

ECONOMICS

Topic 4 – Economic Policies and Management: Microeconomic Reform Policies

- HSC 2009 Q25: Discuss the impact of microeconomic policies on Australia's economic performance.
 - HSC 2011 Q27: Discuss the effects of microeconomic reform on product and factor markets in the Australian economy.
 - HSC 2002 Q25: Explain the role of microeconomic policies in assisting structural change in the Australian economy.
 - Catholic Trial 2005 Q26: Analyse the role of microeconomic policies in improving efficiency and productivity of markets in Australia.
 - Independent Trial 2007 Q26: Analyse the role of microeconomic policies in promoting structural change and improvements in productivity in the Australian economy.
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Introduction

1. General statement
2. Definition of microeconomic policy:
 - (a) Structural change by improving efficiency
 - (b) Long-term policies
 - (c) Increasing AS
 - (d) Product and factor markets
3. Anti-inflationary policies.

~125 words

The Australian Government uses microeconomic reform (MER) policies in order to promote structural change by improving the efficiency in the economy's allocation of resources in the long-run. Microeconomic policies are medium to long-term policies that are aimed at increasing the economy's long-run aggregate supply (AS) by raising the level of efficiency, productivity and international competitiveness (IC) in product and factor markets. Product markets are where final goods and services are sold to consumers while factor markets are where the sale of resources such as labour and capital take place. The Australian Government has effectively used MERs to address structural problems that cannot be addressed in macroeconomic policy and overall are able to improve Australia's level of economic growth levels over the long-term.

1. Effect of MERs ~146 words

MERs target the supply-side of the economy, addressing the inefficiency in production by inducing structural change to lower overall average costs. Structural change is the pattern of production that reflects changes in technology, consumer demand, global competitiveness and other factors. The effects of MERs can be shown from the diagram below:

As shown, the implementation of a MER can result in an increase in AS and a movement of the AS curve to the right, leading to an expansion in aggregate demand (AD) from YE to YE1, signifying an increase in economic growth and also downward pressure on prices from P to P1. Therefore, MERs are anti-inflationary policies as they reduce the average cost of production while increasing the level of productivity, which leads to a growth in real incomes, all without an increase in the price level.

2. Reforms in product markets: National Competition Policy – 1) definition of NCP to reform GBEs, 2) privatisation, commercialisation, corporation and principles of competitive neutrality, 3) principles of NCP. ~288 words

A significant MER that the Australian Government has introduced is the National Competition Policy (NCP) that aims to promote competition in product markets so that firms become more efficient and product goods and services at lower prices for consumers. The Australian Competition and Consumer Commission (ACCC) implemented the NCP in 1995 that extensively reformed competition policies throughout the economy, including reforms to state and territory GBEs where 90% of all economic infrastructure is controlled by GBEs and account for 13% of Australia's GDP.

Under the principles of competitive neutrality, GBEs are now obliged to operate in an equivalent competitive private sector environment, such as the obligation to pay taxes and interest payments on loans. The NCP has promoted the efficiency in GBEs through the corporatisation, privatisation and commercialisation of GBEs. The corporatisation of GBEs, such as Australia Post, encourages GBEs to operate independently from government as if they were privately owned businesses. By removing political and bureaucratic supervision and adopting more efficient and transparent management structures, corporatised GBEs seek to achieve a rate of return on their assets and seek profit margins as like private enterprises. Similarly, by transferring managerial control over to the private sector, the privatisation of many GBEs has exposed natural utilities, such as electricity and water, to market discipline and competition, such as the public float of telecommunications company, Telstra that completed in 2006 and raised \$14.3 bn. Furthermore, the commercialisation of GBEs, such as Sydney Electricity, provides more incentives to improve efficiency through the obligatory payment of dividends to the government. The NCP also aims to limit the anti-competitive conduct of firms in product and factor markets and overall has been very successful in promoting structural change and efficiency improvement, especially in GBEs.

