ESSAY SCAFFOLDS

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PREFACE .

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1. DRIVERS OF GLOBALISATION

EXPLAIN HOW GLOBALISATION HAS LED TO VARIATIONS IN THE STANDARD OF LIVING AND CONTRASTS IN THE LEVEL OF DEVELOPMENT BETWEEN NATIONS

INTRODUCTION

- Globalisation refers to the process of integration between ecos, leading to the emergence of a global market through increased trade and financial flows. Globalisation has contributed greatly to an increased world output, measured by GWP, bringing together advanced, emerging and developing ecos. However, this intermeshing of individual ecos have in many ways disproportionately benefitted the established, thriving ecos as they take advantage of tech, FDI, free trade etc. In doing so, it can be said that globalisation has to a large extent, reinforced the already existing disparity between these types of ecos, manifesting in drastic variations in the standard of living.

THEORY (DON'T KNOW IF NECESSARY)

- An advanced eco refers to an extensively industrialised eco with large, market based ecos. Accounting for 30% of the world population, advanced ecos enjoy higher levels of Y, hence savings, investment and K formation + high standard of living as a result of high economic development and eco/social infrastructure. Their rate of eco growth is relatively stable with an average of 2.5%. Examples include Aus, US, Japan, UK
- An emerging eco is one that is in the process of industrialising, with substantial manufacturing sectors driving their rapid eco growth that averages 5%. Ecos such as India, China, Brazil are experiencing rising levels of eco development and hence SOL, while Y inequality also rises
- A developing eco refers to one that has a low SOL and Y levels, with high Y inequality. Their primary X include agriculture, although their pattern of prodn is experiencing change, to manufacturing and tertiary industries. Such ecos have rel poor levels of infrastructure, with heavily reliance on foreign aid

STATISTICS/TRENDS/OVERVIEW

- The 30 advanced ecos account for 41% of GWP, while the 154 emerging/developing account for the rest •

China alone accounts for 18%

- Most regions have experienced a decline in poverty, but more proportional benefits for emerging ecos •

High Y regions have Y almost 5 times higher than those in low/middle Y ecos

- SS Africa – Income of $3600 vs high Y eco - $47,000
- NIEs + Japan – 20% of global wealth, Africa – 1% of world wealth
- HDI: Norway with highest at 0.949, Central African Republic at 0.352
- Snce 1990, twenty countries have experienced a reversal in their HDIs.
- Thirteen Sub Saharan African countries have experienced decreasing HDIs, reflective of the HIV/AIDS epidemic on life expectancy, one of the three HDI indicators, along with GNI per capita and mean years of schooling.

• A study by the World Bank in 2001 found that countries that increased their ratio of trade to GDP grew almost four times faster than those who did not

• DEVELOPMENT GAP – contrast in levels of eco dev between adv, emerging and dev ecos • Infant mortality rates average about 96 in the least developed countries, compared to 8 in developed countries.

TRADE IN G/S

• The process of trade has greatly contributed to the process of globalisation, referring to the exchange of G/S between ecos across the globe.

• Global trade exists on the basis of comparative advantage that states that an eco with the lowest opportunity cost to produce a certain G/S should specialise in that process, while engaging with free trade with other ecos who specialise in other areas of prodn.

• Since the move towards trade liberalisation in 1970s, the volume of trade has almost increased by 50x, with improvements in transport and communication facilitating this process • Furthermore, the removal of trade barriers and the ratification of multilateral and trade agreements such as the WTO and EU have also contributed to globalisation.

• This has greatly benefitted both advanced and emerging ecos, with industrialising ecos such as China beginning to specialise greatly in manufacturing ETMS, having access to a large pool of labour. This played a pivotal role in catalysing its rapid growth from 1990-2010, averaging over 12% growth over this period. The contribution of emerging ecos to GWP increased significantly from 37% in 1999 to 58% in 2017.

• Only though such rapid industrialisation has it been made possible for emerging ecos to shift their focus on eco development in an attempt to sustain LT growth, alongside make significant improvements in SOL.

• In particular, China, having implemented various eco development policies such as the One Belt One Road and the Western Development Program have seen significant improvements in both material and non material indicators of development, with the HDI rising from 0.5 in 1990 to 0.75 in 2017, while also reducing the number of citizens in poverty abs poverty from 60% to 11% in the last 30 years

• This has been also applicable to East Asian economies, where increased trade and economic development has led to reductions in world poverty and an improvement in the HDIs of these countries over time.

• Despite this, however, developing ecos have experienced minimal improvements in their eco development and hence, SOL, as wealthier countries tend to protect their domestic agricultural sector because they are unable to compete with low foreign imports. This has the effect of reducing trade for developing economies

• Agricultural support for OECD countries has still remained high at 26% of farmers' incomes in advanced economies

• The establishment of regional trading blocs excludes poorer nations not contained within the area to access lucrative global consumer markets

• Benefits of trade agreements are not accessible by developing countries due to the high administrative costs associated with implementing international agreements and lodging appeals against other countries' protectionist measures The World Bank states a 1% increase in administrative costs associated with trade agreements would decrease GWP by $75 billion

• No African country has ever lodged a complaint – too expensive and complex

FINANCIAL FLOWS

• Financial flows refers to the movement of funds between ecos for the purpose of I and bus production • Long term financial flows have heavily favoured advanced/ developing countries – 77% of world FDI to adv ecos – ecos with greater industrial capacity and larger consumer markets lower risk • More recently financial flows have been directed towards developing economies exposing such regions to economic volatility This is seen by the dramatic financial crisis of East Asia in the last 1990s • As a result, FDI into such developing countries decreases, resulting in a lower capacity to invest in eco development projects + stimulate general eco growth - and thus the process of economic development is hindered

• The IMF's structural adjustment policies are seen to serve the interests of rich countries. Recognising this concern the IMF provided zero-interest loans with limited conditions to low-income countries during the global economic recession of the late 2000s

• Developing nations face massive foreign debt burdens and interest repayments on these loans limit the income available for governments to promote economic development through welfare spending. • Total external debt for low-middle income economies was US $6.9 trillion an increase of $1.7 trillion since 2016 The absence of basic rules in the financial system has created tax havens in developing nations

TECHNOLOGY, TRANSPORT AND COMMUNICATION

• The slow adaptation to new technologies in developing countries caused a digital divide • Created a limited access for businesses and consumers to access online opportunities to sell and purchase g/s New

technologies are largely geared to the needs of high-income countries • For example, pharmaceuticals that deal with the health problems of an ageing population are of little help towards developing nations who have abundant labour supplies (but whose main health risks are common infectious diseases)

• Developing nations find it difficult to gain access to new technologies due to intellectual property rights which restrict the benefits of technological transfer to poorer countries

GLOBAL AID

• Global aid and assistance: small-scale efforts made by developed countries to address the problem of global inequalities has cause high global inequality in eco development

• The total level of financial assistance provided to low-income countries was half of what was promised by high-income countries US $143 billion was provided where it was meant to be twice of that as promised in the 1970s by high income ecos

• A significant proportion of aid is spent on 'phantom aid' which is aid fund that do not improve the lives of the poor OECD states that approximately 30% of foreign aid does not contribute towards economic development • The distribution of aid by high-income countries often reflects strategic military considerations rather than the needs of the world's poorest countries Since 2002, almost half of the US $178 billion increase in global aid from high income ecos went to Iraq and Afghanistan

2. CHANGES IN GLOBAL ECONOMY AND EFFECTS ON AUSTRALIA

ANALYSE THE IMPACT OF CHANGES IN THE GLOBAL ECONOMY ON AUSTRALIA'S ECONOMIC PERFORMANCE

INTRO

• Since the early 1980s, Aus has greatly integrated into the global eco through increased global trade, investment, financial flows, as well tech transfer, in pursuit of greater external stability and ultimately, improved internal balance.

• In recent times the world eco has slowed to 3% from its long term average of 4%, underpinned by geopolitical tensions in the form of trade wars most notably between China and the USA, alongside the slowdown of China.

• Despite such global conditions however, the Aus' trade and financial flows have benefitted from growing D for Aus' X of LNG, the depreciation of the AUD to a decade- low, alongside a global trend of extremely expansionary interest rates across the globe, with

• This has postiviely impacted the ability of the Aus eco to maintain its 28 years of interrupted eco growth, alongside its sound performance in maintaining rel low U/E and inflation.

• Could add in a stat about how 63% of Aus' output is determined by I/R, growth and inflation changes in the G7

TRADE

DEMAND FOR LNG DESPITE SLOWING WORLD GROWTH

• Despite deteriorating global growth, Aus' trade balance has been rising since early 2018, reaching an all-time high level of approx. 3.5% of GDP in the closing quarters of 2018. This has been largely due to continually high D for Aus' commodities from China in order to facilitate their eco development through various infrastructure projects. Furthermore, changing sentiments and attitudes more environmentally sustainable means of energy has been reflected by the rapid growth in D for Aus' LNG X has also largely underpinned a strong trade performance.

• In fact, Aus in Jan 2019, became the world's largest exporter of LNG, surpassing Qatar with its volume of X rising over 20% in the past 2 years, and accounting for almost 4% of GDP • Its biggest importers are Japan at 41%, China at 37% and Korea at 10%

• Reflected by the high Terms of trade - currently at 110

• This has assisted in assisting the low levels of eco growth, with net exports adding a larger than usual 0.6% to GDP in the fourth quarter of 2019.

• Furthermore, growing D in the LNG industry has created approx. 3800 jobs, equating to about 17% increase contributed to rel low U/E despite very low eco growth – just as low as GFC levels

PROTECTION – TRADE WAR + OTHERS

• Protectionist policies also have had implications on Aus' trade performance. • Changing attitudes towards free trade in recent times has been greatly catalyzed by the US, which upon Trump taking office, has initiated a major Global Trade War against its largest trading eco, China. Growing concerns regarding national security and self-sufficiency, with Trump placing great emphasis on job/employment creation has seen the adoption of tariffs on various M, with China retaliating with protectionist policies of its own.

• In 2018, the US has applied tariffs on a total of $550B worth of Chinese M, ranging from 10-45%, while encompassing a wide range of industrial and consumer items.

• It has also imposed a worldwide 25% tariff on steel M and 10% on aluminium to slow down growing structural U/E in these inefficient industries of the US.

• This has not only further impacted Chinese industries, but also major Aus bus such as Arrium, who has previously depended on access to US markets for major X.

- Such protectionist measures have been met with retaliatory policies from China, Canada and the EU, causing implications on the global eco
- China has imposed tariffs on $185B worth of US M along with a 25% tariff on US LNG, while the EU has increased its tariffs on American motorcycles from 6% to 31%.
- In the immediate term, Aus will benefit from such growing trade tensions, with China adopting stimulation packages through various infrastructure projects to boost eco growth and ultimately, self-sustainability
- This has contributed greatly to the increased X of Aus LNG to China by 37%, while Aus also accounting for 40% of China's coal M. However the long term, foreseeable ramifications of this trade war is expected to greatly outweigh its benefits.
- This conflict involving two of Aus' biggest X partners, is expected to lower GDP by 0.25% and further 0.5% in continuing years for both ecos involved. Ultimately, this will have the inevitable effect of reducing D for M within these ecos, projected to contribute to a 0.3% lowering of Aus X by 2022 (LT effect)
- This will be underpinned by the inevitable fall in D for Aus X such as coal, alongside P-elastic X such as services, of which China accounts for 25% of.
- It is projected that over 5 years, over 60,000 jobs will be lost, as well as the reduction of wages of 2.4%
- This reduced X rev will consequently lower Aus' economic growth while also increasing U/E for Aus workers in the primary industry, posing serious threats to Aus' already low eco growth

AUD DEPRECIATION

- This strong growth in Aus' X have also been underpinned by the decade-low value of the AUD, being $0.69 USD in November 2019.
- This has had the impact of significantly improving the competiveness of Aust Xs overseas, with X to China improving 18% in 2019 to a record $118B while deteriorating the domestic purchasing power of Ms, hence discouraging M spending. Hence, this has resulted in an increase in X Ys and decrease in M expenditure → led to BOGS surplus of $6.2bn in 2018 → CAS first time in 44 years improved external stability

FREE TRADE AGREEMENTS

- Furthermore, despite recent, rising attitudes towards protectionist policies, the benefits of pre existing free trade policies such as CHAFTA and AANZFTA has worked to offset reductions in trade, especially those in manufacturing, agriculture and services.
- CHAFTA 2015, established between Aus and its greatest X destination, China, has provided X and employment opportunities in Aus.

- The agreements involves a removal of 98% of tariffs, especially benefitting the agricultural products such as beef and wine, which previously held tariffs of over 15%. Win X has doubled in value by 2018 imports over $1B in wine annually

- China has also guaranteed market access for Aus service suppliers in hotels and restaurants, alongside profit-making aged care institutions, providing an opportunity for Aus to continue expanding its services X industries, hence providing employment greater opportunities.
- CHAFTA also includes the reduction of the 5% of Chinese manufactured goods, resulting in lower P for Aus consumers
- AANZAFTA is Aus' largest multilateral free trade agreement, existing between Aus, NZ and ASEAN ecos. Established in 2010, the AANNZFTA has seen tariffs on Aus X reduce from 33% to 4% in the ASEAN region, which encompasses over 20% of Aus' trade in G/S
- Increased access to ASEAN ecos, many of which are rapidly industrialising, has meant that Aus bus are able to tap into global supply chains and access cheaper labour, as well as intermediate goods and passenger motor vehicles (PMV) from these ecos, which have a comparative advantage in manufacturing. This will lead to greater reductions in cost push inflation in the eco.
- While such trade relations with the ASEAN ecos have contributed greatly to the closure of the Aus' automotive industry in 2014-17, leading to over 50,000 jobs being lost, this has also benefitted Aus in the form of a reduction in the average P of automobiles by 2.4% since 2005. Further benefits will accumulate in the LT as Aus is able to specialise in its primary industries, leading to higher levels of eco growth and employment opportunities.

FINANCIAL FLOWS

LNG INVESTMENT

- The previous LNG construction boom ran from 2010 to 2014, with Australia investing $US200 billion in major gas projects.
- Investment of over $12B a year
- However, I of China in Aus has reached a record low

RECORD LOW INTEREST RATES

- In response to weakening global eco conditions as GWP falls to 3% from its usual 4%, central banks across the world has adopted record low cash rates in order to stimulate consumer and I activity and hence eco growth. America is a 1.75%, Europe at 0%, Japan at -0.1%, Canada at 1.75%
- These low global I/R have benefitted Aus' CAD as the interest repayments on Aus foreign debt will be lowered, resulting in lower outflows recorded on the NPY component of the Current Account. • This will benefit the external stability of Aus

CHANGES IN SAVINGS SINCE MINING BOOM

- Savings rate is around 1.5%

3. CHINA CASE STUDY

GENERIC Q: ANALYSE THE CHANGING CHINESE GOVERNMENT ECONOMIC GOALS AND THE IMPLICATIONS THAT THIS HAS FOR THE CHINESE ECONOMY

INTRODUCTION

- Globalisation refers to the increasing integration and interdependency between ecos, involving greater movement of trade, I and labour.
- Over the last 3 decades, China has integrated into the global eco with focus on the goal of maximising eco growth, allowing X and I to drive growth from the 1980s to the early 2000s. It has also looked to shift away from a centralised, planned eco to a socialist, market eco.
- China has achieved this through the 1980 Open Door Policy, trade liberalisation, the undervaluing of the RMB and financial deregulation.
- However, China in recent times, have focused on its eco development to reduce their reliance on the global eco and ultimately, its vulnerability to ext shocks.
- Furthermore, in order to rectify issues caused by rapid eco growth such as Y inequality and environmental degradation, China has implemented the One Belt One Road initiative, Western Development Program, pollution controls and the implementation of renewable energy.

OPEN DOOR POLICY

SPECIAL ECONOMIC ZONES

- China focused on stimulating high eco growth from the late 1980s, realising the growing disparities between China and Western regions of the world. Also suffering from severe poverty, China looked to transition from a developing nation, into an emerging one.
- The 1980 Open Door Policy was China's first major policy, as the Chinese gov implemented various reforms to facilitate and encourage FDI, trade and TNC establishment to maximise growth.
- Such measures include the implementation of Special Economic Zones in areas such as Shenzen, Shanghai, Xieman and Shantou, all strategically placed in close proximity to Hong Kong and Taiwan, China's greatest sources of FDI.
- These SEZs were market-based regions, involving limited gov authorisation in comparison to the rest of China's planned eco. Additionally, the SEZs had cheaper labour and higher M duty exceptions, alongside decreases tax rates for foreign firms at coastal cities from 24% to 15%, all working to develop an attractive environment for foreign I and TNCs to establish.
- Trade in X&M grew from 10% of China's GNP in 1978 --> 36% in 1996, as well as encouraging the growth of China's industrial sector by 40% between 1978 --> 1990
- FDI also tripled between 1980 --> 1988

TRADE LIBERALISATION

- Alongside the establishment of the SEZs, China, upon joining the WTO in 2001, began a reform of trade liberalisation, referring to the removal of artificial barriers to trade.
- China was required, by the WTO, to cut average tariff rates by 60% on textiles, whilst also being required to lower agricultural protection. This also involved the relaxation of 1000s of tariffs, with the average tariff rate cut from 32% to 19% in 1996, and to now less than 10% in 2012. China

began to allow foreign producers to directly sell in the Chinese market, and to establish themselves there if desired.

