



Tamar.

AD

ESSAY

This is one of the best responses I've ever seen Tamar!

Subject:

Economics

Task No.

5

You have an extremely good understanding of all the concepts we have covered. Well done!

Final date for submission:

Monday 19th August 2013

Task:

Essay (approx 1500 words)

Fiscal and monetary policy can have negative impacts on the achievement of some of the macroeconomic objectives of the Australian government. Microeconomic reform, however, offers the promise of achieving all macroeconomic objectives.

Discuss this statements with reference to current and/or past examples

Refer to the AD-AS model in your answer.

Requirements of a discussion:

Statement of the issue: An introduction which introduces the issue and previews the various sides of the argument. Background info may be included

Arguments for and against: Makes points for each side of the argument. Generally introduced by a topic sentence indicating specific argument to be covered and presenting evidence and other elaborations on each argument (examples, statistics, quotations)

Recommendation: Summarises each position presented and often gives a concluding recommendation

Fiscal and monetary policy can have negative impacts on the achievement of some of the macroeconomic objectives of the Australian government.

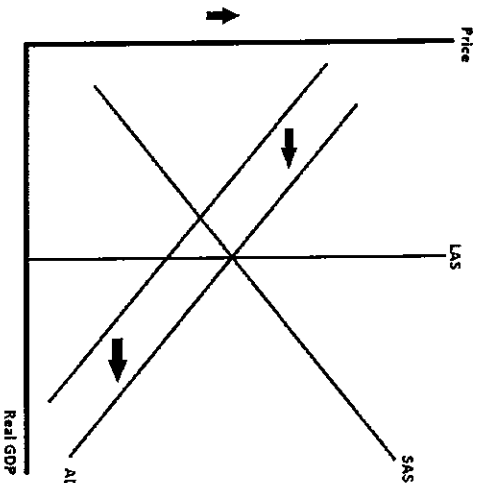
Microeconomic reform, however, offers the promise of achieving all macroeconomic objectives.

Discuss this statement with reference to current and/or past examples

Refer to the AD-AS model in your answer.

Fiscal and monetary policies can be implemented to manipulate aggregate demand. Fiscal policy affects the levels of government spending, while monetary policies change the levels of investment and consumption spending, three of the major components of total expenditure. As a result, implementing policies to change aggregate demand can be used to achieve the four macroeconomic objectives of full employment, price stability, economic growth and external balance. However, manipulating the demand curve alone can sometimes result in negative impacts on some of the macroeconomic objectives, as demonstrated in the AD/AS model below. Increasing aggregate demand prevents price stability and disrupts external balance, and decreasing aggregate demand leads to high unemployment and low economic growth. Microeconomic reform policies are implemented to move both the long run and short run supply curves, and to improve productive, allocative and dynamic efficiency. Supply management policies include tariff and protection reduction, promoting competitiveness, labour market reforms, deregulation of industries, reform of the public sector and taxation reform. Microeconomic reform policies ensure that the market becomes as efficient as possible, while achieving all macroeconomic objectives. Microeconomic reform will, however, increase structural unemployment.

DEMAND POLICIES



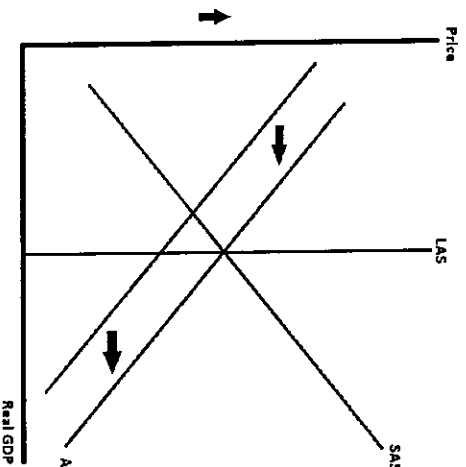
While fiscal and monetary policies that increase aggregate demand are good for economic growth and full employment, they negatively impact price stability and external balance. The opposite effect occurs when aggregate demand decreases.

