

## **Topic Four** **Economic management**

### **Objectives of economic policies**

- § **Economic Growth** – measured by the annual change in our real GDP.
  - Increased living standards
  - Improved unemployment
  - Opportunity for increased investment
- § **Full employment** – refers to the economy at the NAIRU. The **natural rate of unemployment** refers to when there is no cyclical unemployment; there will always be frictional, structural, seasonal and hard-core unemployment.
  - Maximizing economies capacity to produce, leading to increased living standards
  - Minimizing economic and social problems.
- § **Price stability** refers to keeping inflation at an acceptable level. Inflation is a problem because:
  - Reduces international competitiveness
  - Depreciation of exchange rates
  - Distort economic decision making
  - Distort resource allocation
- § **External stability**
  - Achieving equilibrium in the current account of the balance of payments
  - Maintaining international confidence
  - Maintaining acceptable level of foreign debt
- § **Distribution of income and wealth**
  - Create a fairer distribution of income and wealth in an economy
- § **Environment**
  - Economic activity may create side-effects for the environment, such as depletion of resources, pollution and any other damage to the environment. Environmental management may lose out, if there is to be stronger growth.

### **Goals of government policy for 2002**

- § Maintaining sustainable growth in the medium to long term
- § Keeping inflation low
- § Increasing sustainable growth
- § Achieving sustained reductions in unemployment
- § Increasing national savings
- § Sustaining productivity growth
- § Improving Australia's international competitiveness
- § Maintaining international confidence

### **Conflicts**

- § Achieving both a reduction in inflation and unemployment
- § Achieving economic growth and external balance
- § Economic growth and the environment

### **The economic policy mix**

- § Macroeconomic policies have the overall effect on economic activity
- § Microeconomic policies involve specific measures to improve operation of firms, industries and markets.

**Fiscal policy** involves the use of the Commonwealth government's budget in order to achieve the economic objectives, relocation of resources and redistributing of income.

### **The budget**

- § Direct tax (personal and company)
- § Indirect (GST)
- § Other revenues

### **Budget outcomes**

- § **Fiscal surplus** – is a positive balance (revenue > expenses)
- § **Fiscal deficit** – a negative balance (expenses > revenue)
- § **Fiscal balance** – a zero balance (revenue = expenses)

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### **Measures of budget outcomes**

- § **Underlying cash outcomes** – is calculated as total revenues **minus** one-off asset sales
- § **Fiscal outcomes** – counts all expenditure and liability from the day the transaction occurs
- § **Headline budget outcome** – includes everything.

### **Changes in budget outcomes**

- § **Non-discretionary** – changes in fiscal policies that are caused by changes in the level of economic activity.
- § **Discretionary** – changes in fiscal policies that are deliberate changes.

**Automatic stabilizers** are those changes in the level of government revenue and expenditure that occur as a result of economic activity

- § Unemployment benefits
- § Progressive tax system

### **Impact of economic activity**

- § **Expansionary** is when the government is reducing revenue and/or increasing expenditure which will tend to increase economic activity.
- § **Contractionary** is when the government is increasing revenue and/or decreasing expenditure which will lead to a reduction in economic activity.
- § **Neutral stance** is when the government is trying to have a balanced budget.

### **Impact on resource use**

Fiscal policy may directly affect resource use through government spending into that particular sector. Fiscal policy can indirectly affect resource use through tax and spending changes. Governments will more likely use direct influences on particular markets.

### **Impact on income distribution**

Changes in the regressive and progressive tax systems can make income distribution worse. Reductions in spending on community services are likely to affect low-income earners more than high-income earners.

### **Impact on savings and the current account**

When the size of the fiscal deficit increases, so does the public sector debt.

### **Methods of financing a debt**

- § Borrow from the domestic private sector
- § Borrowing from overseas
- § Borrowing from the RBA
- § Selling assets

### **Using budget surpluses**

- § Simply depositing it with the RBA
- § Use to pay public sector debt

**Monetary Policy** involves action taken by the RBA to influence the cost of availability of money and credit within an economy. It is used to smooth the effects of fluctuations of the business cycle.