- China adopted this X-oriented growth strategy to access the global market and hence reap the benefits of free trade, such as technical and allocative efficiency, resulting in a LT decrease in the cost of prodn.
- It is estimated that China's real GDP, as a result of these policies, were 1.5% in 2010s

DECENTRALISATION

- The Open Door Policy also involved the decentralisation of state owned enterprises, reducing the extent of gov intervention in the allocation of resources, attracting TNCs to establish themselves in China. This proved to be extremely effective, as the number of TNCs also increased by over 70,000 in the past 20 years, thereby further enhancing China's eco performance.

UNDERVALUING OF THE RMB (MOST PROMINENT IN 2015)

- China's undervaluing of the RMB has also assisted China in establishing greater rates of growth, increasing China's international competitiveness and hence its D for its X. This ultimately resulted in an increase in X revenue and thus AD, leading to growth .
- This was evident in 2015 as China devalued the RMB by 3% to support X comp, leading to an improvement in the trade balance form -$20B in 2014 to $51B in 2019

IMPACTS OF THESE POLICIES

POSITIVE

- These 3 strategies in order to increase eco growth has been extremely successful, as China, from 1990-2000 experienced 7-10% growth on average, while in 2000-10, averaged 10%.
- This peaked in 2007 at 14.2%, while during the GFC in 2008-09 dropped to 9.6% as China's X suffered. China
- Also, as a result of this rapid growth, Y levels generally rose across China, thus increasing SOL. This was the result of the severity of poverty in China being reduced significantly, with over 400M being lifted out of absolute poverty in the last 25 years.
- These methods have also seen an increase in the nat GNI from $1,500 to $17,000

NEGATIVE

- However, it was through global downturns that China has increased focus on dom C, rather than relying on FDI and trade to underpin their level of growth.
- During the GFC, China's growth fell by 5% as its X markets suffered severely, despite the $580B stimulus package saving them from severe recession. However, since the GFC, China has shifted to focus on rebalancing the eco and on eco development
    - This is displayed through the 2011-12 Euro Sovereign Debt Crisis. Despite Europe accounting for 1/5th of China's X, China was ale to meet the target of 8.2% growth in 2011, as Dom C contributed to over 75% of its growth, demonstrating its shifting priorities to focus on dom C driven growth to ensure self-sustainability.
- China has also looked to focus on the growing disparities between the Western and Northern regions and the South/East urban areas due to the formation of SEZs. This has further

encouraged the shift of focus from eco growth to eco development

- These SEZs experienced higher employment and Y while the agriculturally based rural areas suffered and had near to none development. This resulted in the formation of a dualistic eco, in which the top 10 cities had average incomes 150% higher than the national average, and Shanghai having 200% higher Y than the average city. This resulted in a severe increase in the Gini coefficient from 0.3 to 0.5 in the last 20 years, while the UN describes anything above 0.4 to be severe.

ONE BELT ONE ROAD INITIATIVE – 2013

- China has looked to address this recently through the 201, $1T, One Belt One Road Initiative, comprising of a series of infrastructure developments across Western China, Central Asia and Europe. This involves the implementation of roads, airports, information and communications technology, creating a eco + trade corridor between these regions.
- As resources flow through these regions, this is expected to increase their eco activity and facilitate eco development, providing sources of Y for individuals in the areas, such as Chongqing, whose growth has increased by 11% since 2013

- China looks to involve 68 ecos and 65% of the world, and 40% of GWP. Economists suggest it will increase world trade by 12%

WESTERN DEVELOPMENT PROGRAM

- The Western Development Program also works in conjunction with the One Belt One Road Initiative as the government focuses on building power plants and establishing various modes of transportation to increase eco and social infrastructure and hence, eco activity.
- For example, Chongqing uses the OBOR trade corridor to directly transport their cars to Europe, seeing a 20% increase in their eco activity since. These methods have also seen an increase in the HDI from 0.5 to 0.75 and an increase in educational standards from an average of 8.8 years of schooling to 14 years

ENVIRONMENTAL CONCERNS

- During the period of sustained eco growth, China's manufacturing sector had extremely high D for energy, with little consideration for market failures and environmental implications. This has resulted not only in severe resource depletion but in turn, significant pollution.
- China, emitting 20% of the world's CO_2 emissions in 2010, is the largest polluting country in the world. •

This is as 70% of energy needs has been supplied by coal fired power stations. With less than 1% of cities meeting WHO air quality standards, it is projected that over 600,000 premature deaths will occur by 2020, hence adversely, and significantly impacting the SOL of the population.

ENVIRONMENTAL POLICIES

- Upon growing international pressures, China has set targets for reducing pollution levels through various initiatives. Namely, its signing of the Paris Agreement in 2015 signifies its progress to limit the effects of global warming by reducing CO_2 emissions. Domestically, it has set targets of committing of $6.6B in 2015 to reduce emissions, in conjunction with the complete eradication of coal fired power

stations. Also it has established the Three Gorges Dam in the early 2000s, and the Tengger Desert, the world's largest hydroelectric and solar energy sources respectively. These steps to utilise an alternative energy source, and its other environmental considerations demonstrates China's new focus on eco development.

4. BALANCE OF PAYMENTS/CAD

GENERIC Q: ASSESS THE IMPORTANCE OF FACTORS THAT DETERMINE THE SIZE AND COMPOSITION OF AUSTRALIA'S CURRENT ACCOUNT + IMPACTS OF SUSTAINED CAD ON THE ECONOMY

INTRODUCTION

- The balance of payments (BoP) refers to the record of financial transactions between Aus and the rest of the world over period of time, normally one year. It consists of both the current account (CA) and the capital and financial account (KAFA).
- The CA records non-reversible transactions of receipts and payments for trade in goods and services, and Y flows, consisting of a structural component known as the Net Primary Y (NPY), and a cyclical component of Balance of Goods and Services (BOGS).
- Global eco conditions largely influences Aus' BOP through fluctuations in the IBC, E/R and global I/R rates, while many structural factors such as the S-I gap and narrow X base sustains the CAD that Aus has experienced since 1980s. It currently stands at 2.9% of GDP, fluctuating from 2.2% to 5.5% in the past decade.
- While the Pitchford thesis states that a CAD approx. 3% of GDP is sustainable, a LT CAD exceeding levels of 4-6% can bring upon negative impacts on the eco.

THEORY ON NPY

- The NPY account is structural in nature and is the greatest contributing factor to Aus' CAD, accounting for over 65% of its transactions.

- The NPY records Y debits and credits for the returns on factors of production such as interest repayments and dividends,
- Aus has sustained an NPY deficit since 1980s at -$10B, with it generally worsening, to stand currently at $59.1B.
- The factors contributing to this occurrence can be classified as cyclical or structural, with the former referring to those which vary with the level of eco activity and is usually short term and the latter referring to factors that are underlying and persistent influences and are long term.

INTEREST RATE DIFFERENTIALS

- Domestic and global interest rates differentials are the biggest cyclical factors influencing the deficit of the NPY and hence, contributing to the CAD.
- The I/R of Aus is determined by the monetary policy of the RBA, and drastically affect the level of K inflow into Aus, as a higher I/R relative to that of other OECD economies such as the US, Germany, Japan, will increase K inflow as the high I/R will result in a greater repatriation for the lender.
- This will increase the level of debits as debt servicing costs increase in the NPY account, hence resulting in a worsened CAD
- However, this has not been the case as Australia's current I/R has been at 0.75% whereas its trading partners such as US has an I/R of 2-2.5% and China with 4.35%, thereby resulting in a reduction of the servicing costs of Aus' net foreign liabilities, which comprises 70% of the CAD.

EXCHANGE RATE

- The exchange rate (E/R) refers to the rate at which a unit of dom currency is exchange for a given amount of a foreign currency, with the AUD fluctuating heavily in response to the global D for Aus' X and financial assets.
- It impacts the level of debt repayment on the NPY account through the valuation effect, which in essence, refers to the process in which a depreciated AUD can result in an increase in the size of repayments owed to foreign loaners.
- This will, in turn, increase the level of debits in the NPY account and hence will worsen the CAD (vice versa).
- However, since 2011, the AUD has been depreciating to record lows, currently at $0.69USD. Furthermore, the valuation effect, in practice, has negligible impacts on the NPY and hence CAD as almost 90% of loans are denominated in AUD, while a large % of Aus' net foreign liabilities are hedged through derivatives and natural hedges --> reducing Aus' currency exposure.

DOMESTIC ECONOMIC GROWTH

- The level of domestic growth and Dom eco growth and consequently, company profits will impact the

level of foreign I in the form of FDI/portfolio I and loans. Strong eco growth in Aus will result in improved investor confidence in the eco, hence resulting in greater level of I. This was evident during the MIB, where a surge in mining I opportunities contributed greatly to an increase of I to 9% of GDP in 2011, from its usual 3.1%

- Similarly, strong performance of domestic companies will result in greater levels of portfolio investment, as speculators will seek to gain capital gain --> both this will ↑ K inflows and hence worsen NPY in the LT

SAVINGS AND INVESTMENT GAP

- The largest structural factor impacting the NPY account is the Savings and investment gap, referring to Aus' heavy reliance on foreign I to compensate for the lack of domestic savings, and its ability to fund domestic expenditures. This, alongside the abundance of I opportunities, as well as Aus' attractive AAA credit ratings consequently results in the increase in the level of foreign I, and hence increase in repatriation and debt servicing cost. This sequence is evident as the minerals industry required high levels of I during the mining boom, a demand which was not able to be met by the low levels of dom. savings in Aus. Therefore, as of 2019, 70% of the LNG and 50% of the coal industry is foreign owned. This results in greater levels of debits in the form of dividends and interest repayments leaving Aus, hence increasing our NPY deficit and eventually, CAD. However, levels of savings did slightly increase when compulsory superannuation (MER) was introduced in the 1990s and taxes associated with super was removed in 2004, as this increased Aust' equity overseas. For the first time, between 2013-17, the value of Aus' foreign assets exceed the value of foreign ownership in Aus assets.
- However, this has been masked by continuous rises in Aus' net foreign liabilities, as while Aus' ownership of equity rose by 3.5 times, Aus' loans overseas grew about 6 times.

FISCAL POLICY

- The Aus government's stance of its Fiscal Policy also is a structural factor influencing NPY. If it is to establish an expansionary stance in response to low rates of dom growth and inflation, it will increase international borrowing, hence increasing its public debt which will decrease the size of the NPY. Contrastingly, a contractionary stance to reduce the size of deficits, as evident in the current gov's aim to reach to reach fiscal consolidation, or to stimulate eco growth will result in a decreased level of int borrowing and hence improve the NPY. Foreign debt as a % of GDP in 1980 was 35%, to currently being 60%. This has been the result of an increase in international borrowing

BOGS THEORY

- The BOGS records transactions involving Aus' trade of goods and services with the global eco. • It accounts for 33% of the CA's transactions, standing at a $6.2B surplus in 2017/18. It is a cyclical, more volatile component of the CA meaning it fluctuates from a deficit to a surplus. BOGS is divided into subcategories of net goods or net services, which both records the value of X-M (credits-debits), recording a surplus of $12B and a deficit of $5.9B respectively in 2017-18. Similarly, to the NPY account, the BOGS is also influenced by structural and cyclical factors.

INTERNATIONAL BUSINESS CYCLE

- The activity of the International business cycle (IBC) is the greatest cyclical factor affecting the BOGS account and hence the CAD, as D for Aus G/S X is dependent on the performance of the global eco. A strong performance in the IBC will result in an increase in the D for Aus' X and P for commodities, resulting in greater credits/X Y, ultimately improving BOGS, with the opposite also being applicable. Positive impacts from the IBC were evident in 2004-09 during the global resource booms, where strong growth in China (the destination of 1/3rd of Aus' X) resulted in a significant increase in D for Aus' agricultural and commodities X, resulting in greater credits than debits, hence improving BOGS and CAD. Contrastingly, during 2015, following China's extreme slowdown, Aus' experienced a drastic decrease of 6.6% in its X Y.

TERMS OF TRADE

- Terms of trade (ToT) refers to the relative prices an eco receives for its X and pays for its M, essentially meaning X_p/M_P X 100. The P of Aus' X in comparison to its Mis a large cyclical factor influencing BOGS and hence CAD. A increase in the D for Aus' X will consequently result in an increase in its price, hence an improvement in the ToT. This will result in an increase in the value of Aus' X (value = Qty X P), hence resulting in greater credits in the BOGS. The opposite also applies. The recent trends display a fluctuation in the ToT as a result of world events, such as the global resources boom, where a 30% increase was experienced as result of increase D and hence P for Aus' X. This coupled with a decrease in the price of M of ICT and K goods due to globalisation saw an improvement in the ToT, benefitting the BOGS and hence, reducing the CAD. However, in 2015-16, the ToT fell by 40% with slow world growth of 3%, especially in China and the US. Currently it stands high at 92.7%.

EXCHANGE RATE

- The exchange rate of Aus is influenced by the ToT and can affect the int. comp of Aus X and the price of G/S it imports, hence impacting the BOGS. A higher ToT represents a higher D for Aus' X, correlating to an increase in the D for AUD. This will lead to its appreciation, hence weakening the international competitiveness of Aus X, namely its non-commodity goods. This reduced international competitiveness will result in a decrease in X and hence BOGS. Therefore it can be said that while an improvement in the ToT will improve the BOGS and hence reduce the CAD, its effects are offset/contradicted by the consequential appreciation of the AUD. Such sequences were displayed in 2003-07, during the mining boom where an increase in the ToT resulted in a strong appreciation of the AUD, reducing the int. competitiveness of Aus manufacturers and services.

DOMESTIC ECONOMIC GROWTH

- The level of domestic growth influences the BOGS by affecting the D for M. High levels of growth in the dom. eco will lead to an increase in Y_d, hence leading to higher consumption of M, which will worsen the BOGS, and hence increase the CAD. This was evident as high growth in Y_d during the commodities boom resulted in a poor BOGS performance/high CAD in late 2000s.

INTERNATIONAL COMPETITIVENESS

Discuss international competitiveness first, then discuss the narrow X base (this is because lack of international competitiveness in manufacturing sector has contributed to Aust's narrow X base)

NARROW EXPORT BASE

- The biggest structural factor influencing the BOGS is the narrow X base of Aus, referring to the fact that Aus relies heavily on primary commodities for its X Y as its CA lies in low value-added products such as minerals. Aus' lack of competitiveness in the IT and manufacturing sector means that these expensive goods must be imported instead, therefore meaning that debits are greater than credits, and worsening BOGS and sustaining the CAD

GLOBAL PROTECTIONIST POLICIES

- Can link it to how it restricts Aust's Xs – one example is sufficient

EFFECTS OF A HIGH CAD ON ECO

- A CAD of 4-6% is seen as sustainable. Any higher, for a sustained period of time, can bring upon negative impacts on the eco

GROWTH IN FOREIGN LIABILITIES

- A high CAD may lead to a debt trap scenario, where an eco borrows merely to pay the servicing costs on its existing foreign debt --> further worsens NPY and CAD as servicing costs rise --> loss of investor confidence and potential loss of Aus' AAA credit rating.
- This may lead to K flight --> ↓ financial I --> ↓ eco growth + ↑ U/E

DECREASED INT. CONFIDENCE

- ↓ Confidence in the Aus eco --> ↓ D for AUD --> depreciation --> ↑ M inflation + ↑ cost of prodn for bus that M K goods --> ↑ cost push inflation --> overall ↓ SOL and ↓ eco growth

LOWER EXTERNAL STABILITY

- This all leads to a worsened external stability –> as debt increases --> servicing payments

GOVERNMENT POLICIES

- The Aus gov, in a bid to improve external stability, will undertake contractionary macroeco policies
- Contractionary MP --> ↑ Cash rate to reduce eco growth --> slows down M spending to improve BOGS, while also improving NPY by ↓ equity servicing costs
- The gov, as seen since the GFC, is undertaking fiscal consolidation to ↓ international borrowing, as foreign debt is 60% of GDP. The government plans to reduce it to 0% by 2030. By ↓ public debt --> improves NPY. However, as a result of doing so, eco growth is slowed down --> the BOP constraint
- MER --> may seen MERs implemented to improve international competitiveness and to improve the S-I gap, as seen through the implementation of super

PITCHFORD THESIS

- Theory suggests that firstly, private I or debt is not an issue as private firms take calculated risks when borrowing money from overseas (75% of Aus debt is private)
- Also, if I is used to improve the productive capacity of the eco --> eco growth in the LT • However, during the GFC, gov still needed to provide guarantees for private debt. Also, private firms may still make irrational decisions (GFC)

5. EXCHANGE RATES

CAUSES Q: ASSESS THE IMPACT OF CHANGES IN THE DOMESTIC AND GLOBAL ECONOMY ON AUSTRALIA'S EXCHANGE RATE

INTRODUCTION

- An exchange rate (E/R) refers to the value at which a unit of dom currency is exchange for a given amount of another foreign currency.
- Since 1983, Aus has adopted the floating E/R system, with the value of the AUD being dictated by the P mechanism of S&D in the forex market.
- The AUD is recognised as a commodity currency, moving in sync with changing D for AUS' main X such as coal, iron ore and steel.
- Changes in the global eco, such as the global resources boom and the ESDC heavily affect the D for Aus' X and hence the D for the AUD, whereas changes in the dom eco, such as MP and the RBA's intervention in the forex market, affect the S of the AUD
- While rising to a peak of $1.1USD in 2011 as a result of these factors, the AUD has since been declining, now to a record low of $0.69USD.