Fiscal and monetary policies are implemented to manipulate an economy through influencing aggregate demand. While these policies can have positive economic effects, alone they will not succeed in achieving every one of the macroeconomic objectives. Expansionary fiscal policy (high levels of government spending) and loosened monetary policy, that is, decreasing interest rates to

encourage consumption spending and investment increases aggregate demand. One negative effect of these policies is that a budget deficit (high government spending) results in greater net foreign debt (NFD) and a higher Current Account deficit (CAD), therefore preventing external balance. Inflationary pressures also arise. On the other hand, contractionary fiscal policy (lowered government spending) and tightened monetary policy, increasing interest rates to decrease consumption spending and investment will lower aggregate demand. This will prevent unmanageable inflation and external imbalance, however the unemployment rate will increase and economic growth will decrease.

The conflicting macroeconomic objectives can be seen in the Australian economy. At present, Australia has announced a high budget deficit, meaning that the Government is trying to stimulate the economy to increase aggregate demand. This is to combat the high unemployment rate and increase economic growth; however this will result in greater overseas debt and inflation¹. The Reserve Bank of Australia also lowered interest rates again to a historical low of 2.5% in a bid to encourage investment and consumption spending to increase economic growth and employment². Negatively, demand policies will result in cyclical unemployment as the phases of the business cycle progress. As shown below, these decisions will achieve some macroeconomic objectives but not all.

EFFECTS OF DEMAND POLICIES



The Australian Government and RBA have used expansionary fiscal policy and looser monetary policy to stimulate the economy. This will not achieve all macroeconomic objectives and is therefore not ideal.

Supply management policies can be implemented, often alongside demand policies, and by influencing both the long run and short run supply curves on an aggregate demand/aggregate supply model all four macroeconomic objectives can be achieved, but structural unemployment will result as firms become more efficient. These supply management policies are often known as microeconomic reform policies. Six of the major supply management policies include tariff and protection reduction, competition, labour market reforms, deregulation of industries, reform of the

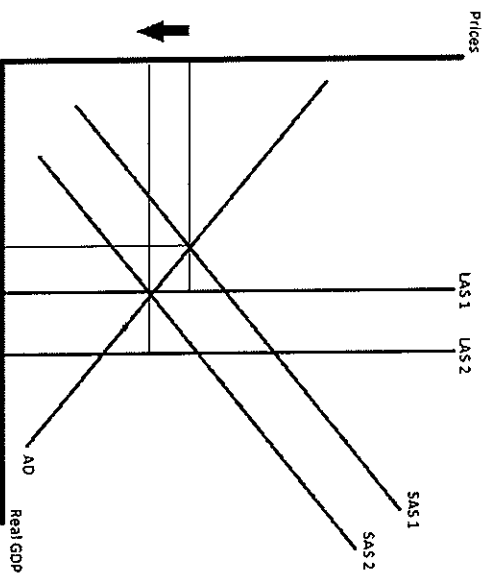
¹ The West Australian, 2013, *Federal Budget Deficit hits \$30b*, <http://au.news.yahoo.com/thewest/a/-/breaking/18304877/federal-budget-deficit-hits-30b/>, acc. 10 August 2013

² ABC News, 2013, *Labour moves to capitalise on RBA decision to cut interest rate to 2.5 per cent*, <http://www.abc.net.au/news/2013-08-06/rba-cuts-official-interest-rate-to-2-5-per-cent/4867978>, acc. 10 August 2013

public sector and taxation reform. Each of these policies work with the intention of improving allocative, productive, dynamic and inter-temporal efficiency within economies. ✓

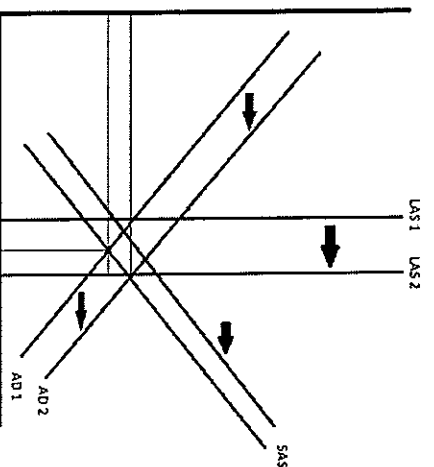
The results of policies are that economic growth will increase and therefore employment will increase in some respects. Increasing the productive capacity will open up more job opportunities, however improved technology will mean firms can cut down on labour, causing structural unemployment. Costs of production will decrease, lowering inflation. Employee income will increase, which therefore increases consumption spending. International competitiveness will increase, creating greater demand for exports and improving the Current Account deficit. Foreign debt and taxation revenue can be used to provide funds for public welfare and community services. In some cases microeconomic reform is most effective alongside demand policies as well, as increasing aggregate demand and supply ensures that employment and economic growth increase while inflation decreases slightly, as demonstrated below. ✓