### **The objectives of Monetary Policy**

- § Stabilize the Australian currency
- § Reducing level of unemployment
- § Encouraging a sustained level of economic growth

### **The Implementation of Monetary Policy**

**Domestic Market Operations (DMO)** refers to the purchase and sale of second hand government securities by the RBA. To ease monetary policy, the RBA would buy second hand government securities from the banks that would create excess liquidity, putting downward pressure on the cash rate. Opposite when they wish to tighten monetary policy.

### **Main factors to explain the Monetary Stance**

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- § The low inflation objectives
- § Inflationary expectations
- § Wage Growth
- § Economic growth and lower unemployment
- § External factors

### **Structural Change and Micro Policies**

**Structural change** refers to the process by which the pattern of production in an economy is altered overtime, and certain products. It involves the introduction of new sectors in the economy emerging, while others decline.

**Microeconomic policy** is action taken by the government to improve resource allocation between firms and industries, in order to maximize outputs. The overall aim of economic reform is to encourage the efficient operations of the market.

- § A more efficient allocation of resources
- § Technical efficiency
- § Dynamic efficiency

### **Micro reform of individual sectors**

- § **Deregulation** involves the removal of legislation which is aimed to improve efficiency of industries.
- § **Financial sector** was the first sector to experience micro reform. These reforms are aimed to reduce distortion in the allocation of resources in an economy as market forces of supply and demand.
- § **Agricultural sector** – moving away from market structures in which monopoly marketing boards
- § **Transport industries**
- § **Telecommunication industries**

### **Improving Australia's trade performance**

Australia's trade strategies have switched from protecting domestic industries, towards policies aimed at improving international competitiveness and improving access to world markets.

**Price and Incomes and Labor market policies** involves government policy action to influence the terms of pay and conditions under which Australians work as well as the prices of goods and services.

### **The reasons for PIP**

- § Reducing inflation and unemployment
- § International competitiveness
- § Reduced strike levels
- § Fairer distribution of income
- § Achieving specific policy objectives

### **Centralized**

Wage rises and other labor market outcomes are primarily determined by the government.

- § Wage indexation
  - Full indexation – wages are increased at the same rate as the CPI
  - Partial indexation – wages would be increased, but less than the CPI

### **Decentralized**

Wages are determined by negotiation between employers and employees

<b>Centralized</b>		<b>Decentralized</b>	
<b>Advantages</b>	<b>Disadvantages</b>	<b>Advantages</b>	<b>Disadvantages</b>
Help to achieve key economic outcomes	Lock in high inflation	Lead to efficient allocation of resources	Greater inequality
Can be used to achieve other economic goals	Slow down structural change	Wage levels can change to achieve equilibrium	Risks of increased industrial action

### **The current industrial relations framework**

- § **Industrial relations (the safety net)**

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Awards apply to workers, who are not covered by an EA, provide a safety net

#### **§ Collective enterprise bargaining**

Involves employers and employees working together to negotiate enterprise agreements

#### **§ Individual employments contracts**

Intended to create maximum flexibility to adjustments to work and pay and conditions

The main function of the **AIRC** is the annual safety net award wage adjustments for workers not covered by enterprise bargaining.

#### **Limitations**

##### **§ Time lags** – is the amount of time that a policy takes to take effect

- Monetary policy – 6-18 months
- Fiscal Policy – up to a year
- Microeconomic policy – depending how it was to be implemented

##### **§ Political constraints**

- Unpopular policies
- The senate

##### **§ Global factors**

- Decrease trade barriers
- Deregulation
- Downsizing
- Decrease government spending
- Privatization
- Reforms to tax systems

#### **Effectiveness**

Macroeconomic management has proved effective in achieving its short to medium terms goals during the 1990's.

Monetary has worked well since the early 1990's in managing the growth cycle and the leave of inflation.

The role of fiscal policy has focused on the longer term goal of sustaining balanced or surplus budget outcomes in order raise national savings.