

MADOLE

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ESSAY

Subject:

Economics

Task No.

7

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Task:

Essay (approx 1500 words)

'Many countries choose to use demand management policies in response to a major downturn, such as the Global Financial Crisis, but long-term economic management should also include supply management policies.'

Evaluate this statement with reference to examples.

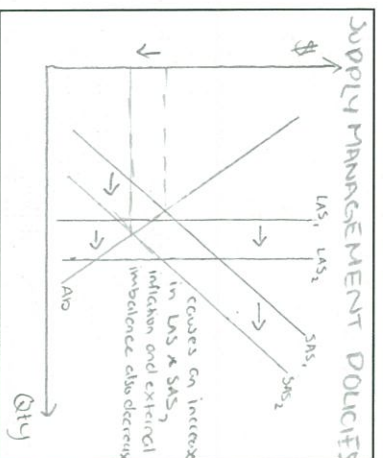
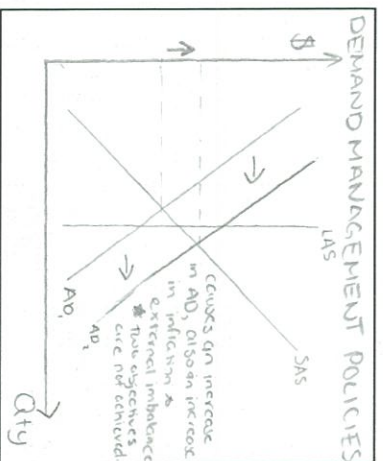
Knowledge and Understanding	Analysis and Evaluation	Communication
<p>A Comprehensive knowledge, in-depth understanding, and focused application of complex economic concepts, principles, models, and skills.</p> <p>Comprehensive and well-informed understanding of the role of economic systems in dealing with the economic problem of scarcity.</p>	<p>Attune and logical analysis and evaluation of economic issues and events (past and current) using economic models and the skills of economic inquiry.</p> <p>Perceptive evaluation of the effects of interdependence on individuals, business, and government locally, nationally, and globally.</p> <p>Incisive analysis and evaluation of the impact of economic change locally, nationally, and globally.</p> <p>Insightful and well-informed evaluation of the way in which economic decisions involve costs and benefits.</p>	<p>Sophisticated communication of economic principles and models, and complex concepts.</p> <p>Consistent, clear, and appropriate use of correct economic terminology.</p>
<p>B Some depth of knowledge and understanding, and focused application, of a variety of economic concepts, principles, models, and skills.</p> <p>Well-informed understanding of the role of economic systems in dealing with the economic problem of scarcity.</p>	<p>Well-considered analysis and evaluation of economic issues and events (past and current) using economic models and the skills of economic inquiry.</p> <p>Well-considered evaluation of the effects of interdependence on individuals, business, and government locally, nationally, and globally.</p> <p>Well-informed analysis and evaluation of the impact of economic change locally, nationally, and globally.</p> <p>Well-informed evaluation of the way in which economic decisions involve costs and benefits.</p>	<p>Clear and accurate communication of economic principles and models, and a variety of concepts.</p> <p>Clear and appropriate use of economic terminology.</p>
<p>C Considered knowledge and understanding, and competent application, of economic concepts, principles, models, and skills.</p> <p>Informed understanding of the role of economic systems in dealing with the economic problem of scarcity.</p>	<p>Considered analysis and evaluation of economic issues and events (past and current) using economic models and the skills of economic inquiry.</p> <p>Considered evaluation of the effects of interdependence on individuals, business, and government locally, nationally, and globally.</p> <p>Informed analysis and evaluation of the impact of economic change locally, nationally, and globally.</p> <p>Informed evaluation of the way in which economic decisions involve costs and benefits.</p>	<p>Competent communication of some economic principles, models, and concepts.</p> <p>Appropriate use of economic terminology.</p>
<p>D Superficial understanding, and partial application of some basic economic concepts, principles, models, and skills.</p> <p>Some recognition of the role of economic systems in dealing with the economic problem of scarcity.</p>	<p>Basic consideration and description of one or more economic issues and/or events (past and current) using some skills of economic inquiry.</p> <p>Basic consideration and description of one or more of the effects of interdependence on individuals, business, and government locally, nationally, and globally.</p> <p>Recognition of aspects of the impact of economic change locally, nationally, and globally.</p> <p>Some awareness of the way in which economic decisions involve costs and benefits.</p>	<p>Communication of some basic economic principles, models, and concepts.</p> <p>Some appropriate use of some economic terminology, with inconsistencies.</p>
<p>E Identification and attempted application of one or more basic economic concepts, principles, models, or skills.</p> <p>Limited recognition of the role of economic systems in dealing with the economic problem of scarcity.</p>	<p>Emerging awareness of one or more economic issues or events (past and current), with limited use of skills of economic inquiry.</p> <p>Limited recognition of one or more of the effects of interdependence on individuals, business, and government locally, nationally, and globally.</p> <p>Emerging recognition of an aspect of the impact of economic change locally, nationally, and globally.</p> <p>Limited awareness of the way in which economic decisions involve costs and benefits.</p>	<p>Attempted communication of one or more simple economic principles, models, or concepts.</p> <p>Limited use of economic terminology.</p>