EFFECT OF SUPPLY MANAGEMENT POLICIES



Implementing supply management policies result in high economic growth, lower unemployment and lower prices. This is desirable if inflation is too high, however if these policies will cause the inflation rate to drop below 2-3%, demand policies may also be implemented. ✓

IMPLEMENTING SUPPLY AND DEMAND POLICIES



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Implementing supply and demand policies results in a maintained level of inflation (slightly lower than initial even), as well as increased economic growth and lower unemployment, thus achieving all four macroeconomic objectives.

One specific target area of supply management policies relates to tariff and protection reduction. This protection is established by the government for local industries against overseas competition, and the aids include subsidies and quotas, however tariffs are the most common. Over time it became apparent that significant protection allowed for inefficiency particularly in relation to resource allocation. This inefficiency led to higher prices for consumers and a lack of international competitiveness on behalf of Australian manufacturers. Reduction in the tariffs and protections provided has allowed manufacturing firms to become more efficient, modern and improved, while competition has increased. One such example of tariff reduction policies occurred amongst textile firms in Australia over the past few decades. This has forced textile companies to operate at maximum efficiency with lowest prices and greatest quality possible.³

Microeconomic reform policies are implemented to increase competitiveness on a local and international scale. Competition is healthy for the economy as it motivates firms to become more efficient and productive to keep costs and prices as low as possible and therefore desirable to consumers. Competition also forces firms to continually modernize, expand and assess their performance. Businesses must invest in new technology and better work practises to maintain a steady profit and consumer satisfaction. The Australian Competition and Consumer Commission (ACCC) is responsible for preventing anti-competitive behaviour, maintaining competition in the market and investigating proposals of mergers, takeovers and similar, enabling ones that will assist the economy as a whole. The ACCC maintains this through the *Competition and Consumer Act 2010*⁴. One recent incident of ACCC intervention occurred with the proposed allocation system changes to Cooperative Bulk Handling Limited (CBH). In this case the changes were approved by the ACCC because they were considered to be of benefit for all involved⁵. If these proposed changes had been considered anti-competitive and bad for efficiency, the ACCC would have the power to prevent the changes occurring.

Labour market reforms are introduced to increase labour productivity, improve labour supply flexibility, improve labour-based skills and control costs within Australian firms. Low levels of labour productivity and high costs have meant that the Australian labour market has been forced to undergo a large amount of adjustment. Improving the market through supply management reforms regulates Australia's productive capacity, economic growth, international competitiveness and ability to react positively to change⁶. Examples of labour market reforms in Australia include the introduction of vocational education and training for greater worker skills, training and employment schemes and private employment placement providers as oppose to the Commonwealth Employment Service. Labour market reforms are typically imposed to deregulate the labour market.

³ NSW HSC Online, n.d., *Australian Textile, Clothing, Footwear and Allied Industries*, http://hsc.csu.edu.au/textiles_design/industries/3_1_3/tariffs.htm, acc. 11 August 2013

⁴ Australian Competition and Consumer Commission, n.d., *About the ACCC*, <http://www.accc.gov.au/about-us/australian-competition-consumer-commission/about-the-acc>, acc. 11 August 2013

⁵ Invest in Australia, 2013, *ACCC consents to CBH wheat port undertaking variations*, <http://www.investinaustralia.com/news/acc-consents-cbh-wheat-port-undertaking-variations-12c3>, acc. 11 August 2013

⁶ RBA, n.d., *Micro reform in the Australian Labour Market: Implications for Productivity and Growth*, <http://www.rba.gov.au/publications/confs/1995/apple-belchamber-bowtell.pdf>, acc. 11 August 2013

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The *Workplace Relations Act* was introduced to reduce and simplify systems within the labour market. Labour market reforms are implemented to deregulate and simplify the labour market, improving the efficiency of Australian businesses. ✓

Industry deregulation allows or markets to function effectively and more efficiently. Regulation in industries is essential to meet consumer, producer and society needs. Regulation can, however, interfere with the market mechanism and promote inefficient resource allocation. Deregulation, whether through removing or reducing regulations that may restrict competition or promote inefficient resource allocation, will ultimately encourage competition and encourage greater efficiency. Firms will have greater incentives to become more efficient, as remaining inefficient will decrease their ability to compete alongside more efficient, and therefore cheaper industries. ✓