MER – FLOATING OF THE DOLLAR

MINING BOOM (APPRECIATION)– TOT, INVESTMENT, CONTRACTIONARY MP

- ↑ D for commodities --> ↑ P of commodities --> ↑ ToT --> ↑ AUD
- As a result of an upswing in the IBC, a global resources boom began taking place from 2004-08, most evidently in Aus' mining sector, as Aus rapidly specialised in the extraction of coal, iron and other commodities. During this time, mining X as a % of GDP grew from 2% to 10%. This growing D in the world eco for these resources was largely underpinned by China, who had averaged over 10% average growth in the early 2000s, reaching a peak of 14.2% in 2007. Consequently, the ↑ D for Aus' X resulted in an ↑ in the P of X, translating into an improvement of the ToT to 130 in 2008. This has meant that Aus' X, becoming more expensive, meaning the amount of AUD required to purchase the given amount of X has increased. This led to an increased in the D of AUD, as the AUD began began appreciating from a low of $0.42 in 1995 to $0.90 in 2007

• ↑ I opportunities + Aus' S-I gap --> ↑ FDI in mining sector --> ↑ D for AUD --> ↑ AUD • As a result of the mining boom, bus opportunities began to rise, especially in resource rich areas of Queensland and the NT. However, with owing to Aus' low level of savings and ultimately, the S-I gap that exists in the Aus eco, the level of I required was not able to be met by dom S, thereby allowing FDI inflows to increase significantly. This increase D for the AUD from foreign I wanting to establish bus in Aus furthered the appreciation.

• ↑ Portfolio I due to ↑ eco growth

• Growing company profits due to rapid eco growth in Aus, and hence, rising values of shares also made I in Aus more attractive, further increasing the D for the AUD

• Contractionary MP --> positive I/R differential --> ↑ K inflows --> ↑ D for AUD • In a bid to subdue inflationary pressures, the RBA implemented contractionary MP, increasing it from 5% to 7.25% during 2003 to 2008. This resulted in a positive I/R differential against other adv ecos such as the US, who during 2007 had an E/R of 5%. Therefore, lending in Aus, during this time derived greater returns, making Aus a more attractive destination for foreign K, leading to a greater D for AUD

POST MIB (DEPRECIATION) – GLOBAL SLOWDOWN, ↓ COMMODITY P, EXPANSIONARY MP

• Slowdown of global eco, especially with ESDC --> ↓ D for Aus' X --> ↓ D for AUD • However, following the MIB and the GFC, the D for Aus' X began deteriorating, underpinned by the cooling down of China's growth from 2010, alongside th 2012 European Sovereign Debt Crisis, heavily dampening the eco growth of EU ecos. With the EU and China together accounting for approx. 40% of Aus' X, their falling eco growth translated quickly to a falling D for Aus' X. This was worsened further by the increasing S of commodities after the MIB, both working to lower the P of Aus commodities and hence worsening Aus' external wage, with the ToT reaching a low of 80 in 2015. This resulted in falling D for the AUD.

MIB LED TO TWO SPEED ECO - EXPANSIONARY MP TO REMEDY

• As well as the above, expansionary MP to remedy the 2-speed eco began a depreciation of the AUD since 2011

• Furthermore, as a result of the rapid appreciation during the mining boom, the D-elastic sectors such as the services fell by approx. 12% in rev during 2007-12, contributing to the formation of the 2-speed eco, as Aus experienced a growing disparity between various sectors. Therefore, the RBA during 2011- 15 significantly decreased its cash rate to 3% from 4.75%, lowering the level of interest gained from nnalongside the slowing down of the global eco, contributed to the depreciated AUD, decreasing to $0.72 from a high of $1.1AUD in 2011. The AUD has, since 2011, depreciated, now at $0.69USD

• This can be attributed to the continuously slow global conditions, resulting in both a low level of D for Aus' X and falling I in Aus. This has had negative impacts on the Aus eco, with Aus now experiencing a decade-low level of eco growth of 1.4%, far from its LT average of 3%. This has spurred the RBA to implement highly expansionary MP, with the cash rate currently sitting at a record low of 1%. This, in comparison to the US' 2.5%, has meant that I inflows into Aus has been lessened, resulting in falling D for the AUD. The AUD currently sits at $0.68

↓ PROTECTION AND ↑ FTAS OF AUS

- ↓ protection/↑ FTAs of Aus --> ↑ comp of niche ag markets and services X --> ↑ D for AUD Make sure you have a sentence in the beginning of the para so that it does not seem disjointed from the previous sentence e.g. Despite the depreciating AUD, demand for AUD is being fuelled by….

LNG XS

- Global shift towards more environmentally sustainable fuels --> ↑ D for Aus' LNG X's --> ↑ D for Aud

SPECULATION AND DIRTYING THE FLOAT

- Excessive speculation from both dom and int influences can affect the AUD, as 95% of AUD trade is in speculative activity (buying/selling of currency in the ST to earn profits off currency P movements) --> prone to changes in I sentiment
  - GFC: Aus lost 30% of value due to expectations that the AUD would continue to fall - Such expectations incurred a case of momentum trading as the falling dollar prompted other speculators to sell AUD --> increasing S further (herd mentality) --> causing it to overshoot - caused the RBA to intervene by dirtying the float
- If individuals in the dom eco expect an ↓ in the value of the AUD, they will sell their AUD leading to an ↑ S and hence, fulfilling the expectations of a depreciation

Q. EXPLAIN HOW MOVEMENTS IN THE AUSTRALIAN DOLLAR CAN AFFECT THE PERFORMANCE OF THE AUSTRALIAN ECONOMY

Q. ASSESS THE IMPLICATIONS OF RECENT EXCHANGE RATE FLUCTUATIONS ON THE AUSTRALIAN ECONOMY

INTRODUCTION

- An exchange rate (E/R) refers to the value at which a unit of dom currency is exchange for a given amount of another foreign currency.
- Since 1983, Aus has adopted the floating E/R system, with the value of the AUD being dictated by the P mechanism of S&D in the forex market.
  - (The value of the E/R can also be measured bilaterally or using the Trade Weighted Index, which compares the movement of the AUD relative to a basket of currencies of major trading partners) • While rising to a peak of $1.1USD in 2011 since the end of the MIB, Aus has experienced a depreciation of the AUD underpinned by global factors such as slowing world growth and I/R differentials, affecting the D for the AUD, while slowing domestic growth has also contributed to the greatest depreciation of the AUD since 1983, now at of $0.69USD. • This

depreciation has had multi-faceted impacts on the Aus eco, as in the ST, BOGS suffer, alongside the purchasing power of individuals. However, in the LT, a depreciation is said to have positive impacts on the businesses and overall economic performance of the Aus eco.

TRENDS PARAGRAPH

- With 50% of Aus' X being fuel and minerals, Aus is labelled as a 'commodity currency'. This was especially the case during the MIB as the D and consequently, the P of Aus resources rose significantly, as the ToT rose to 106 in 2011. This saw the AUD rise to a peak of $1.1USD. While in the ST this appreciation has brought upon favourable impacts such as improved purchasing power and X profits, particularly P elastic, trade-exposed industry began to suffer, such as manufacturing, services X and agriculture. The services industry recorded a 12% fall in rev during 2007-12, resulting in the formation of the 2 speed economy, causing income inequality and structural U/E
- Therefore, in a bid to remedy and address the 'Dutch disease' the Aus gov attempted to depreciate the AUD

CAUSE OF DEPRECIATION

MONETARY POLICY

- The most prominent addressal of this issue was the RBA's expansionary MP, significantly cutting the cash rate 3% from 4.75%, lowering the level of interest gained from lending to Aus in comparison to other adv ecos. This resulted in a decrease in foreign K as lending to Aus became less desirable, and hence lowered D for the AUD.
- This shift towards a depreciation of the AUD was assisted further by the timely slowing down of the global eco, as China's growth began falling to 6-7% from a high of 14.2% in 2007. • This has resulted in rapidly decreasing levels of D for Aus' X and falling I in Aus, both resulting in falling D for the AUD
- Both these factors have contributed to the depreciated AUD as it has fallen since 2011 from $1.1USD to now $0.68USD

SHORT TERM EFFECTS OF DEPRECIATION

INDIVIDUALS

- --> ↓ PP + ↓ SOL
- In the short, immediate term, a depreciation of the AUD is said to have negative impacts on the economy, which predominately is true in terms of the purchasing power of individuals. • As the value of the AUD deteriorates, the P of M rises, thereby eroding the purchasing power of

consumers. This will in turn, lower the SOL in the eco

BUSINESSES

- A depreciation will also negatively impact the performance of Australian businesses. In the immediate term, it is said that volume of both X and M remain constant, as consumers are not responsive to P changes.
- Therefore, a depreciated AUD will mean that overseas consumers can pay less for the same amount of X (cheaper), meaning that Aus X rev will in turn, fall. This will not only reduce company profits in the bus, but also contribute to a worsened BOGS.
- This will only be worsened by a constant, unchanged D for M, despite them becoming more expensive from the depreciated AUD, as volume remains constant also.
- Businesses that M inputs or K goods will also suffer from a rise in a cost of prodn leads to increase U/E and imported inflation

VALUATION EFFECT

- As the AUD depreciates, the size of debt repayment/debt servicing costs (interest repayments) increase, resulting in an worsened NPY deficit and hence a worsened CAD. This will worsen external stability.
- However in practice, this process known as the 'valuation effect' has negligible impacts on the NPY and hence CAD as almost 90% of loans are denominated in AUD, while a large % of Aus' net foreign liabilities are hedged through derivatives and natural hedges --> reducing Aus' currency exposure.

LONG TERM EFFECTS OF DEPRECIATION

- As demonstrated by the J-curve, in the LT, a depreciation of the AUD will bring upon favourable benefits for the BOGS, as consumers start to adapt to P changes, hence meaning that volume is variable.

BUSINESSES

- While the depreciated AUD means that Aus' X are still cheaper, there will be growing D for Aus X as int comp rises, resulting in a greater bus profits as well as improved BOGS, as volume of X increases. This was the case following the depreciation of the AUD in 2012, as P-elastic sectors such as services X began growing by over 12% annually, while the ag industry grew by 4%
- Furthermore, as M become more expensive, the volume of M decreases over time, resulting in an improved BOGS

INCREASED ECO GROWTH

- The amount of foreign currency to purchase the amount of AUD to purchase dom assets in Aus have decreased, meaning that I in Aus has become more attractive.

- Evident during 2015-16, where financial inflows increased rapidly

• This will result in an increase in FDI and portfolio I, thereby increasing eco growth • This has been the recent trend, as since 2012, FDI inflows have increased by 40%

INFLATION

• May rise again due to high eco growth

• Also, imported inflation is still an issue

GOVERNMENT POLICIES

DIRECT INTERVENTION (DIRTYING THE FLOAT)

• In order to prevent excessive speculation, the RBA may intervene by 'dirtying the float'. • To prevent an excessive depreciation, the RBA may buy some AUD in the forex market to place ↑ pressure in the S of the AUD, hence preventing a depreciation (VV)

- In late 2008, when the AUD dropped by ⅓, the RBA bought $3.3b to moderate this depreciation - In 2009, these reserves were sold after the AUD recovered in value. - The RBA has limited foreign currency holdings (less than one day's total transactions in AUD), so this limits direct intervention.

INDIRECT INTERVENTION – MONETARY POLICY

• If the RBA wants to curb a rapid depreciation, it can increase the demand for the $A by raising interest rates. (higher demand for AUD by foreign investors -> higher ER)

- The RBA's main goal is to influence inflation, so the ER is rarely a consideration. - However, a sustained 10% depreciation leads to an 0.25-0.5% increase in inflation

INDIRECT INTERVENTION – JAWBONING

• Release of information to the public without acting upon it --> encourages speculative behaviour

6. PROTECTION + FREE TRADE

• There is a total of 8 policies (4 domestic and 4 global)

• If the Q asks for both dom + global, omit one dom or global

• If the Q asks about Aus' policies regarding free trade + protection,

- Talk about 2 main bi-lateral free trade agreement (CHAFTA and AANZFTA)
- One multilateral – AANZFTA
- Then talk about how sentiments towards free trade has, in recent times, deteriorated due to GFC + retaliation + dumping etc
- Discuss all 4 of Aus' protectionist policies

INTRODUCTION

• Protectionist policies refers to artificial barriers that provide dom producers with an artificial advantage when engaging in trade, commonly in the form of tariffs, subsidies and quotas. • Since the 1980s, globalisation has greatly facilitated the shift towards free trade, with many ecos, including Aus removing trade barriers (av tariff drop by 15%) to reap the benefits of improving both technical and allocative efficiency in the LT, while also reducing P of G/S.

• However, since the GFC, major ecos such as China and the US have begun re-adopting their protectionist policies, ultimately prompting Aus to retaliate with policies of its own. • While lower barriers to global trade have greatly benefitted economic growth and prosperity in the Aus eco for the past 3 decades, these benefits are slowly deteriorating with the prominence of trade tensions, negatively impacting the performance of the Aus eco.

• These include the misallocation of resources, rising prices and SOL of an eco

RECENT TRENDS

• After the GFC, major ecos have begun a shift towards protectionist policies in an attempt to reduce their reliance on the global eco for eco prosperity, while also spurred by motives to protect domestic employment. In fact, the introduction of protectionist policies have outpaced their termination by 3:1 in the G20. This has been experienced by a substantial rise in the number of trade protection mechanisms.

AANZFTA

• Since trade liberalisation in 1970-80s in the global eco, many ecos have been establishing free trade agreements, referring to formal agreements between ecos to abolish barriers to trade • This is mainly owing mainly to the ineffectiveness of the WTO

• In fact, the number of FTAs has increased from 27 in 1990 to now, over 400

• AANZAFTA - 2010 is Aus' first and largest multilateral FTA

• Benefits include

- Aus X tariffs from 33% to 4% benefitting over 20% of Aus' X
- 99% of X to Indonesia will enter tariff-free
- More efficient and comp industries through access to global supply chains significantly cheaper labour – Thailand av manufacturing worker is $12,000 compared to Aus, $60,000 •

Disadvantages are

- Dumping, etc

CHAFTA

- In 2015, Aus has also established a bi-lateral free trade agreement with China, its largest X and M market (1/3rd of X go to China)
- Benefits
  - 86% of Aus X are now tariff free expected to reach 98%. Benefits P elastic industries such as beef, wine, dairy etc
  - 15% tariffs on Chinese manufactured goods cheaper P
  - Guaranteed market access for Aus service providers such as hotels, financial institutions etc - Aged care institutions
  - Under CHAFTA, total good X to China have ↑from $75Bin 15 $106B ↑eco growth and ext. stability.
- Disadvantages
  - For projects worth over $150M additional rights to bring in temporary migrant workers 5000 working holiday visas annually
  - No tariff reductions on sugar

AUSFTA

- Aus' 2nd largest trading partner
- Benefits
  - 90% of Aus X are tariff free
  - Merchandise Processing Fee removed by USA $10M saving for Aus
  - 66% of ag tariffs to 0
  - Doubled I between US and China
  - Estimated 0.4-0.7% GDP for Aus within 5 years
  - Mutual recognition of overseas trained doctors severe shortage of rural Aus health service sector
- Disadvantages
  - Non-equivalent removal of tariffs
  - Preventing entry of Aus cosmetic products into EU

COMPREHENSIVE AND PROGRESSIVE AGREEMENT FOR TRANS-PACIFIC PARTNERSHIP (CPTPP)

- A new FTA between Aus and 11 other eco.
- Similar to the bilateral agreements of CHAFTA and KAFTA, the CPTPP benefits Aus' aim in transitioning from mining-led to services and agricultural led growth with the agreement eliminating more than 98% of tariffs in the free trade area.
- Initiatives include new reductions in Japanese tariffs on beef, significantly benefiting Aus exporters

with Aus beef X to Japan worth $2b in 2017.