MACROECONOMICS ESSAY

"Many countries choose to use demand management policies in response to a major downturn, such as the global financial crisis, but long term economic management should also include supply management policies"

An economy that is experiencing a boom will eventually experience a slowing of economic growth, as investment spending decreases and there is a decline in consumer confidence and demand. This will lead to the economy entering a period of contraction, or a downturn. In this period, there may still be a small rate of positive economic growth. However the economy will be experiencing rising unemployment, low confidence, increased government borrowing and falling asset prices.¹

In order to influence the level of economic activity and hence meet the four macroeconomic objectives, economies often use demand management policies. Since economic downturns have a major effect on aggregate demand, it's important to use these policies to increase aggregate demand in the economy and therefore encourage spending which will have a positive effect on the economy as a whole. Demand management policies are excellent at increasing both economic growth and achieving the full employment objectives. However, in the long term as consumer confidence increases, the demand management policies will have a negative effect on inflation, and hence external balance will decrease as NFD increases. This is why it is important to also introduce supply management policies, since they will aid in the achievement of the macroeconomic objectives in the long run. ✓



Demand management policies affect aggregate demand in the economy. They are implemented in order to affect the economy as a whole, by changing the level of government spending or investment and consumption spending. However, in the process of attaining a macroeconomic objective using demand management policies, two other macroeconomic objectives will not be reached.

Fiscal policy is implemented usually once a year through the federal budget, and it estimates the expenditures and revenues of the economy for the current year, the budget year and the three following financial years.² This means that there can be a high implementation lag through fiscal policy, as it can take a while to have an effect on the economy. However, the effect of fiscal policy is almost immediate. The budget is specifically designed to influence aggregate demand, in order to best benefit the economy. In response to a major downturn in an economy, the government would place into effect a deficit budget, where the government

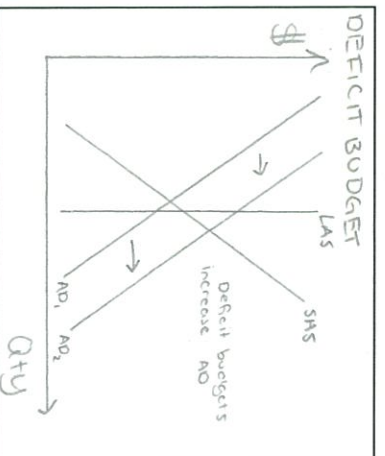
¹ Economics Help, 2014, *Economic downturn definition* | *Economics Help*,

<http://www.economicshelp.org/blog/6976/economics/economic-downturn-definition/>, accessed 7 August 2014