Deregulation was particularly used between the 1980s and 1990s on the financial system, telecommunications and airline companies. Deregulation of the Australian telecommunications system occurred when the virtual monopoly of the company Telstra was abolished in the 1990s. This allowed for other companies to emerge, and Telstra was partially privatised (full privatisation was intentional in the future). Opening up the opportunity for other firms to enter the telecommunications market increased competitiveness, therefore improving efficiency, services and profitability of Telstra and other businesses. Although employment at Telstra dropped, other opening firms such as Optus, AAPT and Vodafone provided new employment opportunities for those who had lost their employment? ✓

Reform of the public sector is another method of microeconomic reform, particularly through measures to increase competition, privatisation and corporatisation. GBEs or Government Business Enterprises are essential for providing things such as telecommunications, railways, airports, power and water for the private sector. Government owned businesses are undesirable however, as they have no competition and no incentives to operate efficiently or produce high quality, well priced products. Privatisation occurs where government or monopoly businesses, such as Telstra, are sold off (privately owned), to increase competitiveness between businesses and therefore improve efficiency, quality and prices. Corporatisation occurs where government businesses and assets are turned into corporations, resulting in more professional and efficient businesses. The Australian Government has implemented corporatisation policies on sectors such as Australian Health Care⁸ reforms. ✓

Taxation system reforms have also improved the Australian economy. During the 1990s, Australia had an extremely poor taxation system, as a result of a narrow tax base, heavy tax burden, high levels of consumption rather than saving, tax evasion and over complication. From the 21st century measures were imposed to reform the taxation system, through the Henry review, which offered recommendations for tax reform. Some of these reforms included the introduction of GST (goods ✓

⁷ Caslon Analytics Aust Telecoms, 2004, *The Era of Competition?*,

<http://www.caslon.com.au/austelecomsprofile2.htm>, acc. 11 August 2013

Pipe Dreams, 1997, *Telecommunications Deregulation*, <http://www.abc.net.au/http/sfst/derreg.htm>, acc. 11 August 2013

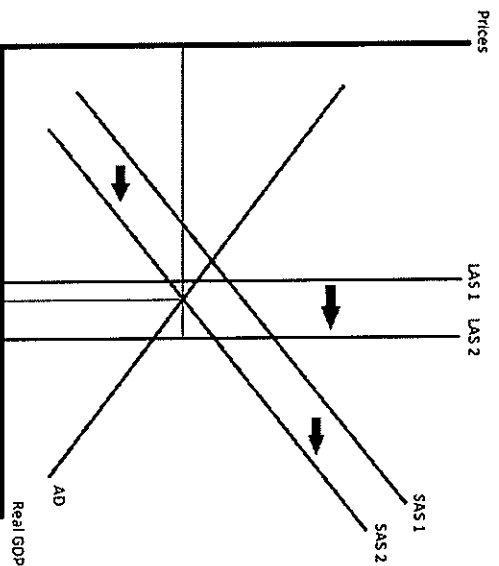
⁸ Wynne, M, 2000, *The Corporatisation of Health Care in Australia*, http://www.uow.edu.au/~bmartin/dissent/documents/health/corp_austral.html, acc. 11 August 2013
Wikipedia, 2013, *Corporatization*, <http://en.wikipedia.org/wiki/Corporatization>, acc. 11 August 2013

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and services tax), to broaden the base⁹, a halved rate of Capital Gains Tax (CGT)¹⁰, company tax rate reduction and tax concessions. As a result of these reforms tax evasion has become harder, as the system is simpler with fewer loopholes for error.

Microeconomic reform is beneficial in that it results in improved efficiency and productivity, reduced cost-push inflation, improved quality and service, greater choice and better value products. The greatest disadvantage of supply management policies is that it results in increased short term structural unemployment. As firms become more efficient, fewer employees are needed and typically those with least entrepreneurial value are discarded. This leads to structural unemployment, as demonstrated below.

STRUCTURAL UNEMPLOYMENT FROM SUPPLY MANAGEMENT POLICIES



Supply management policies result in structural unemployment, as firms shed employees to become more efficient.