- It also includes the elimination of all tariffs on sheepmeat, cotton and wool, seafood and wine, which further benefit Aus agriculture X.
- With services to CPTPP countries accounting for 21.5% of total Aus services X, the CPTPP enhances the level of transparency and predictability for Aus services exporters.
- Moreover, the Agreement also promotes productive foreign investment in Australia by liberalising the screening threshold at which private foreign investments in non-sensitive sectors are considered by the FIRB, from $266 million to $1.154 million.

- Whilst, this potentially impedes on the gov's ability to achieve external stability as a result of ↑credits on theKAFA, its impacts have been minor. Therefore, assists Aus' transition to services-led growth, as well as ensuring low inflation and increased external stability through greater market access

GLOBAL TARIFFS

INDIA'S TARIFFS ON CHICKPEAS AND LENTILS

- A commonly used form of protection are tariffs, or taxes on M, implemented to increase the cost of M in their dom market, thereby allowing their dom producers to become more P comp, hence providing an artificial advantage.
- Since 2012, India has begun raising their tariff rate on agricultural M such as chickpeas and lentils, from 30% to now 60%, in an attempt to both improve the competitiveness of their own farmers, while also being a means of retaliation against the US' recent adoption of tariffs.
- Australia, the world's largest exporter of chickpeas, has been adversely affected, with the value of Aus Chickpeas exported to India, since 2011/12, has increased 995%.
- Aus' competitiveness in the Indian market has deteriorated rapidly, to an extent where half of chickpea plantation in Aus has been now ceased, with many now undergoing a transition to cereal and canola as a replacement.
- This has had the direct effect of worsening BOGS in the Aus eco, while also creating structural U/E in rural areas, where agricultural prodn is prominent.

US CHINA TRADE WAR

- Trump since taking office, has initiated a major Global Trade War against its largest trading eco, China – Due to growing concerns regarding national security and self-sufficiency, with great emphasis on job/employment creation
  - In 2018, the US has applied tariffs on a total of $360B worth of Chinese M, ranging from 10-45%, while encompassing a wide range of industrial and consumer items.
  - It has also imposed a worldwide 25% tariff on steel M and 10% on aluminium to slow down growing structural U/E in these inefficient industries of the US.
  - This has not only further impacted Chinese industries, but also major Aus bus such as Arrium, who has previously depended on access to US markets for major X.
- Such protectionist measures have been met with retaliatory policies from China, Canada and the EU, causing implications on the global eco

- China has imposed tariffs on $110B worth of US M along with a 25% tariff on US LNG, while the EU has increased its tariffs on American motorcycles from 6% to 31%.

- In the immediate term, Aus will benefit from such growing trade tensions, with China adopting stimulation packages through various infrastructure projects to boost eco growth and ultimately, self-sustainability
- This has contributed greatly to the increased X of Aus LNG to China by 37%, while Aus also accounting for 40% of China's coal M. However the long term, foreseeable ramifications of this trade war is expected to greatly outweigh its benefits.
- 2% fall in the ASX overnight fall in I confidence
- This conflict involving two of Aus' biggest X partners, is expected to lower GDP by 0.25% and further 0.5% in continuing years for both ecos involved. Ultimately, this will have the inevitable effect of reducing D for M within these ecos, projected to contribute to a 0.3% lowering of Aus X by 2022 (LT effect)
- This will be underpinned by the inevitable fall in D for Aus X such as coal, alongside P-elastic X such as services, of which China accounts for 25% of.
- It is projected that over 5 years, over 60,000 jobs will be lost, as well as the reduction of wages of 2.4%
- This reduced X rev will consequently lower Aus' economic growth while also increasing U/E for Aus workers in the primary industry, posing serious threats to Aus' already low eco growth

GLOBAL SUBSIDIES

AGRICULTURAL SUBSIDIES

- Subsidies, referring to financial assistance provided to dom suppliers, have also been prominent, especially in agricultural industries, due to the elastic nature of the products, along with the level of comp on the global market
- The EU has, since 1962, adopted the Common Agricultural Policy, annually accounting for 37% of the EU's budget from a previous 73%.
- Although a substantial decrease, this subsidy still accounts for 20% of European farmer's Y. Similarly, Japan, despite highly inefficient production of food, prioritises self-sufficiency, providing farmers with subsidies that account for 50% of farmers' Y. Both Japan's and the EU's subsidies are in stark contrast to the assistance Australian farmers receive, contributing to a mere 2% of Y. This extreme disparity has prevailingly made it difficult Aus' ag X industry to thrive, with ag as a % of GDP decreasing from 24% --> 12% in the past 25 years, while also reducing an estimated $9B per year.
- Reduces ag output of all eco by 5% annually,

GLOBAL QUOTAS (IF ESSAY Q IS GLOBAL + DOM, INCLUDE)

CHINA BANS COAL IMPORTS FOR AUSTRALIA IN DALIAN PORT

- China's govt policy – limit Aus coal Xs to 12 million tonnes a year, severely reducing market

access to Aus' greatest X destination, accounting for a third of trade.

- Official reason – checking for quality
- Unofficial reason – retaliation against Aus banning Huawei building 5G network in Aus (national security)

DOMESTIC PROTECTION

X INCENTIVES

- Therefore, as a result of rising global protectionist policies, Aus has increased funding by $60M to the EMDG, a scheme to encourage small to med size bus to penetrate X markets, by reimbursing Xers for some of their costs in promoting their X in new markets.
  - The gov covers 50% expenses above $5000 provided that their total expenses are at least $15,000, meaning that Aus bus will be able to produce more efficiently and hence operate in foreign markets at a lower P, increasing int comp.
  - The EMDG has assisted over 4000 Aus bus, with each dollar spent generating net eco benefits valued from $1.55 to $7.03. While for the government, such scheme will, in the short run, improve the competitiveness of Aus X, contributing to the current BOGS surplus of $8B, by generating $3B in X rev.
- However, such methods of protection may shield or misleadingly better inefficient industries, hence leading to an inefficient allocation of resources in the LT.
- For gov --> ↑ G . But, in the LT, this will derive further benefits as Aus' X comp increases

ANTI-DUMPING OF CHINESE STEEL

- While attempting to improve the competitiveness of dom producers, Aus has also actively protected dom employment, especially from overt acts such as dumping, referring to the selling of a good in a foreign eco at below the cost of prodn in the home eco.
- Recently, in a bid to protect dom steel producers from the dumping of steel by china, Aus has implemented tariffs of 15% in 2018 --> decline of iron and steel M from $400m --> $250M from 2012-->17
  - BlueScope experienced a 119% increase in profits from the previous year
  - Also has benefitted the gov, as it has experienced an ↑ in rev from $390B --> $488B from 2012-16 - But for individuals, it has meant that individuals have experienced ↑ P by an av of 20%
- Has benefitted domestic steel producers such as Arrium where 65% of its sales base are subject to anti-dumping applications □↑ artificial international competitiveness.
- Whilst this measure protects the employment of approximately 100000 individuals in the uncompetitive steel industry, it has consequently led to a reduction in allocative efficiency, as well as higher input costs for firm

- Productivity Commission estimates that for every $1 increase in tariff revenue, economic activity decreased by 64 cent

TARIFFS ON ITALIAN TOMATOES

- 5-8% tariff on 50% of imported tomatoes as Italian producers from the SAP have been able to produce cans at below cost
- This has had the effect of ↑ P by an average of 25%, 60c --> 75c for canned tomatoes •

This will ↓ choice and ↑ P for consumers

- But, Aus' sole canned tomato producer, SPC Ardmona, can compete against cheaper imports: 70c vs $1.40

LOCAL CONTENT RULES

- Moreover, another protectionist policy is Aus' implementation of a procurement of materials for gov projects through local content rules. Under the legislation changes in 2016, companies bidding for gov projects worth more than A$4m will be required to outline how much locally produced material is included and that their inputs comply with Aus product standards. These measures aim to benefit local firms, such as steel producers through the ↑emphasis on local content but because of the clauses around standards and whole of life costs, and the assistance of eliminating the presence of imported products in the market ↑artificial international competitiveness. These local content rules assist in ensuring employment in Aus firms but at the expense of ↓allocative efficiency, as well as ↑cost push inflation through the increase in input costs of Aus firms.

7. ECONOMIC GROWTH

ACCOUNT FOR THE CHANGING SOURCES OF ECONOMIC GROWTH IN AUSTRALIA AND ITS EFFECTS ON THE AUSTRALIAN ECONOMY

- Eco growth is underpinned by an expansionary stance of the MP
- H/H C increased by 0.3% and was 1.7% higher in year ended terms --> very weak C growth as it usually contributes to 60% of GDP
- General G exp on C was strong at 5.4% over the year --> 0.2% of GDP contribution
- I showed weakness in terms of the contraction in dwelling I by -1.9% over the year

• Net X --> contributed to growth with a 2% rise in X and a -0.6% decline in M --> 0.2% contribution to GDP • ToT rose by 3.1% (currently 100)

MINING BOOM 2003-2008 -

• ↑ World growth, especially from China, who has been growing at an average rate of >10% from 2000-10. This meant the D for our commodities such as iron ores and coal, used for energy ↑ ↑ X P and eventually, volume growth.

- Peak of 4.1% growth in 2003/04

'The rapid industrialisation and urbanisation of the Chinese economy underpinned the strong rise in commodity prices from around the mid 2000

• Effects

 ↑ Employment in the mining sector --> early 1990s: peak of 10.5% --> Since the mining boom, downward trend to 4% (lowest since 1974) and also decreased U/E by 1.25% - especially strong in resource-strong eco such as Qld and WA--> ↑ SOL from ↑ Y
H/H disposable Y raised by 13%, real wages by 6%

 New bus I I spending by the mining sector increased from 2 per cent of GDP to 8 per cent (increased I) --> ↑ growth of many sectors

 Inflation – as high as 4.1% in 2007

 Environmental degradation

 Also, ↑ NPY deficit as company profits in the form of dividends leave Aus
50% of coal and 70% of LNG industry is foreign owned

APPRECIATION OF THE AUD

• 0.85 1.02 2010-12

• Formation of the two speed eco – reliance on X based sectors for growth – manufacturing, agriculture and service X suffered.

• The AUD appreciated from 0.47 USD to 0.85 from 2001-08 due to commodity P and D -

U/E in many sectors that suffered due to the appreciation ↓ SOL

- This also meant ↑ transfer payments for govs ↓taxation
- But ↑ purchasing power
- 2 -speed economy
- Tourism in some ares such as nth queensland fell 8%
- The Chief executive of the Queensland Tourism Industry Council has labelled it as 'catastrophic' - Cairns which has thrived on tourism, had U/E as high as 8.3%
- Manufacturing also suffered, as the Aus Industry group's index for industrial performance fell to 40.3, the lowest level since the GFC – Ford laid of 440 workers in Victoria – 2012

GFC

• Saw a sharp decrease in X-M due to ↓ growth of major trading partners – world growth at -1.7% • However, Aus maintained positive growth of 1.5%, but relied on macroeco policies - fiscal stimulus package and expansionary MP for growth

- ↓ C and I as a result of decreased confidence

• ↑ U/E --> ↓ SOL

• BOGS deficit --> CAD got worse at 6.6% (average of 5%) --> lowered our external stability • Gov revenue decreased

INTRODUCTION

• Economic growth refers to the increase in the total output/volume of G/S that an eco produces over a period of time, typically a year. It is measured by the annual rate of change in real GDP, and typically occurs as a result of an increase in aggregate demand (C+I+G+X-M), referring to the total level of expenditure/D in an eco. This growth is usually sustained, as is the case for Australia, by growth in the eco's aggregate supply, or total productive capacity, as the eco is able to meet growing D, hence allowing greater rates of growth. Australia, over the past few decades has relied on changing sources of eco growth, utilising them to sustain a historical record growth period of almost 30 years. This includes the mining I boom in 2003-08, continuous, effective use of macroeco policies such as FP and MP, and also various MERs such as labour reforms, infrastructure spending, and trade liberalisation. Generally, the impacts of eco growth on an eco is considered to be desirable, translating into improvements in the QOL, U/E and ↑ I for businesses. However, the different sources from which growth occurs as a result of can bring upon potentially negative impacts. Aus has experienced such through the accelerated deterioration of the environment, a 2-speed economy, and inflation.

MINING BOOM

• Since 2003, Australia's X industry has benefitted from strong world growth, exceeding an average of 10%. This was driven especially by China, as it underwent rapid industrialisation/urbanisation. Therefore, D for Aus' commodities such as iron ore and coal increased significantly, resulting in a consequent ↑ P, with iron ore P increasing over tenfold in from 2003-09. Aus soon saw an improvement in its ToT, reaching 95. This strong growth in the commodities X industry of Aus drove its strong economic performance over the early to late 2000s, reaching a peak growth of 4.1% in 2003/04. While mining normally accounts for 2% of GDP, it contributed over 8% during the period of the mining boom.

• As a result of high D, U/E in the mining sector decreased significantly, particularly in the resource rich states such as Queensland and Western Australia. Overall, U/E ↓ by 1.25%, to approx. 4%, the lowest since 1974. As in the long term more jobs were created in the mining sector, an increase in real wages by 6% was observed, and along with an rise in H/H disposable Y by 13%, resulting in an increased in the SOL for many, especially those who owned mining assets. This also subsequently amplified C in the dom eco, further driving growth.

• Businesses in the mining sector, due to positive expectations, began to I in K goods at a much greater rate. As spending increased in the mining sector form 2% of GDP to 8%, many businesses began to grow greater eco growth.

• However, the mining boom also brought upon undesirable impacts on the Aus eco, as inflation began to rise as the eco neared full capacity, to a high of 4.1% in 2007, reducing the PP of consumers, resulting in a ↓ in SOL soon after the occurrence of the mining boom.

• The CAD was also negatively impacted after the mining boom, as the high levels of FDI and portfolio I inflows in the KAFA account, resulted in high levels of NPY debits, leaving Aus in the form of dividends and interest repayments. As 50% of the coal and 70% of the LNG industry is foreign owned, much of the profits gained as a result of a surge in mining activity soon left Aus to its foreign investors. This saw the worsening of the NPY account, resulting in a growing CAD, surpassing 7% of GDP in 2005.

• Heavy mining activity also had implications on the environment, as the ↑ use of K goods was fuelled/sustained by the use and subsequent depletion of non-renewable, carbon-emitting commodities such as natural gases/coal. The climate change department predicted Aus' emissions will

↑ by approx. 24 percent by 2020 compared to 2000 levels, apportioning responsibility to the extraction and processing of energy resources. This, in the long term will result in a lower SOL for individuals.

APPRECIATION

• As D for Aus' commodities ↑, the D for the AUD also followed suit, reaching $1.12USD in 2010 from $0.85USD in 2012. While this proved to ↑ the purchasing power of dom consumers, the international competitiveness of many other sectors that X elastic goods suffered below av. growth namely agriculture, manufacturing and service industries. This resulted in the formation of the 2-speed economy, as disparities between the mining sector and the aforementioned sectors began to grow.

• This saw a rise in the U/E rate of many of these sectors, resulting in a ↓ in SOL -

This also meant ↑ transfer payments for govs ↓taxation

GFC

• Strong economic growth was soon interrupted after the mining boom by the GFC in 2008/09 as the world eco growth fell to -1.7%, including many of Aus' major trading partners such as the US, who had 0.5% growth. As a result, the D for Aus' commodities also decreased, meaning Aus could no longer rely on X as a source of growth. However, as a result of Aus' effective eco management in using pre emptive MP as well as FP, Aus was able to avoid a recession, yet instead maintain a positive growth of 1.5%.

