



(mainly revaluations of issued shares and securities purchased by overseas investors). The table above illustrates the relationship between the current account deficit in the September quarter 1995 and the change in net foreign liabilities that occurred during this quarter.

In the September quarter 1995 therefore, Australia had a current account deficit of \$6393m. While in theory the current account deficit should equal the capital account surplus, in practice these items are rarely in balance and equality has to be achieved by the balancing item. If we make the current account deficit equal the capital account surplus by subtracting the balancing item, the deficit for the September quarter is \$6184m. In order to finance a deficit of \$6184m, Australia borrowed \$2805m in overseas funds and allowed foreigners to make \$3379 worth of equity and 'other' investments in Australia (\$3484m less \$105m). Note that although Australia borrowed \$2805m during the September quarter, the overall level of net foreign debt did not rise by this amount but rather fell by \$505m. This was due to favourable valuation effects which actually reduced the value of our debt by \$3310m.

It should also be noted that just as current account deficits can affect the level of Australia's net foreign debt, so the cost of servicing this debt

can add directly to our current account deficit by increasing the income deficit. In 1994–95 for example, 9 per cent of all Australia's current account debits (and almost half its income debits) consisted of interest payments on foreign debt.

#### **Historical Perspective.**

While Australia has nearly always had a deficit on its current account, it wasn't until the 1980s that these deficits were associated with a build up of foreign debt. Earlier deficits were not associated with a build up of debt because the deficits were on average lower and the capital inflow to finance these deficits was largely long-term equity. In the 1980s however, Australia experienced persistently high current account deficits and almost all the capital inflow needed to finance these deficits was in the form of overseas borrowings.

In the 1990s, a high proportion of the capital inflow to Australia has been coming in the form of foreign equity investment. In 1993–94 for example, the inflow of net foreign equity investment was \$25b, more than sufficient to cover the \$17b current account deficit in that year. This was a major factor contributing to the \$4.1b decrease in Australia's net foreign debt between 1992–93 and 1993–94, despite an increase in the current account deficit during the period. (The appreciation

in the Australian dollar over the period also contributed to the fall in our net foreign debt).

#### **Reducing the CAD and Foreign Debt.**

If Australia is to reduce both its current account deficit and its net foreign debt then progress needs to be made simultaneously on two fronts. First, exports have to grow faster than imports. Second, there needs to be a corresponding increase in savings so that more of our investment is financed from domestic savings rather than by borrowing from overseas. Without an increase in savings, any income gain from a rise in exports will be lost to an increase in expenditure on imports.

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