When weighed against demand policies, however, this cost is not significant. Policies to decrease aggregate demand, often implemented to counteract inflationary pressures and external imbalance, result in cyclical unemployment, which also naturally occurs during a downturn in the business cycle.

COUNTERACTING NEGATIVE EFFECTS

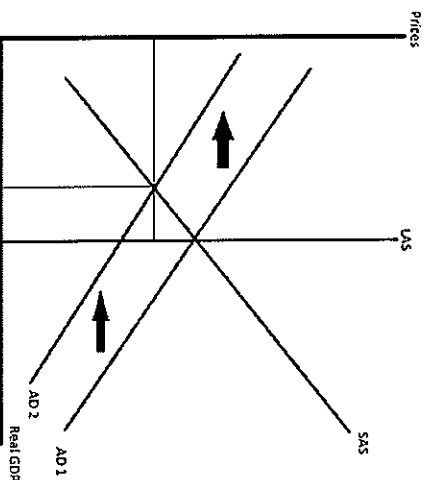
Good Judgment.

⁹ Business.gov.au, n.d., *Taxation | Goods & Services Tax (GST)*,

<http://www.business.gov.au/BusinessTopics/Taxation/Taxesexplained/Pages/GoodsandServicesTax.aspx>, acc.

¹¹ August 2013

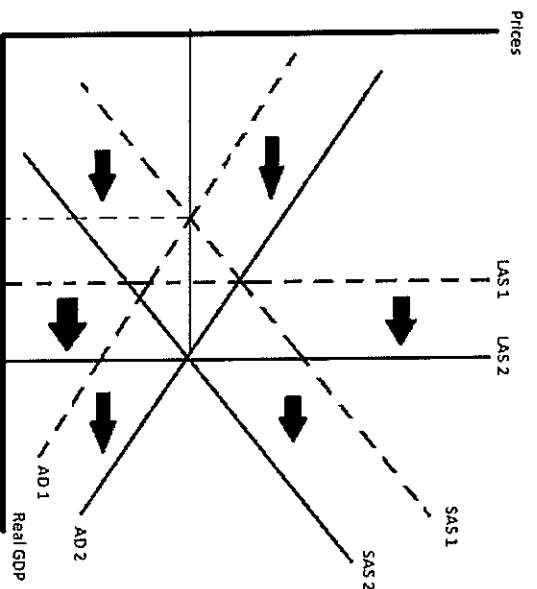
¹⁰ Australian Taxation Office, 2013, *Capital gains tax*, <http://www.ato.gov.au/General/Capital-gains-tax/>, acc. 11 August 2013



Demand policies to counteract price stability and external balance issues result in cyclical unemployment.

Another cost of microeconomic reform is that inequality in the distribution of income occurs. Smaller firms may not be able to keep up with the increased competition and especially with decreased tariffs, which may result in these firms leaving the market. This inequality is also related to structural unemployment, as those earning lower incomes, and therefore of less value to businesses lose their jobs to increase efficiency, allowing the rich to become richer and the poor to grow poorer. Implementing supply policies alongside demand policies is often the best way of achieving the best economic situation, as economic growth is high, unemployment is low, prices are stable and external balance is achieved. ✓

POLICY MIX ACHIEVES ALL MACROECONOMIC OBJECTIVES



Increasing demand and supply will result in maintained price levels, increased economic growth, lowered unemployment and external balance.

Microeconomic reform or supply management policies are more effective at achieving all four macroeconomic objectives of full employment, price stability, economic growth and external balance than fiscal and monetary policies to influence aggregate demand. Demand policies will achieve two macroeconomic objectives at the expense of another two, such as achieving full ✓

employment and economic growth but not external balance and price stability, whereas microeconomic reform encourages economic growth and employment without arousing inflationary pressures, hence maintaining external balance. Using a range of supply and demand management (achieving non-inflationary economic growth) policies will maintain the best overall economic position, as it is not possible to maintain the perfect situation as the economy can change so dramatically. Policies do not guarantee their predicted result, and costs and benefits of each decision must be analysed to ensure the best mix of policies are used to target those areas that are deemed most important. As confirmed by Dr David Orsmond of the Reserve Bank of Australia, no policy mix will solve all problems for an economy, but selecting a number of actions to target the areas of greatest concern will ensure the best results¹¹.

2,042 words

Excellent Essay Tamar!

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