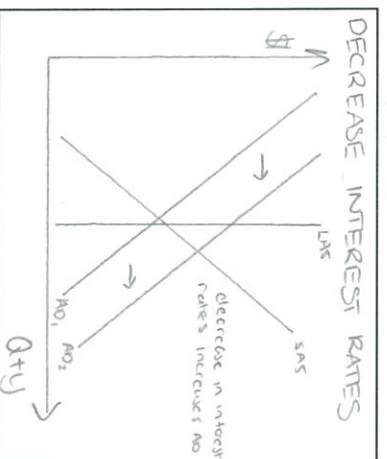
² Australia Government, 2014, *Frequently asked Questions*, <http://www.budget.gov.au/2014-15/content/faq.htm>, accessed 25 June 2014

has higher outlays than revenues. The increase in government spending in this situation will encourage spending in the economy and therefore have a positive effect on aggregate demand.

A deficit budget needs to be financed, since the government is spending more than it receives through taxes and other revenues. Often the financing of the budget is done through borrowing overseas; however, it can be also done through borrowing from the RBA or borrowing from the public. Financing a deficit budget causes a decrease in external balance through the increase in the CAD. The macroeconomic objective of price stability is also not achieved, since inflationary pressures arise in the economy. The 2012-13 budget is an example of a deficit budget. The economy at that stage was in a major downturn, experiencing only a small rate of economic growth. In response to this situation the government increased spending and decreased the taxes in order to stimulate growth in the economy.³



The monetary policy is determined by decisions made by the Reserve Bank. It specifically influences demand, by affecting the amount of consumer and business spending in the economy. Consequently, the monetary policy has a small implementation lag, since it can be put into effect quite quickly. However, it takes a much longer time for the policy to have an effect on the economy. The tool of the monetary policy is the cash rate, which is manipulated in order to impact the effective cost of money, and hence the amount of money spent by consumers and businesses. The monetary policy is normally used to control inflation and hence the cash rate is increased when inflation is high in the economy. The economy however, is currently in a downturn and operating with a slow rate economic growth, therefore inflation is not a problem. In this case the RBA would decide to decrease the cash rate in order to have an expansionary effect on the economy. Consumers are therefore encouraged to spend in the economy and consequently this will have a positive effect on aggregate demand. An expansionary cash rate can be seen in the current Australian economy, since the cash rate is at 2.5% which is the lowest it has ever been, and it has remained at that rate for the last year.⁴ The cash rate is at this low in order to promote consumer spending and to increase business investment.

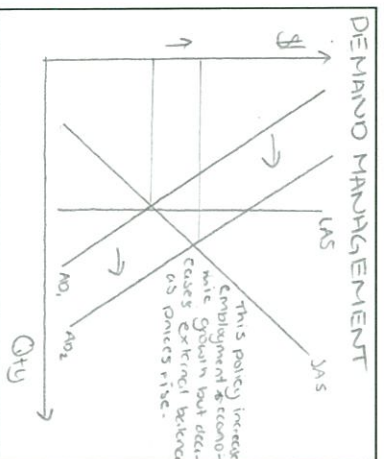


³ Australia Government, 2012, *Budget Overview*, <http://www.budget.gov.au/2012-13/content/overview/html/index.htm>, accessed 17 August 2014

⁴ Reserve Bank of Australia, 2014, *Cash Rate Target*, <http://www.rba.gov.au/statistics/cash-rate/>, accessed 18 August 2014

Demand management policies help to attain two of the macroeconomic objectives. Therefore, when the economy is operating with a slow rate of economic growth and has entered a period of contraction, demand management policies increase the currently slow rate of economic growth as well as leading to higher employment. Since a downturn has a major negative effect on aggregate demand, the fiscal and monetary policies can be used to have this positive affect on the economy by causing an increase in aggregate demand.

