ECONOMICS

Microeconomic Reform

Assess the effectiveness of microeconomic reform in achieving the Australian Government's economic objectives

Australia's recent economic performance both pre and post-GFC has been impressive, with 19 years of consecutive economic growth, an inflation rate that has remained on average within the 2-3% target band, and an unemployment rate that remains well below treasury forecasts. However, this due not only to Australia's macroeconomic policies, but also the result of our successful implementation of microeconomic reform, which has targeted long term structural problems in order to improve economic efficiency. However, the short term costs of micro reform include significant costs in the textiles, clothing, footwear, and automotive industries. Despite this the imperative for continued micro reform remains, given the long term economic benefits gained from increasing the sustainable growth range, and the scope of issues yet to be addressed.

Microeconomic policies focus on the supply side of the economy, often targeting specific sectors to address structural imbalances and productivity over the long term. They reflect the Washington Consensus, the accepted Western growth model that advocates free markets, democratic governance and the removal of government regulation. It has four main objectives; economic growth, internal balance (inflation and unemployment), external balance (CAD and NPY Account) and finally, the broader issues of the distribution of income and environment.

We can assess the success of micro reform towards economic growth over the short and long term. In the short run, there is the risk of short term structural adjustment costs, such as higher unemployment and the closure of inefficient firms. Indeed, the introduction of the regressive Goods and Services Tax doubled our inflation rate to 6%, halving our growth rate to 1.8%. Furthermore, the pro-enterprise bargaining Work Choices policy resulted in short term uncertainty, despite any possible long term benefits. Yet despite these short term reversals and the fact that over the long run it can take 20 years for the benefits to become apparent, micro reform does successfully eases capacity constraints, whilst raising efficiency as evidenced by the increase in labour productivity from 2% pa in the 1980s to 3% in the 1990s and the increase of our sustainable growth rate from 3-4% to 3.5-4%.

In recent years, micro reform has included that of the 'first wave' over the 1980s, and their continuation into the 1990s under the Keating and Howard governments. The first wave included the floating of the AUD in 1983 and financial section deregulation in the early 1980s to remove capital controls and allow foreign banks to enter the Australian market and compete with domestic banks ensuring more favourable outcomes for consumers. In terms of trade policy, unilateral reductions across a range of industries especially manufacturing and TCF industries drove down prices and forced inefficient firms to innovate under the threat of closure. Under labour market policy, the shift away from centralised wage determination towards enterprise bargaining and individual bargaining instead introduced much needed flexibility, encouraging firms to hire more workers, these many policies combining forces to encourage economic growth.

The pace of reform continued into the 1990s following the 1993 Hilmer Report, with the historic 1995 National Competition Policy establishing uniform rules to ensure workable competition (the highest practical level of competition given the unique characteristics of any industry) across the breadth of the economy. These included areas previously devoid of competitive forces including state government instrumentalities such as electricity, transport, water and ports as well as a range of professions. Overall, the Productivity Commission estimates the NCP increased Australia's GDP by 2.5% ($20 bn) and this figure is likely to increase as the new government implements the remainder of the proposals- a shining testament to the vast potential of judicious micro reform to stimulate economic growth. This was supported by other initiatives such as the Good and Services Tax in 2001, public sector reforms, infrastructure investment and will be furthered by future reforms such as the Mineral Resources Rent Tax, the National Reform Agenda and the National Broadband Network.

Similarly, unemployment follows the general trend of short term instability followed by long term economic benefits with the government seeking to maintain it at 5-6% (the natural rate of unemployment) in the short to medium term before utilising micro reform to address labour market inefficiencies. The adoption of unilateral tariff cuts has ushered in greater competition from overseas producers, hence contracting inefficient domestic industries resulting in higher structural unemployment. In the last 5 years, it has been estimated that 30 000 jobs in the textile, clothing and footwear (TCF) have been lost due to ongoing protection cuts. In addition, micro reforms productivity emphasis has increased job insecurity with major corporations regularly 'downsizing' their workforces in favour of casual and part time jobs- e.g. Telstra following the abolition of its government monopoly and exposure to greater competition.

Over the long run however Micro reform reduces unemployment and creates jobs in newer industries. Increased labour market flexibility facilitates the flow of labour to the markets where it is most needed, resulting in a sustainable increase in employment.

Inflation wise, micro-reform contributes to lower underlying inflation by increasing competitive pressures in the economy. This improves dynamic efficiency by forcing firms to adjust supply quickly to demand changes and seek lower-cost production processes, hence improving cost push inflation. Furthermore, following the removal of protection imported inflation dropped, and artificially highly priced domestic industries were forced to improve their competitiveness or be forced out of the market.

Australia has also experienced improvements in terms of its external stability within its Current Account Deficit and Net Foreign Liabilities, despite the occurrence of short term deteriorations in the CAD. Following reductions in protection, Australia may become increasingly reliant on cheap overseas goods, resulting in a higher deficit on the trade balance in the CAD. Cyclically, there is 'balance of payments constraint', where rises in growth have led to import surges, because Australian suppliers lack the dynamic efficiency to respond quickly enough. However as firms become internationally competitive the trade balance should improve, with growth triggering increases in domestic production rather than increased imports.

However, given the persistent 'structural' causes of our CAD; a low savings rate and over reliance on foreign debt, micro reform must focus on improving Australia's national savings. Hence measures such as increasing the compulsory superannuation guarantee from 9-12% by 2019 will help to alleviate these pressures.

Finally, micro reform has had a mixed impact upon the broader issues of the distribution of income and the environment. Despite improvements upon income inequality arising from the increased super guarantee, as a general rule micro reform leads to an increased dominance of market forces, which tends to favour higher income earners in a deregulated labour market whilst disproportionately disadvantaging rural and regional Australia. Environmental issues have been left largely unaddressed following the failure of the Carbon Pollution Reduction Scheme in the Senate in late 2009, its absence filled by initiatives to improve energy efficiency and renewable uptake.

Altogether, microeconomic reform comes with its own unique set of long run advantages and short run disadvantages. Across the government's economic objectives of economic growth, internal/external balance and broader issues, micro reform has yielded a mixed set of results that have increased Australia's sustainable rate of growth, improved our inflation and unemployment rates and have had a lesser effect on external stability, income inequality and environmental sustainability. The importance of judicious macro and micro policies working in tandem remains crucial, and in future years the government must always strike the right balance of intervention when it implements micro reforms- or run the twin risks of market failure and distortionary effects.