ECONOMICS

Australia's Microeconomic Policy

"Discuss the impact of microeconomic policies on Australia's economic performance."

Microeconomic reforms in Australia have improved productivity and reduced prices in Australian infrastructure services. These changes raised the average income of Australian households, helped reduce inflation through the development of competitive markets and created employment opportunities in expanding industries.

Adapted from Productivity Commission January 2008

Microeconomic policies are complementary to the government's use of macroeconomic policies. Whilst macroeconomic policies can be implemented to achieve economic growth and internal and external balance in the short to medium term, microeconomic policies can simultaneously operate to improve the efficiency of resource allocation and raise labour, capital and multifactor productivity in the long term. Microeconomic policies often cause and involve structural change in an economy therefore changing its pattern of production in order to make industries more productive, efficient and competitive. This results in an increase in the level of aggregate supply in an economy however the process of structural adjustment often brings temporary costs such as **short term structural unemployment** and **inequitable distribution of income**. However the long term benefits of successful microeconomic reforms contribute to an improved macroeconomic performance, overcoming structural constraints to produce **increased output (GDP)** which leads to **sustainable rates of high economic growth, increased national income, price stability and employment**. Some of the microeconomic policies that have improved productivity of the factors of production include reforms such as reductions in protection, IR and taxation reforms and the National Competition Policy.

Reductions in protection improves the level of allocative efficiency as inefficient import-competing firms' restructure or close, allowing more resources to be redirected to sectors that provide a comparative advantage such as mining and agriculture in Australia, leading to increased international competitiveness and employment opportunities. The dismantling of industry protection to promote import competition, raise industry efficiency and increase the size of Australian exports was applied to Australia's two struggling industries: Textiles, clothing and footwear (TCF) and Passenger Motor Vehicles (PMV). ***Reforms undertaken since 1988 have resulted in a decline in tariffs on PMV from 57.5% in 1988 to 5% since 2010 and TCF down to a 5-17.5% tariff with all quotas removed in 1993.*** This increased competition amongst suppliers ensures price signals in the market better reflect consumers' desires and firms will pay more attention to cost reductions and improve productivity by becoming more innovative with new production techniques or technology. These improvements assist the international competitiveness of Australian firms and discourage price increases and therefore firms are less likely to grant excessive wage rises and thus suppress inflation. Firms become more flexible allowing the benefits to accrue over time to increase output and real GDP and thus increase household income and living standards.

However adjustments must be made by reducing protection levels where inefficient domestic firms are forced to close down or downsize, creating structural unemployment that can turn into long term unemployment unless government assists with labour market retraining programs, social welfare and tax systems. In the short run, distribution of income will also be unequal with higher skilled workers receiving majority of benefits but in the long run, the economy will benefit as a whole with higher rates of productivity and efficiency.

Through IR reforms, Australia has shifted from a centralised wage determination system that used wage indexation to decentralised wage fixing in late 1980s in response to increasing labour efficiency. Through wage indexation where price increases justify a wage increase, wages rise easily in good economic conditions however is difficult to reverse in downturns thus inflation and unemployment become higher than they would otherwise be. Instead a decentralised system allows wages to rise and fall more rapidly in response to economic conditions and provides wage rises when firm's productivity increases thus it depends on the worker's increase in output. This provides a greater incentive for workers to increase their output in order to gain a wage increase and thus increasing productivity. Introduced during ***Accord 6 (1991)*** enterprise bargaining, where employees negotiate working conditions and wages with employers at enterprise level, promotes a more flexible labour market and increases employment opportunities as promoted in the ***Workplace Relations Act 1996***. The safety net awards system that protects low skilled employees with a low bargaining position with minimum wages and condition was also introduced as ***Fair Work Australia's*** responsibility in the ***Fair Work Act 2009***. The continuous process of award modernisation in making awards (statement for min. wage/working con. For specific job) simpler instruments that don't impede workplace efficiency also increase employment. Through a series of labour market reforms, the functional flexibility of the workplace has been increased with employers now able to change how labour is deployed in the workforce and thus encourage them to hire additional workers. Technical efficiency has improved with less waste generated in the use of labour thus reducing costs and increasing productivity.

<u>With reforms to the taxation system</u>, higher levels of productivity, savings and investments can be achieved due to increased incentives based on a reduction in equitable and compliance costs. The ***New Tax System introduced in 2000*** introduced several reforms such as the abolition of a distorting indirect taxes, replaced by a broad based ***Goods and Services Tax (GST) of 10%*** on most goods/services. Inefficient indirect taxes such as sales tax were also abolished with cost reductions for producers and a ***lower company tax rate of 30% introduced***. This allowed the tax system to become simpler, more efficient and equitable. The Henry report 2010 was the most comprehensive review of our tax system in 10 years with 136 recommendations. However the government plans to focus mainly on ***Resources tax (40% super profits tax) on resource companies from 2012-13 to collect extra $12b in revenue from first 2 years of operation*** and increased infrastructure spending in resource states. These measures are based on sharing the benefits of the commodity boom with the Australian people by funding some of the Government's infrastructure programs however the passing of this legislation remains unknown with the current parliament. In the 2008-09 budget the government announced cuts in personal income tax from July 1st 2008 to July 1st 2010 which were designed to raise incentives to work (through higher productivity), save and invest.

<u>The National Competition Policy</u> encourages firms to improve their dynamic efficiency to enabling them better equipped in responding to changing consumer demands to maximise their market share. It is a key element of current MER that underpins reforms to public trading enterprises (PTE – government owned businesses) that now have to pay taxes to ensure competitiveness in market amongst private companies. It limits the anti-competitive conduct of firms, reforming regulation which unjustifiably restrict competition such as deregulation of telecommunications industries to provide more choice, fosters "competitive neutrality" between private and government businesses when they compete in market through the now required tax and dividend payments from govt. businesses etc. The benefits of the NCP are estimated to be very large with a 5.5% increase in real GDP, 3% rise in the level of real wages and $5.9b boost to Commonwealth revenues.

The impact of MERs can be seen at a microeconomic level with greater competition and a more "consumer driven" society that results in technical, allocative and dynamic efficiency gains as firms utilise competitive advantage to raise productivity.

However these gains must be balanced against the costs of structural adjustments such as structural unemployment and income inequality. However to offset this, expanding services sector and mining industry will create more jobs due to the global resources boom. In order for this process to be carried out the government must retrain and reallocate displaced workers and provide sufficient social welfare in order for MER benefits to be shared equally in the Australian population.