When faced with a downturn in an economy, demand management policies help the economy in the short run, by increasing the economic growth in the economy and the levels of unemployment. However, demand management policies do not help to attain the achievement of all the macroeconomic objectives at a time, only two of them. In this case, although economic growth in the economy is increasing, and unemployment is decreasing, neither the price stability objective nor the external balance objectives are being achieved. This is why it is important for this economy to introduce supply management policies which will build the economy into a more stable and sustainable position in the long run.



Supply management policies affect both short run and long run aggregate supply in the economy; however they are referred to as microeconomic in character, since they affect particular industries and business in an economy. Unlike demand management policies, supply management policies can attain the achievement of all macroeconomic objectives, in the long run. Supply management policies increase economic growth. They aim to increase the productivity of these companies, as well as increasing the competition between them to improve efficiency. The decrease in costs of production for the businesses causes them to invest in new technology and also lowers inflation. It causes an increase in international competitiveness which will cause a decrease in the CAD as exports increase. Hence, it is key in an economy to implement supply management policies with demand management policies in order to increase growth and employment whilst having a minimal effect on inflation. The six main areas of supply management policies include, tariff and protection reduction, competition, labour market reforms, deregulations of industries, reform of the public sector and taxation reforms.

In order to protect industries and companies in an economy, the government puts into place different protection laws, like tariffs, quotas and subsidies. These help companies to deal with overseas competition in a few different ways. Tariffs cause imported goods to become more expensive, hence increasing the quantity of goods domestic companies are willing to supply. Subsidies decrease the costs of production in companies, allowing them to supply more and hence decreasing the amount of imports into a country and quotas limit the amount of imports into a country, meaning that domestic industries are more likely to supply goods to the economy. However, although protection prevents industries from being lost, it decreases allocative efficiency and isn't sustainable. The removal of protection causes the inefficient companies in an economy to be lost, and although it causes an increase in structural unemployment, it also causes companies to be more innovative and improve production. This benefits both consumers and the economy as a whole; specifically in the long term as living standards improve. The reduction of tariffs can currently be seen in the Australian

economy with the new free trade deal being made with Japan. In this deal, the 5% tariff on Japanese and manufactured items has been completely removed. This will have a positive effect on Australian consumers, with imported goods becoming cheaper and more affordable. In return, tariffs on Australian beef exports to Japan have been reduced and other food tariffs have been eliminated, allowing them more market access.⁵

Competition is another form of supply management policies. Competition is important in an economy, since it increases efficiency in local firms as they aim to compete against overseas industries and prices. It applies pressure on industries as they compete to maintain their market shares. They become more productive in order to keep prices and cost down, whilst producing goods of better quality through investment in new technology. Without competition in an economy, industries would not have the incentive to be efficient with their goods, and therefore become less productive. The ACCC monitors competition in the economy, by prohibiting contracts, agreements and understandings between industries which are likely to cause a decrease in competition in the market⁶. This can be seen in the way the ACCC intervened with petrol retailers in Melbourne, who were attempting to set prices in order to substantially lower competition in that area. This is a breach of the *Competition and Consumer Act* and consequently the ACCC will prosecute all involved with the price fixing agreements⁷.

Labour market reform is another form of supply management policies. It consists of allowing firms and industries to control their own workplace regulations and wages in order to increase workplace productivity. The main aims of labour market reform are to improve the skills of the labour force by increasing their productivity and to control the costs of industries in order to increase international competitiveness. This was set out through *The Workplace Relations Act* and one of the most important parts of this reform has been to move away from centralized wage fixing.

Related to labour market reform is the deregulation of industries, which is also a supply management policy. It consists of removing the regulations and rules which are placed on industries, since they have a negative effect on the economy. Regulations interfere with the market mechanism, which encourages inefficiency and results in the misallocation of resources.