• The Aus gov used the fiscal budget to stimulate the eco, allowing it to rely on G (government expenditure) as a source of growth. The Rudd government, in total, used a $52B stimulus package ($10B in 2008 and $42B in 2009), as every average single worker received a $900 immediate, one-off payment, in a bid to encourage C.

• The RBA also utilised expansionary MP, as it decreased the cash rate from 7% in 2008 to 3% in 2009 in an attempt to ↑ C and I, in a period where confidence was low.

• Although Aus was able to weather the events of the GFC without much damage to its eco, U/E, as a result of an increased in cyclical U/E, increased overall by 2%. As a result, gov revenue from Y tax was significantly lessened. This, along with increased expenditure on the fiscal spending saw a general increase in gov debt to X

LOW DOM I/R

• Soon after the GFC, Aus began to focus on rebalancing its eco and to remedy the 2-speed eco that formed as a result of the strong performance of the AUD after the mining boom. It also began its transition from relying on mining I as a source of growth to non-mining industries. Therefore, to assist this structural change, the RBA decreased the cash rate from 4.25% in 2012 to 1.5% in 2016. This saw a decrease in D for the AUD as I was not seen to be as profitable, and ultimately, a depreciation of the AUD from $1.02USD to $0.76USD. This supported the growth of the service X, as education, tourism and manufacturing X were able to be more internationally competitive.

• This alleviated some of the U/E in certain areas of Aus that was affected most, especially in tourism dependent areas such as Cairns, that suffered U/E as high as 8.3%, increasing the SOL in those

areas.

ASSET P

• Aus' housing P have seen an upward trend since 2014, reaching a peak of 4% growth, caused mainly by high investor confidence and increased capital inflows from China into housing assets. • However, since 2017, property values fell by $133B, indicating a slowdown in the housing market (starting a downward trend). This has largely impacted eco growth negatively, due to a decreased, or lessened wealth effect, where the net worth of property owners decrease, leading to lower C due to falling confidence in the security of Y and W etc.

• However, recently, there has been an increase of 0.8% on average in dwelling prices nationally in Aug 2019. This increase should be further stimulated by the cash rate cuts, which promotes borrowing and I into housing assets

AS PARAGRAPH

• While growth can be the result of ST increases in AD, much of the reason as to why Aus has been able to sustain LT growth for almost 3 decades is due to consistent expansions in AS, as such improvements allow a greater capacity of eco growth as it can keep pace with rising AD, sustaining it without the impacts of inflation.

MER - PRODUCTIVITY GROWTH

• Various microeco reforms in the late 1980s --> early 1990s, especially in the labour market, resulted in strong labour productivity growth, from 1.3% in 1980s to 2.1% in 1990s. MERs such as the liberalisation of trade through the removal of tariffs and quotas also exposed many dom businesses to competitive pressures and encouraged the integration of tech in their prodn process, to compete with global producers. This led to greater rates of innovation in Aus and increases in productivity. This increase in competition benefitted consumers, as the P of G/S decreased, as well as a greater range of choice.

MER – INFRASTRUCTURE

• Aus, after suffering from capacity constraints, which manifested mainly as bottlenecks in transportation began focusing on infrastructure to sustain prevent the recurrence of such limitations to periods of strong eco growth. This was evident in the years following the GFC, as the gov, in its fiscal budget, introduced many LT infrastructure initiatives such $22B "Nation Building Infrastructure" in transport, broadband, clean energy, universities and health care.

• The total productive capacity of the Aus eco has also been increased due to the ↑ population in recent decades, as it allows for a larger labour force and hence, greater G/S prodn. This growth in pop has been driven mainly by migration, accounting for over 64% of Aus' population increase since 2001. The number of skilled migrants has also increased from 45000 in 2000 to over 130,000 in 2017, increasing overall productivity of the workforce, better equipping it to meet D, as a larger amount of

output can be produced from the same amount of input.

- Therefore, Aus has relied on many sources to increase AD and hence, growth in the ST, including the performance of the global eco and macroeco policies. However, to sustain LT growth, it has also invested in many microeconomic reforms to increase AS. These various sources has had multi-faceted influences on the economy of Aus.

8. UNEMPLOYMENT

Q. ANALYSE THE CAUSES OF UNEMPLOYMENT AND ITS EFFECTS ON THE AUSTRALIAN ECONOMY + MACROECONOMIC POLICIES

INTRODUCTION

- U/E refers to the situation where individuals are willing/able to work and are actively seeking it, but are unable to find suitable employment.
- It is measured by the number of people unemployed in the labour force as a %, currently at 5.3%. • U/E is primarily the result of downturns in the eco leading to ↓ AD, as well as structural change. Other types/causes of U/E include frictional, hidden U/E, along with productivity growth and movements in participation rates.
- It is generally considered that a rise in U/E is negative for the eco, being the cause of both social and eco issues. These include a higher opportunity cost of lost output, lower SOL, as well as worsened income inequality.
- Therefore, containing U/E is one of the Aus gov's main objectives.
- Fiscal Policy and Monetary Policy are extensively used to achieve this, but having been limited by the NAIRU (Full employment), where cyclical U/E does not exist, MERs and in particular, labour market reforms, are necessary.
- While the Aus gov has largely been successful in containing U/E with U/E at 5.3%, this statistic does not fully reflect the growing problem of underemployment in Aus, where people who work part

time/casually wish to work longer hours.

• Currently at approx. 8.5%, this has contributed largely to Aus' underutilisation rate of 8.9%

CAUSES

CYCLICAL

• Cyclical U/E refers to U/E resulting from a contraction in eco activity/AD, also known as involuntary U/E •

This is as the D for labour is a derived D from the G/S it produces. Therefore, as eco activity contracts, the D for G/S falls due to decreased confidence and Y in the eco --> ↓ D for labour and hence increased U/E

• It is generally considered that U/E rises when EG is below 2.5%, and falls when EG is above 3% •

Cyclical U/E has been a sig contributor to U/E in Aus, as EG is below LT average, at 1.4% currently •

During the GFC, eco growth fell to 1.3%, resulting in an increased U/E rate to 6.2% from 4%.

STRUCTURAL

• Structural U/E occurs as a result of a mismatch between the skills required and available in the eco, being the result of structural change in the eco. This refers to the process by which patterns of prodn changes to reflect changes in tech, consumer D, global comp over time.

• With the MERs of 1980s-2000s initiating extensive structural change in the eco, structural U/E has accounted for most of Aus' persistent LT U/E.

• There are two main causes

  • Technological change

    - Emergence of new prodn methods and techniques in the past few decades have led an increased substitution of labour for K, due to increased efficiency and productivity --> leads to increased redundancy and hence structural U/E
    - The growth of computer tech and automation will threaten 52% of jobs in the next 15 years --> 'Future workforce trends in NSW' report 2015

  • Globalisation/MER

    - Trade liberalisation MER in 1988: Tariffs down from 20% in 1990 to 1.7% in 2016. This has led to increased exposure of Australian manufacturers to low cost Asian comp such as China, Japan and Korea.
    - This was especially the case with Australia's automotive industry. Failure to compete with cheaper manufacturers, and the withdrawal of a $600M subsidy --> resulted in the 'hollowing out' of Aus manufacturers such as Holden, Ford and Toyota, as 50,000 jobs were lost in 2017 --> structural change as resources begin to flow towards more efficient industries (time lag)
    - Thailand, who is now our 2nd greatest source of motor vehicles after Japan and ahead of Korea, pays $12,000 salary for workers, whereas pays $60,000-70,000
    - This shift was responsible for 1/3rd of job losses in 2017
      - Could also talk about shift away from mining boom. 15,000 jobs to 90,000, now back to 30,000

FRICTIONAL

• Represents people that are temporarily unemployed as they change jobs

- It is inevitable, but can be reduced by efficient job matching services
- Frictional and structural U/E combine to form the NAIRU, the Non-accelerating Inflation Rate of Unemployment, otherwise known as full employment.
- This suggests that structural, frictional and hardcore U/E are inevitable, and any efforts to reduce U/E below this point will lead to inflation

HIDDEN/DISGUISED

- Refers to those who can be considered U/E but do not fit the official definition, therefore, are not reflected in the U/E stats
- Include discouraged job seekers, or those not actively seeking employment due to family, ST illness, study etc

PRODUCTIVITY GROWTH

- In the ST, an increase in prod from MER etc will lead to an increase in U/E as fewer employees will be required per unit of output
- However, in the LT, an increased productivity will lead to an increase in eco growth as AS increases, hence leading to a greater D for G/S and thus, greater D for labour to meet this ↑ D.

PARTICIPATION RATES

- During periods of eco recovery, many who were previously not looking for work, such as discouraged jobseekers, will see that employment opportunities are improving and hence, start seeking it.
- They will re-enter the labour force, but unless they obtain a job immediately, will become U/E

UNDEREMPLOYMENT

- Refers to those who work part time or casually but wishes to work more/switch to full employment • Reflects the shift away from full time work to casual --> casualisation or labour fragmentation • Suggests that employers/bus are more willing to reduce hours than to lay off employees • Causes include --> the gig eco, more flexible work hours as well

EFFECTS

OPPORTUNITY COST OF LOST OUTPUT AND INCOME

• U/E means that the labour resources of an eco are not being used to full capacity, meaning the eco is operating below its production possibility frontier.

• As a result, real GDP is lower than it should be, as the total output of G/S is lowered. • As a result, AD falls, leading to lower eco growth, as bus I, C and prodn all falls, leading to further U/E and hence, initiating a cycle

LOWER WAGE GROWTH

• ↑ U/E means that there is an excess of S in the eco. According to the P mechanism, this should lead to a fall in the equilibrium level of wages
- Low at 2.3%

• However, it is generally considered that wages have a 'downward stickiness', meaning they do not tend to fall/get reduced as they are set through formal enterprise agreements or industrial awards • Instead, ↑ U/E --> manifests into slower wage growth rather than actual reductions in wages

LOWER SOL

• U/E also worsens the standard of living in the eco

• For the U/E, Y falls as they become dependent on welfare payments --> ↓ choices and opportunities for spending, saving, education and healthcare --> ↓ SOL

• Similarly for the employed, tax burdens rise as they cover the cost of Y support to the U/E --> ↓ y_d --> ↓ SOL

LOSS OF HUMAN CAPITAL AND LABOUR MARKET SKILLS

• Over time, cyclical, or ST U/E can develop into LT structural U/E through hysteresis, the process by which U/E in the current period leads to a persistence of U/E in the future periods as the U/E lose skills, job contacts and motivation --> ↓ AS in the future and hence further ↓ eco growth

GOVERNMENT

• ↑ U/E will lead to ↓ tax rev and also, ↑ transfer payment obligations to the unemployed – automatic stabilisers

• In terms of discretionary spending, the gov will also be required to increase funding to training and labour market programs/injections into the eco --> deterioration in the gov's budget stance, or ↑ opportunity cost, which can be used elsewhere --> ↓ eco development

WORSENED INCOME INEQUALITY

• U/E also results in a more unequal distribution of Y, as the U/E become more reliant on Y support from gov welfare payments --> ↓ Y for consistent periods of time --> ↑ inequality, contributing to other major social issues such as poverty, family tensions, crime, mental health

MAIN GROUPS

• Youth: 3x general pop, due to insufficient number of entry level jobs, poor secondary education outcome •

Indigenous Aus: 4x nat av a 21.3%

- Age related
- Specific regions
- Immigrants

POLICIES TO ADDRESS CYCLICAL UNEMPLOYMENT

- The gov will use expansionary macroeco policies to stimulate eco growth to counteract cyclical U/E, which occurs as a result of ↓ D for G/S in the eco
- However by Okun's law

MONETARY POLICY

- **MP refers to the RBA's manipulation of the cash rate to influence consumer/investor sentiment and hence affect AD.**
- Through the intertemporal substitution channel, expansionary MP has the effect of stimulating eco growth as borrowing becomes cheaper, encouraging both consumers and investors to consumer and invest --> ↑ AD. This will lead to ↑ eco growth, as more G/S will be D --> ↑ D for labour
  - It also has the effect of discouraging savings as the interest gained on loans is low --> currently at an all-time record of 0.75%
- In the exchange rate channel, an expansionary I/R also causes the depreciation of the AUD, leading to ↑ Int comp of services X --> ↑ employment opportunities
- In response to the GFC, I/R were lowered from 7.25% --> 3.25% from 2008-09 to supporting spending --> resulted in U/E of only 6.2%, from an expected 10%
- However, the time lag (6 months) makes it less precise in reducing U/E, as it has to act pre emptively. Also, now at a historic low of 0.75% --> less effective in stimulating growth

FISCAL POLICY

- Similarly, FP can be used to stimulate the eco by using the Budget to directly ↑ the level of injections in the eco --> multiplier effect --> ↑ AD and hence, increasing D for G/S
- Again, during the GFC, the Aus gov provided $10.4B worth of cash payments to H/H, while also implementing infrastructure projects through the Nation Building and Jobs Plan, worth $42B • This led to a drastic turn from a surplus of 1.8% of GDP, to a deficit of 2.1% in 2009 alone

POLICIES TO ADDRESS STRUCTURAL UNEMPLOYMENT

- However, FP and MP are relatively ineffective in addressing structural U/E, a large component of the NAIRU • The NAIRU refers to the rate of U/E where there is no cyclical U/E, and U/E is only comprised of frictional and structural U/E

• As depicted by the Phillip's curve, it is considered that any attempts to reduce U/E below the NAIRU will result in cost push inflation, as ↑ eco growth --> will lead to ↓ U/E --> ↑ P pressures on a limited supply of labour --> ↑ wage growth --> cost push inflation (↑ wages will also lead to ↑ D inflation)

• Currently, the NAIRU is estimated to be at 4.5%, meaning that macroeco policies still have the potential to ↓ U/E. But, any improvements in the AD will only be effective up until the NAIRU, as any further efforts will ↑ inflation

• **Therefore, shows the limitations of macro in ↓ LT U/E and hence necessitates a policy mix, with MER**

LABOUR MARKET REFORMS

• Reforms to the labour market constitute a large component of MER, as ↑ decentralisation of the industrial relations system/wage determination system/labour market has led to the ↑ prod and flexibility of the labour market --> thereby directly addressing structural, frictional and youth U/E etc

• Aus has undergone a drastic shift from a highly centralised wage determination system, to a highly decentralised one, reflecting a greater reliance on market forces of S&D to determine wage outcomes on an enterprise level, being a better reflection of prod growth • Efficient allocation of resources

- Overall, the decentralisation of the labour market has resulted in a more efficient allocation of resources, as firms with a greater capacity to attract labour has done so --> ↑ AS of the eco --> ↑ employment opportunities in the LT

• ↑ Flexibility

- Also, the introduction of individual, collective/enterprise bargaining has resulted in ↑ flexibility of the labour force, as wages and conditions were able to be negotiated on an enterprise level.
- Therefore, during times of ↓ eco growth, firms are able to allow wages to fall while retrenching workers --> GFC expectation of 10% --> 6% only
- Also, enables the eco to absorb -ve eco shocks --> LT growth

• Cost of hiring/compliance costs

- Also, the simplification of the awards system has also reduced the cost of hiring --> ↓ cost push inflation
- Fair Work Act 2009

  Administered by the Fair Work Commission --> national approach has reduced compliance cost to employers --> thereby encouraging ↑ employment

• Overall, changes to the industrial relations system has subdued rapid wage growth and increased

the flexibility of the labour market. This has allowed Aus to experience U/E levels about 3% than the OECD average, despite having the highest min wage in the world

LABOUR MARKET POLICIES

- Gov also influence labour market outcomes through their policies relating to education/training, social security and employment services to ↑ PR and prod (through ↑ skill) --> investment in human K. Can also target certain groups or certain types of U/E
  - Gonski reforms (improves education in disadvantaged areas by aiming for national equality, aim to increase school retention rates) --> ↑ employability of individuals
  - 2016: $752M PATH to ↓ youth U/E by combining training obligations with incentives for employers --> mandatory 6 weeks of training, employers given $6K-10K for employing - Tightening eligibility requirements for social welfare payments
  - Job Services Australia – Federally funded network of employment agencies that provide assistance to job seekers --> ↓ frictional U/E --> ↓ NAIRU
  - Tightening eligibility requirements for social welfare payments --> 23 hours per week actively seeking work – made compulsory for all unemployed people in 2015 before being eligible for transfer payments

9. INFLATION

Q. ANALYSE THE CAUSES AND EFFECTS OF INFLATION IN THE AUS ECO + POLICIES TO ADDRESS

INTRODUCTION

- Definition: Inflation refers to the sustained increase in the general level of P in an eco over a period of time, measured by a percentage increase in the CPI, a weighted basket of G/S purchased by H/H • Causes: Inflation is caused by D-pull or cost-push inflation, along with imported inflation, which has become more prominent in recent years, as stated by the RBA
- The Aus gov has attempted to contain infla tion between a range of 2-3%. Inflation below this rate, as we are currently experiencing with a rate of 1.6%, will pose the issue of deflation, which hinders eco growth. Contrastingly, high inflation, being a constraint to eco growth, will bring upon negative implications across the eco, decreasing SOL, reducing int comp and worsening U/E.
- In order to attain P stability, the Aus gov has utilised both macro and MER
- MP and FP work countercyclically to stabilise rapid fluctuations in AD/the dom bus cycle and hence, inflation, whereas microeco reforms work to ↑ AS in the LT to increase the capacity to which the Aus eco can meet D for G/S, thereby subduing inflationary pressures.