3. Reforms in product markets: Reducing protection levels ~300 words

Another MER the Australian government has implemented is the reform to trade policies through reducing protection levels to improve the competitiveness and level of productivity of Australian industry. Changes to government industry assistance policy began in the 1980s to improve Australia's export performance and thus Australia's economic growth through structural reform. In the short-run, the dismantling of industry protection, such as tariffs and quotas, forces domestic producers to restructure and become more efficient in order to compete with overseas producers, thereby increasing the volume of Australian exports. In the long-run, the reduction in protection levels reallocates resources away from inefficient industries that are not able to achieve economies of scale to industries of which Australia has a comparative advantage in, strengthening Australia's specialisation in these industries and its role of exports contributing to Australia's economic growth.

(b) Since Whitlam's 'across the board' cut in 1973, the Hawke government continued to dismantle protection levels from through phased-in cuts to protection over four years from 1988 to give industries time to restructure, so as to minimise transition costs of high levels of business failure and an increase to structural unemployment. Ever since, the protection of manufacturing fell from an average of 15% in 1989 to 10% in 1993-94 to 5% by 2000. For the PMV industry, all import quotas were abolished and tariffs were reduced to 15% by 2000 and 10% in 2005 under the Howard Government. The gradual dismantling in protection over time is estimated by the Productivity Commission to have led to an increase of \$4 bn to GDP and an increase in export volumes. Overall,

the levels of manufacturing protection has fallen from 35% in 1970-71 to 5% in 2006-07, reflecting the government's effective implementation of trade policies to reduce protections in order to restructure Australian import-competing industries.

[add-on for question on specifically trade policies – ordering of a) and then b)] ~119 words

(a) In 1973, the Whitlam government introduced a 25% 'across the board' cut in protection to stimulate greater industry efficiency and offset high inflationary pressures as structural change leads to lower average costs in product markets and tariff cuts would lower import prices to consumers. However, this policy was highly unsuccessful as the protection cut was too great and sudden and had led to high degrees of business failure and an increase to the rate of unemployment. Rent seeking behaviour from the textiles, clothing and footwear (TCF) and passenger motor vehicles (PMV) industries led to reapplications of protection levels in the late 1970s on the basis of protecting domestic employment against the growth in overseas market share in the economy.

4. Reforms in factor markets: Industrial Relations reforms (labour resources) ~221 words

Another key MER are the Industrial Relations (IR) reforms that began in 1985 to change the determination of wages away from a centralised system to a highly decentralised system based on productivity improvements. IR refers to the way in which wages and working conditions are fixed between employees and employers. The main IR reform of EB was introduced by the Labour Government in 1991 during the Accord Mark 6 and had led to lower inflationary pressures as wage rises became linked with productivity gains and therefore do not lead to increased overall average costs. Also, the new productivity-based system led to a more efficient allocation and mobility of labour resources as the market forces of demand and supply determined wages, signifying a greater efficiency in the factor market of labour. Workers are thus encouraged to attain more skills and qualifications to negotiate large wage increases and thus enjoy a higher quality of life, therefore raising the Australia's labour productivity and also the average standard of living. The current IR system, under the Fair Work Act 2009, is based on the further spread of enterprise bargaining to increase Australia's labour productivity while also protecting employees on low incomes with a strengthened safety net. Overall, the MER of IR reforms have mainly led to an increase in Australia's labour productivity and also a reduction of inflationary pressures over the long-term.

Conclusion ~97 words

Overall, the microeconomic policies implemented by the Australian Government have been very effective in increasing Australia's long-run aggregate supply and ultimately lifting economic growth and living standards. Through reforms to trade policies, the labour market and also the implementation of the NCP, the Australian economy has experienced an increase in efficiency, productivity and IC, while the reduction in average costs have reduced the growth in prices and thus prevented Australia from experiencing high inflation levels. Thus, the implementation of microeconomic reform policies has been very successful in reforming various product and factor markets in the Australian economy.

Teacher Comment

A very impressive explanation of MERs. I am assuming that you will not be using sub-headings in your Trial exam responses.