress in its 2012 Millennium Development Goals report:-

“The target of reducing extreme poverty by half has been reached five years ahead of the 2015 deadline, as has the target of halving the proportion of people who lack dependable access to improved sources of drinking water. Conditions for more than 200 million people living in slums have been ameliorated—double the 2020 target.”

One target that is yet to be achieved is that of the reduction in mortality of children under 5 years of age. The chart below shows the improvement in infant mortality (per 1,000 infants) between the years 2005 and 2010.



Source: World Bank

Disparate rates of progress

Although progress continues to be made on lifting standards in developing economies, progress has not been uniform across regions. There have been substantial gains made in the East Asian region. One of the main drivers of this region's performance has been the rapid industrialisation of China. Between 2000 and 2011, per capita income in China rose from \$US 949 to \$US 5,430 per annum. The growth in China is also benefiting surrounding nations, with other countries in this region also recording impressive improvements.

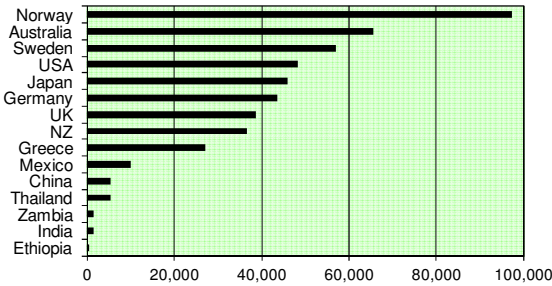
Progress in the world's poorest area, being the Sub Saharan African region, has been the slowest. This is highlighted by the 2012 famine in West Africa. Some indicators actually show deterioration in development progress in this region. The inability to control various diseases, especially HIV/Aids, continues to impact heavily on health in this region. Showing the extent of underdevelopment, the table below provides various development indicators for this region.

Key Indicator (2010)	Sub-Saharan Africa	High Income Countries
Life Expectancy	54	80
Infant Mortality per 1,000	122	6
Malnutrition (% Children <5)	22%	0%
Measles Immunisation (1-2 year olds)	75%	93%
Internet Users per 100 people	11	73

Source: World Bank

The chart below shows the overall level of income per person in various countries, highlighting the magnitude of the difference between the developed and developing world.

Gross Domestic Product per Person (\$US Year 2011)



Source: IMF

Development assistance

There is little dispute that many of the characteristics of low income and underdeveloped economies such as poor health, malnutrition and high infant death rates are problems that the world needs to address. In addition to improving the health and living standards of fellow human beings, efforts to assist underdeveloped economies may also lead to benefits in boosting trade volumes globally. Demand to purchase goods and services will increase when an economy develops.

The improvement in the quality of life of underdeveloped economies may also increase the overall level of global political stability. There may be fewer prospects of political uprisings of forces opposing incumbent Governments if living conditions are being improved.

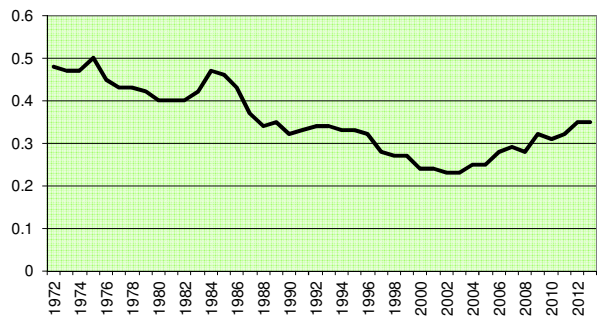
Traditionally, assistance to developing countries has come in the form of grants and donations. However, increasingly the focus of assistance is swinging towards *free trade access* and *debt relief*. The Doha round of multi-lateral trade provisions being managed by the World Trade Organisation contains specific measures to remove trade protection imposed by developed economies that make it difficult for developing nations to trade.

In June 2005, the finance ministers of the G8 nations (representing 8 of the largest economies) announced that debt relief would be granted to 18 of the worlds most indebted developing nations. The debt, from loans made by the World Bank, IMF and African Development Bank, would be waived with the G8 nations promising to reimburse these agencies. Australia made a contribution of \$136 million to this debt write-off.

Australia's overseas aid

In the 2012/13 financial year, Australia plans to provide \$5.2 billion in official development assistance, representing slightly more than 1% of total Government expenditure. This expenditure, which is \$0.4 billion higher than estimated in 2011/12, results in a ratio of foreign assistance to national income (GNI) of 0.35%. This is well below the peak rate of assistance of around 0.5% reached in the mid 1970s. However, the Australian Government expects to gradually increase this ratio to a target of 0.5% by 20015/16.

Australia's Development Assistance (% GNI)



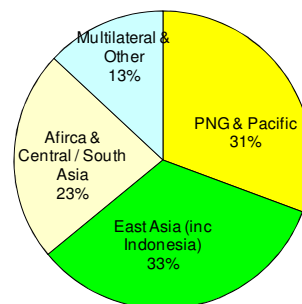
Source: 2009/10 Budget Papers

Australia's aid program has a heavy relative weighting to the Pacific. The statement below, from the 2012/13 Budget papers, highlights the some of the particular difficulties faced by the Pacific Island Countries (PICs):-

"Development progress in the Pacific has been mixed and the region as a whole is off-track to achieve the MDGs by 2015. Most PICs are small and remote with high cost structures and few economies of scale. In most countries there are relatively few income earning opportunities. The region lags behind comparable developing countries in terms of health and education indicators. Climate change will also affect PICs more than most, notably through more extreme weather patterns."

The chart below shows the expected distribution of Australia's aid by region in 2012/13.

Australia's Aid Distribution 2012/13



Source: 2012/13 Budget Statement. AusAid programs only.