CAUSES

- Note: Possible to have all types/causes of inflation operating simultaneously

• However, often 1 or 2 causes are prominent at one time

- e.g. Mid 1970s --> early 1980s inflationary exp + cost-push prominent
- 1980s --> D Pull
- 2000s --> Mining boom --> D pull inflation
- Recently --> inflationary exp ↓

DEMAND PULL INFLATION

• **D-pull inflation occurs when AD outpaces/outstrips AS (productive capacity) of the eco.** •

This was evident when the (X-S) increased drastically during the MIB --> leading to ↑ C + I and hence, further eco activity This is represented by the increase in AD from AD to AD_2

• During 2008, eco growth ↑ to 5% --> ↑ P as consumers force P up by bidding against each other for the limited G/S available, as they are willing to pay a higher price for the level of G/S.

• As output cannot expand any further in the ST, P therefore ↑ from P_1 --> P_2 --> inflation of 5% during 2008, from 2% in 2007

• Currently eco growth is extremely low at 1.4%, underpinned primarily by low C being the result of slow wage growth, as well as ↓ G. Therefore, ↓ D pull inflationary pressures have contributed to the rel low inflation rate of 1.6%

COST-PUSH INFLATION

• Cost-push inflation occurs when the cost of factors of prodn increase, and producers pass these ↑ costs in the form of ↑ P

• Due to ↑ cost of prodn, suppliers now produce a given qty at a higher P, represented by a shift from AS_1 to AS_2 and hence, ↑ from P_1 --> P_2

• Traditional sources of cost-push inflation

1. Wages: When wages ↑ faster than prod growth, the cost of labour for each unit of labour ↑. Wages = 60% of bus' costs. Therefore, firms will pass on the wage ↑ to consumers by ↑ P to maintain profitability
2. Oil/other raw materials: An ↑ in P of final product as firms pass on the ↑ P to maintain profits

 RBA estimates a 10% ↑ or ↓ in petrol P --> contributes to 0.4% to inflation annually •

Under a centralised wage determination system before 1980s, unions demanded a percentage

increase in wages every year regardless of prod growth --> leading to both cost push and D pull inflation

- However, currently, Aus has experienced downward pressure on labour costs due to a decentralised IR system, where wages increase proportionally to prod growth --> wage growth is more sustainable
- Also, fuel P and clothing P have been rel ↓ due to ↑ M

IMPORTED INFLATION

- Imported inflation refers to inflation that has been transferred to Aus through int transactions •

This may occurs through a depreciation of the AUD, as each AUD buys less of foreign currencies, or a direct increase in the P of M. Both will lead to ↑ M inflation

- Also, trade-exposed industries that value-adds to imported components, or uses M K goods will face higher costs --> ↑ P for consumers
- However, the extent to which an ↑ in overseas P or a depreciation of the AUD will result in inflation will depend on **market conditions**
  - If M face comp from local products, importers may ↓ profit margins and not pass onto consumers the full effect of the overseas P ↓ or depreciation
    - RBA 2015: imported inflation now accounts for a much larger share of the headline inflation rate's variability than before

INFLATIONARY EXPECTATIONS

- If individuals expect an ↑ in inflation, they will aact in a way that ↑ inflation 1. If P of G/S is expected to ↑, consumers will purchase products before P ↑ --> ↑ C in eco --> ↑ D-pull inflation. Similarly, if a firm expects ↑ D or an ↑ in cost of prodn, they will ↑ P to max profits --> inflation
  2. If employees expect an ↑ in inflation, they will bargain for ↑ wages to preserve the PP of their nominal wage. (Workplace contracts typically negotiated for the next 2-3 years.) ↑ Wages --> passed on by firms --> cost push inflation --> ↑ wage D. **This is the wage-price inflationary spiral**
     - Is not V prominent as wage D and wage growth are very low at 1.3%

MONETARY INFLATION

- **Excessive ↑ in money supply**

  - When the ↑ in the money supply > eco growth, an ↑ volume of money chases the same amount of G/S and ↑ P. Therefore, ↑ in the money supply without an ↑ in real prodn --> monetary inflation

EFFECTS

- Most of the impacts of inflation are negative.

STANDARD OF LIVING

- Unless wages ↑ to keep up with inflation, consumers will lose their purchasing power, as their

real income will ↓ --> ↓ G/S such as education, food, basic services--> ↓ SOL

- This is especially the case for those on fixed Y such as pensioners, as they cannot negotiate for ↑ wages

- Also, low Y earners may face ↑ I/R on their borrowings if inflation rises.

CONSTRAINT ON ECONOMIC GROWTH & UNCERTAINTY

- Inflation = main constraint on eco growth – prevents eco growth from ↑
- Also, inflation further distorts decision making and restricts LT eco growth aa producers/consumers change their spending & I decisions.
  - Investors will tend to I in ST speculative ventures that yield high returns in a high inflation enviro (real estate or other assets) rather than undertake productive, Y producing activity (e.g. starting a company).

    Therefore, AS and LT eco growth is ↓
  - ↑ inflation also discourages bus I as producers are uncertain about future P and costs + future profit levels. Inflation also erodes value of existing savings --> discourages S

    Reduces the rate of K accumulation, needed for LT growth --> ↓ eco growth

UNEMPLOYMENT

- Closely linked especially in the ST, as ↑ inflation --> firms who expect their costs to go up rapidly are hesitant to hire, and willing to fire --> ↑ U/E
  - Also, ↑ P --> ↓ int comp of dom producers --> ↑ U/E
- Also, high inflation will result in contractionary FP and MP --> ↓ growth --> ↑ U/E in the ST&MT

INTERNATIONAL COMPETITIVENESS

- ↑ inflation --> ↑ P for Aus' X --> ↓ int comp and qty of X. Also, as P of dom goods ↑, consumers will also switch to M subs --> worsening BOGS (VV)

EXCHANGE RATE

- In the ST, ↑ inflation --> appreciation as speculators expect the RBA to ↑ I/R in response --> ↑ I - However, ↑ inflation generally causes the AUD to depreciate over time

INTEREST RATES

- ↓ inflation --> ↓ I/R as nominal I/R are based on a real rate of return + inflation

BENEFITS

- Small amounts of inflation can be beneficial because it **allows for adjustments in rel. P** in an eco without requiring reductions in normal P which can often be 'sticky' (esp. for wages) - Therefore the RBA targets **low** inflation levels that avoids both the -ve consequences of ↑ inflation **and** deflation
- The greater benefit of ↓ inflation --> reduces the likelihood of the eco experiencing deflation--ve consequences (Japan for 20-30 years). Deflation can
  - Give consumers an incentive to delay purchases, which can ↓ consumer spending --> puts the consumer eco at a standstill --> recession
  - Make borrowing money less attractive as the amount to be repaid is ↑ in real terms - Interfere with people's intertemporal choices whereas inflation does not

  Currently however, inflation is at 1.6% --> due to slowdown in C --> risk of deflation
  - Over the LT, sustained ↓ inflation may foster greater int confidence in Aus, strengthening the AUD

POLICIES

MONETARY POLICY

- MP plays the central role in maintaining inflation, and has so since 1993.
- If inflation ↑, the RBA uses contractionary MP to ↑ I/R --> dampens consumer & investor spending --> ↓ eco activity --> ↓ inflation
- The RBA **g**enerally aims to ↑ I/R before inflation ↑
  - The RBA ↑ I/R 7 times in 2009-10 to address concerns about inflation ↑ after GFC • The RBA attempts to make its use of the MP predictable by emphasising consistently its intention to use it to maintain inflation --> has had the effect of lowering inflationary expectations (jawboning) --> further ↓ inflation
- Although ↑ I/R may ↑ cost of borrowing and hence I in K goods for bus, it is offset by benefits

FISCAL POLICY

- The gov through the Fiscal Budget may ↑ rev and ↓ spending --> ↓ D pressures in the eco --> ↓ D-pull inflation
- Currently, the Aus gov has reached a surplus due to a contractionary stance. However, this is conflicted with the need to ↑ eco growth, which is at 1.4%

MICROECONOMICS REFORM

- MER has resulted in more efficient methods of prodn due to ↑ comp and an ↑ allocative/tech efficiency . Therefore, P has ↓ and also, it is harder for dom producers to ↑ P due to ↓ P of M • Labour market reforms --> ensures that wage increases are linked to prod improvement • Infrastructure spending --> ↓ capacity constraints faced by bus
- NCP (1995) – promote comp in markets --> ↓ costs

10. EXTERNAL STABILITY

Q. ANALYSE THE RECENT CAUSES AND EFFECTS OF EXTERNAL STABILITY ON THE AUSTRALIAN ECONOMY

INTRODUCTION

• External stability refers to an eco's ability to service its foreign liabilities over the MT-LT, ensuring that imbalances in its external accounts does not hinder dom eco goals such as growth, U/E or inflation. • External stability is measured by the current account deficit (CAD) and net foreign liabilities (NFL) both as a percentage of GDP.

• Aus' sustained CAD of an average of 3-4%, alongside growing NFLs were previously considered to be detrimental to the performance of the Aus eco, underpinned by structural factors such as the S-I gap, Aus' narrow X base and a lack of int competitiveness and productivity.

• However, concerns regarding external balances have diminished in recent times, firstly due to the fact that Aus, for the past 3 decades, has enjoyed sustainable eco growth, low inflation, low u/e while experiencing larger external imbalances that most other adv ecos. Furthermore, the CA has also seen significant improvements from favourable eco conditions, reaching a CAS for the first time since 1975

• This can be attributed to fluctuations in the E/R, I/R differentials and, strong X performance due to the growth of LNG.

• Such factors have contributed to improvements in the external stability of the Aus eco and further, greater eco growth, lower U/E and volatility.

LONG TERM/STRUCTURAL CAUSES

SAVINGS AND INVESTMENT GAP

• The largest structural factor impacting the NPY account and also, the CAD is the Savings and investment gap, referring to Aus' heavy reliance on foreign I to compensate for the lack of domestic savings in order to fund domestic expenditures.

• This S-I gap exists as Aus has a low H/H savings rate of 1.5%, alongside its abundance of I opportunities that are K-intensive, especially in the mining industry. Aus' attractive AAA credit ratings also makes it a desirable and profitable I destination, resulting in the increase in the level of foreign I, and hence increase in repatriation and debt servicing cost.

• This sequence was evident as the mining industry required high levels of I during the mining boom, a demand which was not able to be met by the low levels of dom. savings in Aus. Therefore Aus relied greatly on foreign K and I to the extent where now, 70% of the LNG and 50% of the coal industry is foreign owned, whereas net foreign debt has risen from 6% in 1980s to 60% now. The consequent levels of debits in the form of dividends and interest repayments leaving Aus, has contributed and sustained Aus' NPY deficit and eventually, CAD.

• However, levels of savings did slightly increase when compulsory superannuation (MER) was introduced in the 1990s and taxes associated with super was removed in 2004, as this increased Aust' equity overseas.

- For the first time, between 2013-17, the value of Aus' foreign assets exceed the value of foreign ownership in Aus assets. However, this has been masked by continuous rises in Aus' net foreign liabilities, as while Aus' ownership of equity rose by 3.5 times, Aus' loans overseas grew about 6 times, thereby sustaining the CAD

NARROW EXPORT BASE

- The narrow X base of Aus has also contributed to inability of Aus' trade balance to sustain surpluses.
- This exists as Aus relies heavily on primary commodities for its X Y as its CA lies in low value-added products such as minerals and agriculture. These two components alone account for over 65% of Aus' X revenue
- Aus' lack of competitiveness in the IT and manufacturing sector means that these expensive goods must be imported instead, therefore meaning that in the LT, M expenditure will greatly exceed X revenue, thereby worsening BOGS and sustaining the CAD.
- Furthermore, this narrow X base also increases Aus' susceptibility to sudden fluctuations in D for its X, as commodities tend to be quite volatile in D thereby, Aus is exposed to sudden falls in D and hence, X revenue worsens BOGS
- In recent times however, Aus has began shifting towards non-mining sources of X revenue and growth, with the gov promoting by means such as the $47.5 million Advanced Manufacturing Growth Fund, providing grants that support capital projects from small and medium enterprises • Has also shifted to services X growing from 12% to 20% in the last 20 years

LACK OF INTERNATIONAL COMPETITIVENESS/PRODUCTIVITY

- Can discuss how privatisation and labour market reform has improved Aust's international competitiveness since the 1980s. Although, labour market productivity has lagged in recent times. The govt is attempting to address this by investing in human K

SHORT TERM/CYCLICAL CAUSES

- Despite these structural factors sustaining the CAD and worsening Aus' foreign debt levels, favourable global conditions have in recent times, improved Aus' ext stability, recording the first current account surplus since 1975 during the third quarter of 2019

GLOBAL LOW I/R

- In response to weakening global eco conditions as GWP falls to 3% from its usual 4%, central banks across the world has adopted record low cash rates in order to stimulate consumer and I activity and hence eco growth. America is a 1.75%, Europe at 0%, Japan at -0.1%, Canada at 1.75%
- These low global I/R have benefitted Aus' CAD as the interest repayments on Aus foreign debt will be lowered, resulting in lower outflows recorded on the NPY component of the Current Account.

STRONG X

- Aus' trade balance has been rising since early 2018, reaching an all-time high level of approx. 3.5% of GDP in late 2018. This has been largely due to continually high D for Aus' commodities from China in order to facilitate their eco development through various infrastructure projects. Furthermore, growth in D for Aus' LNG X has also largely underpinned a strong trade performance, reflecting changing sentiment towards more environmentally sustainable means of energy.
- Aus in Jan 2019, became the world's largest exporter of LNG, with its volume of X rising over 20% in the past 2 years, and accounting for almost 4% of GDP
- Its biggest importers are Japan at 41%, China at 37% and Korea at 10%
- Reflected by the high Terms of trade - currently at 110
- This has assisted in assisting the low levels of eco growth, with net exports adding a larger than usual 0.6% to GDP in the fourth quarter of 2019.
- Furthermore, growing D in the LNG industry has created approx. 3800 jobs, equating to about 17% increase contributed to rel low U/E despite very low eco growth

E/R

- This growth in X has also been supported greatly by the decade-low E/R, currently at $0.69 USD, mainly as a result of a record 0.75% cash rate
- The low cash rate has led to a lower I/R differential with other adv ecos, with USA at 1.75% etc lower levels of foreign K inflows into Aus --> lower D for Aud depreciation
- This has contributed to increased competiveness of Aust Xs overseas and decreases domestic purchasing power of Ms → increase in X Ys and decrease in M expenditure → led to BOGS surplus of $6.2bn in 2018 → CAS first time in 44 years
- However, this depreciation has had rel

EFFECTS

CAD IMPACTS

- Debt trap scenario
- Loss of investor confidence K flight loss of eco growth
- Forces gov to adopt fiscal consolidation
- Link the point about Pitchford thesis to previous point by stating that '*Although these are the negative theoretical effects of a high CAD, Pitchford thesis states that private firms when engaging in international borrowing, make calculated decisions, hence lowering any risk. Also, if foreign K is being used to improve the productive capacity of the eco, then a sustained CAD will not pose a problem to eco stability*

- In fact, the lower CAD and the recent, improved performance of the Aus eco will bring upon positive impacts

INCREASED INTERNATIONAL CONFIDENCE AND INVESTMENT

BETTER CREDIT RATING AND LOWERED VOLATILITY

11. DISTRIBUTION OF INCOME AND WEALTH

DESCRIBE THE CAUSES AND EFFECTS OF AN UNEQUAL DISTRIBUTION OF INCOME AND WEALTH, AND THE POLICIES THAT CAN BE USED TO ADDRESS THIS ISSUE

- Make sure that you separate income and wealth – don't talk about them together

INTRODUCTION

- Y refers to the monetary benefit gained by individuals or H/H from the sale or ownership of factors of prodn, or from transfer payments, over a period of time.
- W, however, is defined by the net value of a individual's assets over a period of time, calculated by assets minus liabilities
- Income and/or wealth inequality refers to the degree to which Y and W is unevenly distributed among people in the eco.
- Aus has a relatively uneven dist of Y, with the quintile receiving Y 10x higher than those in the bottom 20%.
- However, wealth is more unequally distributed, primarily due to home ownership rates, with the top quintile having a net worth around 70 times higher than the bottom quintile.
- This is as Y and W is strongly linked, with a higher Y results in a higher savings ratio, granting

individuals/HH with a greater capacity to generate wealth (VV)

• Measured by the Gini Coefficient, Aus is ranked 23/35 OECD ecos with 0.33, with perfect equality being at 0.