Supply management policies also include reform of the public sector. Government Business Enterprises provide key services for the private sectors in an economy. However since they have no competition, there is no incentive for them to use resources efficiently and produce goods of good quality. Therefore the public sector needed to be reformed through privatization and corporatization. For example, Australia Post is a government owned organization which the current government has decided to not privatize. This is because the Post provides services to rural areas which a privatized organization would consider inefficient and a waste of resources.⁸

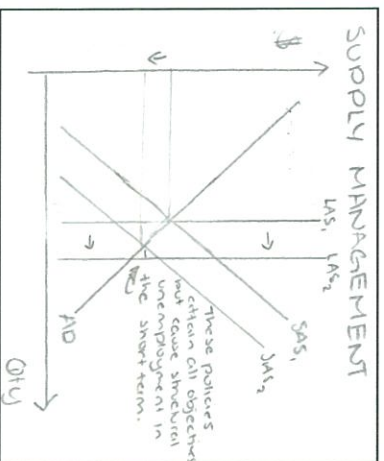
⁵ Murphy, K., 2014, *Tony Abbott: free trade deal reflects shared values of Japan and Australia*, <http://www.theguardian.com/world/2014/apr/07/tony-abbott-free-trade-deal-shared-values-japan-australia>, accessed 21 August

⁶ ACCC, n.d., Anti-competitive agreements, <http://www.accc.gov.au/business/anti-competitive-behaviour/anti-competitive-agreements>, accessed 21 August

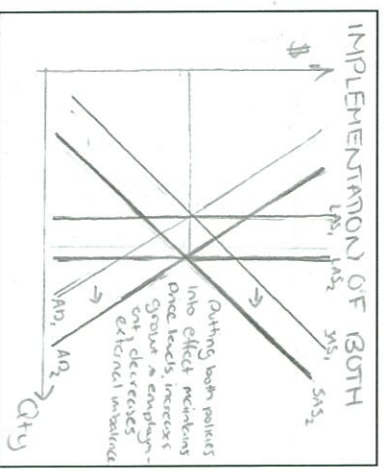
⁷ ACCC, n.d., *ACCC takes action against Informed Sources and petrol retailers for price information sharing*, <http://www.accc.gov.au/media-release/accc-takes-action-against-informed-sources-and-petrol-retailers-for-price-information-sharing>, accessed 22 August 2014

⁸ Hutchens, G., 2014, *Abbott government rules out privatisation of Australia Post*, <http://www.smh.com.au/federal-politics/political-news/abbott-government-rules-out-privatisation-of-australia-post-20140528-3933dq.html>, accessed 29 August 2014

The final supply management policy consists of taxation reform. Taxation reform is designed to increase economic incentive, lower production costs, increase the equality of income distribution and create a better environment for business investment. For example, in the latest budget, the government has decided to abolish the carbon tax, in order to increase the productivity of businesses, whilst reducing their costs of production.



Supply management policies specifically aim at increasing the efficiency and productivity of industries. The increase in output due to these improvements has long term benefits. There is higher employment as well as increased economic growth. The increase in efficiency in firms also reduces inflation in the economy through decreased costs of production. Finally, increased competition and lower costs of production help in attain the macroeconomic objective of external balance. Although supply management policies help to achieve all the macroeconomic objectives it also has negative effects on the economy. There is an increase in structural unemployment as inefficient industries are lost and other industries shed labour in order to increase their own efficiency. Inequality in income distribution also occurs, as supply management policies do not affect all industries in an economy equally and there is a loss of job security.



In order to influence the level of economic activity and hence meet the four macroeconomic objectives, economies often use demand management policies. Since economic downturns have a major effect on aggregate demand, it's important to use these policies to increase aggregate demand in the economy and therefore encourage spending which will have a positive effect on the economy as a whole. Demand management policies are excellent at increasing both economic growth and achieving the full employment objectives. However, in the long term as consumer confidence increases, the demand management policies will have a negative effect on inflation, and hence external balance will decrease. This is why it is important to also introduce supply management policies, since they will aid in the achievement of the macroeconomic objectives in the long run.

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