ECONOMICS

Describe the Government's management of economic growth in Australia.

Economic growth refers to an increase in a nations total output of goods and services. It is generally considered the most important single measure of an economies performance as growth creates employment, allows for increased consumption and raises the standard of living. As a result the Government utilises many economic policies include macro and microeconomic reforms in order to carefully manage the benefits and negative effects of economic growth on the economy.

In Australia economic growth is measured by changes in real GDP, which is nominal GDP adjusted for inflation. Economic growth may also be measured by determining the level of aggregate demand in the economy. This is calculated in the formula AD = C + I + G + (X-M). The total level of AD will be equal to the national income for the economy, thus Y = C + I + G + (X-M). This equation is significant as increases in consumption, investment, GE, exports and decreases in imports will increase GDP and so lead to economic growth. If the opposite occurs a contraction of GDP will result and there will be a downturn in economic growth. Economic growth can also be seen through injections and withdrawals, for example S + T + M > I + G + X will cause the economy to contract. Australia's economic growth currently sits at approximately 2%, which is forecast to rise to 3.25% in 2010-11 and 4% in 2011-12.

The careful management of economic growth is crucial to ensure the benefits are achieved whist negative effects associated with growth are minimised. Economic growth enables the standard of living to rise which results in a higher standard of living as investments in health and education improve life expectancy and overall wellbeing. Unemployment, especially cyclical is reduced whilst the 'automatic stabiliser' effect dampens the impact on the economic cycle by increasing tax receipts and decreasing transfer payments. However, economic growth leads to an increase in D-pull inflation whilst upward pressure on wages can also lead to cost-push inflation. This increases the need for interest rate rises to slow the economy. Environmental damage is likely in order to meet demands on natural resources. Economic growth increases Australia's CAD and foreign debt as well as contributing to increased inequality through the distorted distribution of income and wealth.

Prior to the GFC Australia experienced the longest period of consecutive economic growth in its history of 19 years. In order to sustain this level of growth AD and AS was successfully allowed to grow at approximately the same rate. If AD had exceeded AS excessive inflation and growth in the CAD/Foreign debt would have emerged. In order to avoid these issues the Government utilised both macroeconomic and microeconomic policies. In order to maximise AS a wide range of reforms were microeconomic reforms were introduced. To match this growth, fiscal and monetary policy was utilised to match the growth in AD to AS. Budget surpluses were mainly chosen so as not to stimulate inflation or increase the CAD/Foreign debt, whilst monetary initiatives were made as required. Prior to 2008 Australia had not been in a recession since 1991-2. The GFC cause large losses and fears of further losses due to Sub-Prime lending in the USA. This caused Australia's economy to contract and narrowly avoid recession. As the economy recovers quickly the rate of economic growth is mainly reliant upon global forces. Currently Australia's growth rate is dependent mainly upon the Chinese and global economies, whilst fears of a slow down in Europe still remain a concern.

Monetary policy was implemented prior the GFC as Australia's major economic problem was rising inflation due to supply capacity constraints that emerged as a result of a skilled labour shortage and infrastructure bottlenecks. In response the RBA raised interest rates to a high of 7.25%. During the GFC as Australia's economic growth slowed, 6 out of 10 major trading partners went into recession and the Chinese economy significantly slowed the RBA lowered the cash rate to 3%. This aimed to stimulate AD in order to minimise the fall in the rate of Australia's economic growth. As the economy recovers, Australia is growing more rapidly than expected although the RBA has raised the cash rate in increments to its current level of 4.5% to prevent the economy from growing too rapidly. The RBA continues to maintain the cash rate at this level despite pressure to increase rates due to strong growth, rising inflation, falling unemployment and increasing CAD figures. However European uncertainty and the subsequent threat of a global slowdown are preventing further rate rises.

During the GFC fears of a recession led to a budget deficit of $57.6b which was designed to stimulate AD. Other fiscal measures such as pre-budget stimulus packages were also made in order to promote rapid growth in the economy. As the economy has grown much faster than expected, in the 2010-11 budget the deficit reduced to $40.8b, due to both discretionary and non-discretionary fiscal measures.
Discretionary policies announced in the budget that aim to control the growth in AD include the 40% Resources Super Tax, increased tobacco tax, a cap on real growth in spending at 2% and a $1b reduction in foreign aid. As the economy continues to grow strongly non-discretionary policy is automatically reducing the size of the deficit through increased tax receipts and decreased transfer payments due to falling unemployment. Fiscal policy also plays a role in raising AS through budget initiatives that aim to increase Australia's productivity. Investments in infrastructure such as $1b on rail projects and $200m on critical skills training aim to ease supply capacity constraints previously experienced that restrain economic growth.

Australia has implemented many microeconomic policies that mainly aim to raise the efficiency and productivity of domestic business. This then raise the supply capacity of the economy and so the level of sustainable economic growth that does not produce adverse levels of inflation or CAD/Foreign debt. Most microeconomic reforms were introduced 20 years ago and include reduced protection, privatisation, corporatisation, deregulation of financial markets, floating of the $A, National competition policy and a move towards enterprise bargaining. As there have been few reforms since, the benefits of these improvements in AS have been largely obtained. As a result supply capacity constraints problems have emerged that prior to the GFC were restricting the level of Australia's economic growth. In response, the government has announced a new range of polices designed to boost the supply capacity. In the 2008-9 budget the skilled migration intake was increased and the removal of tax on superannuation payments paid to over 60s was announced. In 2009-10 the pension aged was increased to 67 whilst $22b was spent on infrastructure. Most recently the Henry Tax Review announced numerous changes to improved Australia's efficiency although the majority such as a congestion tax have not yet been adopted. However, the company tax rate will be cut by 2% and compulsory superannuation will be raised by 3%.

Currently Australia has both domestic and international threats to its economic recovery. The main domestic issue is inflation which is currently 2.9%, only just within the RBA's target range. This has resulted from increased AD associated with a growing economy and as unemployment falls and skilled labour becomes scarce cost push inflation is also a contributing factor which could force a rise in interest rates. Globally, the European due to debt problems in Greece, Portugal, Spain and Italy have caused concerned of a renewed global slowdown. Additionally, inflationary pressures in China could force interest rates to rise which would reduce their rapid growth rate. If this occurred Australia's export prices and volumes would be impacted, slowing the economy. The CAD also remains an issue as it has been rising since the March quarter 09 from $4.6b to its current level of $16.5b. Consistently high CAD's place Australia at risk of excessive foreign debt. The RBA could avert this issue by raising cash rates to lower demand for imports. The CAD can be effectively represented by (X-M) and thus the larger the deficit the bigger the reduction effect on Australia's economic growth when considering the national income formula, $Y = C + I + G + (X-M)$.

The negative and positive effects of economic growth must be carefully managed by the Government whilst considerations of both domestic and global influences are required to ensure optimum outcomes for the economy. Various reforms and policies are utilised by the Government to effectively manage the economy, which was especially evident prior to the GFC. Greater microeconomic reforms in particular as well as the continuation of informed policy alterations will ensure that the pursuit of economic growth remains a major economic objective of government policy.