• This is caused by periods of U/E, inequality of opportunity, age, education and cultural background. • An uneven dist of Y/W has widespread social and eco impacts, presenting both costs and benefits. • Nevertheless, the gov utilises both macroeco and microeco policies to alleviate the level of Y/W inequality in the eco, including progressive Y tax, transfer payments and compulsory superannuation.

CAUSES

LABOUR MARKET REFORMS

• Labour market reforms including the decentralisation of the wage determination system has resulted in **inter and intra industry wage dispersion**

• Enterprise agreements have established the link between Y increases and prod improvements. Hence higher skilled works can bargain for ↑ Y whereas low skilled workers have ↓ bargaining power • Also, more efficient firms in an industry can pay ↑ wages --> **intra** industry wage dispersion • Industries with ↑ union presence and power --> ↑ Y rises --> **inter** industry wage dispersion • Therefore, although labour market reforms have ↑ the int comp and flexibility of the labour market --> it has contributed to the ↑ in the Gini Coefficient from 0.3 in 1997 to 0.337 in 2016

ECONOMIC GROWTH

• During periods of ↓ eco growth, cyclical U/E rises. The U/E must then rely on gov benefits which are sig lower than av Y earned by those in employment

• Contrastingly, during ↑ eco growth --> eco benefits flow to ↑ Y earners or those who own factors of prodn/financial assets--> ↑ W
- ↑ Eco growth --> ↑ D for skilled workers --> ↑ Y etc
- After 25+ years of eco growth, Y inequality has ↑ with the poverty rate increasing from 12% in 2003 to 14% in 2017

• Kuznets Curve
- It can be argued that there comes a point where the eco benefits will 'trickle down' as Y inequality generates more jobs --> Kuznets curve

HIGH INFLATION

• ↑ inflation will erode the real Y or PP of those on fixed Y or lower Y. Often, these workers do not have the sufficient bargaining power to index their wages to inflation increases

• However, ↑ Y earners own financial speculative assets whose value ↑ with inflation • Therefore, both Y and W inequality is worsened by ↑ inflation

AGE AND EDUCATION

• Y tends to be highest between ages of 25-64 (working life)

• Younger workers have ↓ skills and experience, whereas higher skilled/trained workers can attract ↑ Y -

Degree > Diploma > Vocational > Year 12

Av weekly earnings are highest for post grad degree - $1675, lowest for those without a non school qualification - $882

• W follows a similar pattern – rising for most of their lifetime, falling as they get older

GENDER AND OCCUPTION

• There is a gender pay gap of women making 16% less than men. Exists due to several reasons

1. In the past, fewer opportunities to acquire education, skills and experience
2. Culturally, women have more home caring responsibilities than men --> often works part time --> limits chance to get senior, ↑ Y positions
3. Men and women choose different occupations. Jobs that require higher level of education and/or are more risky, so attract higher pay (mining, construction)
   - Managers/professionals earn up to an av of $2300 while labourers earn around $1440

CULTURE AND CULTURAL BACKGROUND

• Recent migrants from English-speaking countries tend to earn approx. $1200 --> $4000 more than Aus natives – reflects the larger % of highly skilled migrants, and the ↑ D for language proficient workers

• Y dist among all migrant groups slowly conforms to the Aus average

GEOGRAPHY

• Inequality exists between different states and cities

- NT ($1900) and ACT ($1770)– highest weekly earnings, with Tas the lowest ($1117)
  ACT and NSW also have younger pop, whereas Tas has older pop
- WA and NT, with the largest share of mining activity have greatly benefited
- In NSW, people in urban areas earn 30% more than those in regional areas --> due to cost of living and employment opportunities

INEQUALITY OF OPPORTUNITY

• Existing inequality in the dist of Y/W tends to perpetuate inequality of opportunity - ↑ Y earners have better access to educational opportunities --> ↑ education --> ↑ Y - People who acquire W through inheritance have a much greater opportunity to ↑ W through I

- People may not have access to the same network of people that may offer new opportunities

ECONOMIC EFFECTS

LOWERED ECONOMIC GROWTH

- ↑ Gini coefficient is associated with ↓ eco growth in the MT
- Higher levels of Y to higher Y earners, who have higher MPS, will lead to increased leakages into the eco and hence, lower levels of C lower eco growth
  - OECD report says ↑ in Y inequality in OECD ecos between 1985 --> 2005 reduced cumulative growth by almost 5%
- Also, entrenched, LT ↑ Y inequality --> deprives the ability of ↓ Y H/H to accumulate physical and human K
  - E.g. Under I in education --> ↓ quality of the workforce --> ↓ labour prod

REDUCED OVERALL UTILITY

- An asymmetric dist of Y also reduces the total utility/satisfaction in the eco, as the principle of diminishing marginal utility suggests that as more of a good is consumed, it will provide progressively less utility to the customer. Therefore, ↑ Y consumers who have a greater Y_d will begin to C less --> ↓AD.

INCREASES WELFARE SUPPORT

- Moreover, sustained, LT Y inequality or ↑ U/E places ↑ D on gov exp as a larger number of people require assistance --> dependent --> ↑ gov deficit or VV

SOCIAL COSTS

SOCIAL CLASS DIVISIONS

- ↑ Y inequality results in ↑ conspicuous C (C of expensive, luxury G/S) --> class distinctions such as the upper, middle and working class
  - This may cause tension + ↑ crime and social disorder --> ↓ social cohesion

POVERTY

- ↑ relative poverty as ↑ Y inequality contributes to the development of an underclass of ↓ Y earners, who have limited access to education etc --> self-perpetuating cycle of disadv + crime, suicide, ↓ life expectancy
  - 2000-17: 10-14% of Aus at poverty at any one time

ECONOMIC BENEFITS

- However, ↑ Y inequality may bring upon favourable eco impacts through the **Incentive effect**

↑ PRODUCTIVITY

- As through the decentralisation of the wage determination system, ↑ prod is linked closely to ↑ wages. Therefore, new entrants and existing participants in the labour force will be encouraged to ↑ output --> ↑ prod --> ↑ AS

↑ SKILLS AND EDUCATION

- Also, those with ↑ qualifications and skills reap ↑ Y awards --> ↑ incentive to ↑ education/skills, assuming children in ↓ Y H/H have the same opportunity to access good education

↑ LABOUR MOBILITY

- Inequality among regions of Aus will encourage people to move to where they can for ↑ Y -
  Mining boom attracted migration to WA and NT which experienced an 8% wage growth in 2011-12 --> ↑ efficiency of labour allocation

↑ RISK TAKING

- The prospect of substantial Y rewards accruing to entrepreneurs --> ↑ risk taking associated with new I and innovation --> ↑ prod capacity of the eco

↑ POTENTIAL FOR HIGHER SAVINGS AND K FORMATION

- ↑ Y earners have a higher APS. Therefore, a greater number of ↑ Y earners through ↑ Y inequality will result in ↑ savings --> ↓ Aus' reliance on foreign K --> ↑ CAD

POLICIES

- FP and labour market reforms have the most direct impact, whereas the side effect of MERs and MP can also indirectly impact inequality

FISCAL POLICY – AUTOMATIC STABILIERS

- The non-discretionary component of the FP, automatic stabilisers, lower inequality by taxing the wealthiest group a greater proportion of their Y via the PAYG system.
  - The gov, with this revenue can fund transfer payments, effectively redistributing Y to lower socio-eco groups
  - Transfer payments accounts for 36% of G
    - Age pension - 2018-19: $47B – largest proportion. Spent $725M into aged care services
    - U/E benefits
    - Disability benefits - $22B to NDIS but $4.6B underspent
    - Carers payment – 2018-19: $9B
- Aus' Gini Coeff before taxes and transfer payments is 0.52 --> 0.34, also, Y for the highest quintile would be 22x higher than the lowest. With gov intervention, it is approx. 6x greater

FISCAL POLICY – TAXATION REFORMS

- The gov can also make discretionary, structural changes to the progressive, PAYG taxation system to improve the equitable dist of Y

• In 2019-20, as an extension of the 2018-19 Budget's tax cut, the gov has announced $158B in tax relief, from the previous $144B
  - This involves up to $1008 Y tax offset for low to mid Y earners
  - However, by 2024, with the elimination of the $87,000 to $180,000 (37%) tax bracket, tax payers earning between $45,000 --> $200,000 will have their rate cut from 32.5% to 30%
  - This has been criticised, with an approx. 62% of benefits going to the top 20%, while the bottom 30% receives 7%
  - Also, this will reduce revenue by $158 billion from 2019-20 to 2029-30

SOCIAL WAGES

• Refers to the amenities provided by the gov to society. They tend to improve the dist of Y as lower Y earners receive proportionately, the most benefits

PUBLIC FREE EDUCATION

• 2018-19: Expanded the **Universal Access to Early Childhood Education Program** by announcing $428M I --> will benefit 350,000 children and allow more women to return to work

MEDICARE

• **2019-20:** $1.1B boost to Medicare over 5 years for primary care and frontline health services - Gov will end the indexation on Medicare rebates a year earlier than planned – will make it cheaper to access 119 GP services --> will cost gov $187M

PBS

• 2018-19: To ↑ access to medicine - $1.4bn to PBS + e-prescribing for safer medicine • $331m funding for new and amended listings on the PBS, including medicines to treat cancers - reduced prices from $55,000 to $40.

CHILDCARE REBATES

• 2018: Gov introduced an integrated **child care subsidy** that pays for 85% of child care costs for families earning up to $65,000.

BACKGROUND

• 2019-20: ABSTUDY – Assistance to families of Aboriginal students who need to stay away from home to study

• 2018-19: **A Stronger Rural Health Strategy:** Focusing on improving the health of people living in rural, regional and remote Aus --> through better teaching, training etc.
  - Also addressing doctor shortages across rural/remote areas by strengthening bonded programs

REGRESSIVE TAXES

• C taxes such as the GST and excise tax on tobacco means that the lowest 40% of Y earners have a higher tax burden – 12% of Y is tax, but with C taxes, it is 15%

MACROECO POLICIES

• 56% of Y comes from employment. Therefore, U/E is the main cause of low Y, as the U/E must rely on gov benefits which are sig below av Y --> gov uses macroeco policies to reduce U/E + other MER (listed in the U/E essay)

LABOUR MARKET POLICIES

• Decentralisation of the labour market has greatly widened Y inequality, as under enterprise agreements, workers with grater skills and bargaining powers have achieved higher Y • Also, as the allocative efficiency of the eco has increased, so has specialisation, leading to a greater D and hence pay for skilled workers

• However, modern awards, minimum wages and NES of $19.49 sets a safety net •

Include MER U/E policies used in the U/E essay

- PaTH 2016-17 ($752M)

COMPULSORY SUPERANNUATION

• Has reduced inequality significantly since its implementation in 1992

- Employers must contribute at least 9.5% of wages to a super fund, which they cannot access until their retirement
- 2025 – will increase to 12%

• Particularly important for the bottom 20% of wealth-holders as it is one of the few sig financial assets that they possess

• However, tax concessions to voluntary super contributions may benefit higher Y earners who can set aside extra Y at lower tax rats

• 2015-16 Budget: Stricter caps on tax concessions - $25K at tax rate of 15% rather than $30K + $0.5M lifetime cap

INDIRECT GOVERNMENT POLICIES

• Monetary policy

- Expansionary MP through the asset P and wealth channel will worsen Y inequality as D and hence P for housing assets rise
- But contractionary MP through the cash flow channel will also worsen Y inequality as low Y earners tend to be net borrowers and VV

• Microeco reform

- MERs are generally intended to improve efficiency and returns on I to owners of assets. Therefore, MER will result in benefits flowing to wealthier asset owners.
- Also, MER can cause structural U/E as bus 'downsize' to improve profits --> lower Y - However, these MER policies are often accompanied by 'adjustment packages' to alleviate the inequality cause

  Carbon tax – tax cuts + family benefits for those earning under $150K

12. ENVIRONMENTAL SUSTAINABILITY

Q. EVALUATE THE SUCCESS OF GOVERNMENT POLICIES DESIGNED TO ACHIEVE ENVIRONMENTAL SUSTAINABILITY IN AUSTRALIA

This is the rationale for environmental policies and will help provide context. However, for this question, it does not need to be more than one para (max two paras)

I.e. 1. Negative externalities

2. Free riders

3. Human health

4. Enviro as a source of growth

INTRODUCTION

- Environmental sustainability or ecologically sustainable development , based on the principle of intergenerational equity, refers to the efficient management and use of resources so that access by current and future generations, as well as enviro quality is not compromised
- The gov must intervene in the eco to achieve this objective, due to a number of reasons. 1. This is firstly due to market failure, which occurs when an unregulated free market produces undesirable outcomes called negative externalities, such as pollution.
  2. Also, private firms cannot prevent 'free-riders' from benefitting from a clean environment, thus have no incentive to promote enviro sustainability
  3. Within the enviro, clean air and water is imperative to the SOL and eco dev. Finally, the enviro also contains resources that contribute greatly to Aus' LT eco growth and X --> therefore, need to be preserved
  4. Thus, clean and sustainable enviro becomes a public good provided by the gov
- The gov intervenes in the market to achieve enviro sustainability through both market based policies such as taxes, subsidies and incentives, along with gov legislation such as bans and permits. • With the enviro quickly deteriorating, Aus has been ineffective in effectively ensuring enviro sustainability, ranking 20th in the world for the UN Sustainable Dev Goals

THEORY – REASON FOR INTERVENTION

MARKET FAILURE

- The government needs to intervene in environmental management due to market failure, which occurs when the free market fails to allocate resources efficiently, leading to socially undesirable outcomes
  - This is because in the free market, the P mechanism only takes into account private costs and benefits, while not taking into account wider social costs and benefits borne by all of society
  - The market will only take into account private costs and benefits of prodn, resulting in the price of P and output of Q, were borne by either the producer or consumer

however, the P would rise to P_1, reflecting the increase in cost of prodn. Output would also fall to Q_1, highlighting that G/S with –ve externalities tend to be overproduced.

- Essentially, when the Marginal Social Cost is greater than the Marginal Private Cost, negative externalities arise, which refers to the unintended social cost of an eco activity whose cost is not reflected in the operation of the P mechanism. Examples include pollution, climate change (shaded area)
- (Something to note – Vertical distance = size of externality. In the presence of –ve externalities, social costs are greater than private costs)
- The eco costs of climate change is expected to be a reduction of GDP by 4.8% by 2100

FREE RIDERS

• The gov must also intervene in enviro management due to the fact that a clean, sustainable environment is considered a public good.
- This is because it is non rival, meaning its consumption or use does not hinder the ability of others' consumption.
- Also, it is considered non-excludable, as producers cannot exclude consumers from enjoying the benefit of the good even if they are not prepared to pay.
free-riders.

• As a result, free-rider activity arises, where private firms would not be able to charge consumers, hence having no incentive to provide a clean and sustainable environment.

• Therefore, the government provides a clean and sustainable enviro.

HUMAN HEALTH

• The gov must intervene to prevent the deterioration of health in the eco. Clean air and water is directly linked to life expectancy. Therefore, a negative externality such as pollution which causes pollution and hence diseases --> deteriorate SOL and eco development (HDI) --> LT eco growth

• In Aus, due to strong enviro regulations, the HDI is quite high at 0.91. But, the skin cancer rate is increasing by 140%

ECONOMIC GROWTH

• The gov must also ensure enviro sustainability because non-renewable resources that are not replenished at an equal level to their consumption, are important future sources of growth • Aus has the world's largest reserves of Zinc, lead, nickel and 3rd largest of iron ore. Hence, the mining sector accounts for 7% of GDP and 50% of X.
- In order to ensure non-renewable resources are used at an optimal rate that is acceptable for both the present and future generations, and hence ensure eco growth in the LT, the gov must ensure ES
- OECD: Policies to improve ES and EG such as I in low-emission infrastructure can increase output by 1% for G20 ecos by 2021

POLICIES – MARKET BASED

- The gov can intervene using market based policies, including taxes, subsidies and incentives to influence the behaviour of private producers

TAXES

- In 2012, the Carbon tax was introduced, charging $23/tonne on bus emitting over 25,000 tonnes per year --> forced 500 of the largest polluting producers to pay for tax carbon emissions – effectively 'internalising' the externality.
  - Very effective as emissions were reduced by 4% in 2012-14 and generated $6.6B in rev

  - However, it raised the cost of electricity (important factor of prodn) by **9.5%**

    Reduced real Y and SOL. Therefore, was repealed in 2014 – also link to political constraints

- Other taxes include excise taxes on petrol (38c per litre), tobacco (70c per cigarette) which reduced the negative externalities of smoke pollution and health issues

SUBSIDIES

- Gov may also provide subsidies which promotes and incentivises eco activity that promote ES and generate positive externalities.
- **Small-scale Renewable Energy Scheme –** provides rebates to home owners for solar panels, supporting up to 20% of costs for 5 years
- **Large-scale Renewable Energy Scheme –** encourages I in renewable power stations wind and solar farms or hydro-electric power stations to reach the 2020 **Renewable Energy Target** - **Renewable Energy Target** – 20% of electricity S to be generated from renewable energy by 2020 - This has been very effective, with it being at 19% as of now.
- 2014 – Direct Action Plan – involved the establishment of the **Emissions Reduction Fund** - $200M provided to landfill companies to generate electricity from landfill, reduces methane emissions

  This policy is not very effective compared to carbon tax (get data about how much emissions reduced because of ERF)

POLICIES - GOVERNMENT LEGISLATION

- More effective method to eliminate negative externalities

BANS/LIMITS

- Bans: The most extreme action a gov can take as it will remove all externalities associated with a certain eco activity – very effective
  - Fuel Quality Standards Act 2000 – ban on leaded petrol by 2002 --> carcinogenic
    Very effective as air lead levels reduced by 50% from 2002
  - Ban of incandescent light bulb sales in 2009 – estimated reduction in greenhouse gas by

800,000 tonnes

- Water Management Act of 2000 – Farmers can only store 10% of runoff on their property --> preventing the depletion of rivers – protects ag industry (10% of GDP). But has been quite ineffective due to the prominence of droughts currently.

PERMITS

• The gov may require individuals/bus to hold a license to partake in an enviro damaging activity - Fisheries policies used for both recreational and commercial fishers – catch limits and regulations

TARGETS

• Targets are goals for the gov to achieve certain enviro objectives. Often formed in int negotiations. Int agreements are necessary because climate change affects every country. - Kyoto Protocol – Ratified in Aus in 2007. Goal was to only increase the emission of 4 major greenhouse gases by 8% (2008-12)

 Successful as emissions reduced by 5%

- 2015: Paris Agreement – 190 countries aimed to contain global warming below 2 degrees above pre-industrial levels

 Aus established the Emission Reduction Target of 5% below 2000 levels by 2020, and 28% below 2005 levels by 2030

 However, no real incentive to follow through

- Montreal Protocol – 1987

 Involves the phasing out of CFCs and introducing HFCs as a replacement by 2030.

Extremely effective as 98% of ozone-depleting substances eliminated by 2004 • Overall, targets require the action of many ecos. Also, they cannot be directly enforced, limiting their effectiveness. However, Aus has been rel successful, reducing their emissions by 5% since 2008

EVALUATION

• Overall, Aus has been somewhat effective in ensuring ES, but must continue to implement ES strategies, despite its ST eco costs

13. MONETARY POLICY

Q. ASSESS THE ROLE OF THE MONETARY POLICY IN ACHIEVING PRICE STABILITY IN AUSTRALIA

INTRODUCTION

- Monetary Policy (MP) refers to the RBA's manipulation of the cash rate to influence consumer and investor sentiment in the eco, hence affecting AD as a macroeconomic policy
- The cash rate, referring to the market I/R for unsecured overnight loans between financial institutions is influenced by the RBA's domestic market operations, and serves as a benchmark for general I/R in the eco, hence influencing eco activity. By doing so, MP works to achieve its goal of eco growth and price stability.
- Since 1993, MP has served the primary role of maintaining price stability in the Aus eco, specifically, aiming to achieve an inflation target range of 2-3% CPI over the business cycle.
- However, while MP has been largely effective in the LT in achieving price stability, its effectiveness since the mining boom has deteriorated significantly, being subject to various limitations such as the liquidity trap, time lag and contradictions between MP and Fiscal Policy.

TRENDS

- Since 2011, the cash rate has been consistently expansionary, settling at 1.5% for over 30 months during 2016 to 2019 in a bid to stimulate the slowing Aus eco. A record low of 0.75% was announced in October 2019 in response to Aus' concerning eco growth of 1.4%.
- During such periods of low eco growth, D-pull inflationary pressures are relatively low due to slow wage growth and consume confidence, meaning the inflation rate is likely to fall below the target range of 2-3%, as evident through the current rate of 1.6%
- Hence, MP has attempted to ensure P stability by stimulating growth and hence inflationary pressures.

INFLATION TARGETING

- In 1993, MP, under the RBA, began operating independently from the gov to become the primary macroeconomic policy in achieving the inflation target of 2-3%
- This change in the macro eco policy mix followed the MP's lack of success in achieving multiple goals simultaneously, but more significantly, ensured that I/R decisions were not distorted by political influences.

THEORY – OPEN MARKET OPERATIONS

- In order to influence the cash rate and hence, the level of eco activity, the RBA undertakes Domestic Market Operations in the Short Term Money Market (STMM), the market for ST loans between banks and other financial institutions
- While the cash rate is generally set by the P mechanism, the RBA alters the S of funds by buying/selling second hand Commonwealth Government Securities (CGS)

• In order to lower the cash to undertake expansionary MP, the RBA will buy CGS from financial institutions, depositing funds in the sellers' Exchange Settlement accounts and hence, increasing the S of funds in the STMM.

• This increase in S will put downward pressures on the money supply and hence lowers the cost of borrowing that is, the cash rate

• This decrease in the borrowing results in a cost saving for banks and subsequently, the competition between other financial institutions will cause them to pass this cost savings to consumers in the form of lower interest rates on home loans, credit cards and personal loans etc

• (The same applies for the reverse: to undertake contractionary MP (higher cash rate), the RBA will buy CGS, hence decreasing the money supply in the STMM. This will increase the cost of borrowing and hence, result in a higher cash rate. In order to maintain profit margins, financial institutions will consequently increase their I/R to consumers

TRANSMISSION MECHANISM

• Through this movement in the cash rate, the RBA influences eco activity through the transmission mechanism. This refers to the process in which a change in the cash rate first affects other I/R in the eco, and then the effect of these changes on eco activity and inflation.

• The transmission mechanism operates in, and influences the eco through 4 primary channels

INTERTEMPORAL SUBSTITUTION CHANNEL

• The cash rate through the intertemporal substitution channel, affects levels of C and S. • In the case of an expansionary MP as we have seen since 2008, the cost of borrowing will significantly decrease, thereby encouraging borrowing by both bus and consumers. This will result in an increase in the AD components of C and I, hence leading to eco growth • Contrastingly, it will also lower the level of S as the return on loans in the form of I/R will decrease. This will result in a lower level of leakages and hence, a stimulation of eco growth, leading to greater inflationary pressures

• (The opposite also applies (VV) – CHANGE to fit question or stimulus !)

CASH FLOW CHANNEL

• Through the cash flow channel, an expansionary MP will have the effect of lowering the level of I/R repayments on debt, hence resulting in a greater disposable income or cash flow for H/H and businesses.

• The average H/H debt in Aus is over 200% of net Y, ranking 4th highest in the world • Hence this will greatly improve cash flow and lead to increased C and I in the eco and hence, bring about D-pull inflation

• Conversely however, for higher Y earners who tend to be net savers, will experience a deterioration on the Y earned from loans, theoretically leading to a deterioration in their C and I. However, the RBA states the positive impacts on 'borrower H/H' comfortably offsets the negative C impact on

'saver H/H'

ASSET PRICE AND WEALTH CHANNEL

• A reduction in the cash rate will also impact the eco through the asset P and wealth channel. • A reduction in the I/R will result in a decreased cost of borrowing, encouraging H/H to undertake loans and purchase financial assets. This will lead to an increase D and hence P of assets, primarily property and housing assets, contributing to the wealth effect, a phenomenon where asset owners experience an improvement in their perceived level of wealth and hence, begin to C more. Both the increase in asset P and the higher levels of C from higher Y H/H who tend to own assets, will result in an increase in eco growth and hence inflation.

• Also, lower I/R will lower the cost of borrowing to I in K goods leading to a lower cost of prodn and hence lower cost push inflation in the eco

EXCHANGE RATE CHANNEL

• A lowering of the cash rate will significantly influence the AUD through the exchange rate, deteriorating our interest rate differentials in comparison to other major ecos.

• The AUD, largely as a result of the low I/R of 0.75%, currently sits at $0.69 USD • As the return on lending/loans deteriorates, financial inflows from foreigners will decrease, along with an increased outflow due to dom lenders looking for international alternatives, possibly leading to capital flight.

• This will lead to an increased S and lowered D for the AUD, both applying downward pressure n the AUD, leading to its depreciation as currently being experienced as it sits at a low level of $0.69USD

• This will increase the int comp of Aus X, while M become more expensive, leading to an improvement in Aus' balance of trade, as both M and X competing industries thrive • This has the unintended effect of stimulating greater eco activity and hence, inflationary pressures

SUCCESSES OF MONETARY POLICY

• Since the induction of inflation targeting since 1993, MP has been highly successful in containing inflationary expectations and hence maintaining price stability

• The target of 2-3% has been met consistently with the average rate of inflation since 1993 being 2.6%, compared to an average of 6-10% prior to 1990

• It has also largely contributed to Aus' 26 consecutive years of growth, as evident in the GFC, where it undertook expansionary MP by slashing the cash rate from 7.25% to 3.25%, allowing Aus to avoid a technical recession.

LIMITATIONS

- However despite its LT success, the MP is subject to various limitations that has increasingly diminished its effectiveness on the Aus eco

LIQUIDITY TRAP

- Currently, the effectiveness of MP is greatly hindered by the liquidity trap, a situation where I/R, once falling below a certain level, is no longer successful in stimulating eco growth, only contributing to higher rates of inflation
- This is due to the fact that any cut below a certain rate will have a negligible impact on the spending/borrowing behaviour of consumers.
- Furthermore, the recent 0.25% cut of the cash rate to a record low of 0.75%, has not been passed onto consumers in full by any of the 4 major banks, in a bid to secure their rapidly deteriorating profit margins.
- This has resulted in the failure of MP in effectively stimulating growth

TIME LAG

- Furthermore, MP is restricted by a long and variable time lag of 6-18 months, before the full impact of I/R changes are felt in the eco through the transmission mechanism

- This occurs as consumers and bus do not their change their spending and borrowing behaviour immediately. This was evident during the 1991 recession, where the expansionary MP took almost 2-3 years to stimulate D and eco growth
- Therefore, the RBA focuses on eco forecasts for the next 12-18 months and engage in pre emptive MP, resulting in a lower level of precision of MP as eco conditions may change during this time lag.

BLUNT INSTRUMENT

- MP is also considered to be a blunt instrument, as it is unable to target individual sectors of the eco that is causing a fluctuation of eco activity
  - This was evident during 2010-12, where the cash rate was increased from 3.25% to 4.75% in a bid to subdue inflationary pressures during the mining boom. However, this had the effect of greatly appreciating the AUD to $1.10USD, contributing to the formation of a 2-speed eco, as P elastic X sectors such as services and ag greatly suffered.
- This is as different sectors of the eco have differing levels of I/R sensitivity or elasticity, with some responding quicker to I/R changes (housing and I sector)
- Therefore, a decrease in the I/R will impact all types of spending, even if the initial problem is excessive saving in just one component of AD --> inflation

CONTRADICTION

- Coordination is required between the macroeconomic policies of MP and FP for either to be effective. However, this may not be possible due to political constraints in fiscal policy formulation and different eco priorities. This is evident as while the RBA's goal of P stability remains, the FP has focused on achieving fiscal consolidation.
- The 2019-20 Budget, while having expansionary elements, is contractionary in nature, allowing the gov to reach the first surplus since the 2000s. This is despite however, extremely low levels of eco growth and its contradicting impacts on the expansionary MP.

EXPANSIONARY MP AND CONTRACTIONARY MP

- By nature, contractionary MP is more effective than expansionary MP. This is because there is no upper-bound for the cash rate, but there is a zero-lower bound – real interest will not fall below 0 as banks would be paying people to borrow money.
- Also, consider how MP is successful in reducing demand-pull inflation (e.g. during the first MIB), but it is not too effective in increasing demand-pull inflation (as seen by the low levels of inflation over the past couple of years)

EVALUATION

- Has been largely effective in containing inflation since inflation targeting, but has, since the conclusion of the second MIB, been relatively ineffective in stimulating eco growth and hence maintaining the inflation rate between 2-3%, currently at 1.6%

Consider the impact on MP on cost push inflation (maybe potentially imported inflation if time permits) discussing different types of inflation will help demonstrate your knowledge of price stability

14. FISCAL POLICY

Q. DISCUSS THE EFFECTIVENESS OF FISCAL POLICY IN ACHIEVING THE GOVERNMENT'S OBJECTIVES

- Fiscal Policy questions will often be linked to one or more eco issues – therefore for any essay, introduce the theory + recent trends and then the paragraphs of the issues that are relevant to the question
- If the question is 'effect of macro policies on two eco objectives', structure it by
  - Intro
  - Impact of fiscal on both
  - Impact of monetary on both
- Also, the wording of the question is VERY important – if the question is 'Discuss how [Policy] impacts [issue], then it is a macro essay. However, if it is 'Discuss the implications of [Issue] and how [Policy] is used', it is a topic 3 essay, and should be structured by;
  - Intro
  - Issue

- Policy

INTRODUCTION

- Fiscal policy is a countercyclical macroeconomic policy that involves the use of the Com Gov's budget to alter levels of gov expenditure and taxation (revenue) and hence, influence AD.
- By doing so, the gov may achieve the eco objectives of sustainable eco growth, which then allows it to achieve the goals of full employment and price stability.
- This is conducted through expansionary FP, where the level of G exceeds the previous years', leading to an increased budget deficit or a decreased budget surplus (Vice Versa)
- It may also directly use the Com Budget to address the issues of external stability and a more even dist of Y and W, along with environmental sustainability
- However recently, the effectiveness of FP has been hindered by the high levels of net debt, currently at 18% of GDP. In a bid to achieve fiscal consolidation to 0% by 2030, contractionary FP has been implemented in the 2019-20 Budget despite extremely sluggish levels of growth at 1.4%,

TRENDS

- Since the GFC, where the Budget reached a deficit of 2.1%, the gov has been working towards reaching a surplus in order to achieve consolidation.
- Reaching a $690M deficit in 2018-19, the gov has projected a $7.1B or 0.4% of GDP surplus in 2019-20, aiming to use the surplus to pay off public sector debt

ECONOMIC GROWTH

AUTOMATIC STABILISERS

- Automatic stabilisers refers to the non-discretionary changes in the FP's level of gov rev and expenditure, responding counter cyclically to eco activity in order to minimise the fluctuations in the business cycle • The components of automatic stabilisers are transfer payments and the PAYG personal Y tax system • During periods of low eco growth, Y tax revenue falls as wage growth stagnates and employment opportunities deteriorate, leading to a lower marginal rate of tax. This has the effect of lowering the level of leakages in the eco.
- Furthermore, during a recession, the D for transfer payments in the form of U/E benefits grows rapidly, leading to an increase level of G and hence injections, having an expansionary effect on eco growth. (VV – DEPENDS ON Q)

- Amidst the GFC, the countercyclical effects of automatic stabilisers contributed to Aus' prevention of a technical recession, maintaining eco growth of 1.3%
  - Y tax revenue decreased by 12% while U/E transfer payments increased by 40%

DISCRETIONARY SPENDING

- Discretionary FP refers to deliberate changes to the gov's rev and tax policies
- Any direct injection into the eco will result in an increase in AD through the multiplier effect, where the initial gov exp can be spent again in an eco, resulting in a multiplied increase in C and I and hence, eco growth
- Again, during the GFC, the Aus gov provided $10.4B worth of cash payments to H/H, as every average single worker received a $900 immediate, one off payment in a bid to encourage C • The Rudd gov also implemented infrastructure projects through the Nation Building and Jobs Plan, worth $42B – infrastructure spending on highways and schools + subsidies for insulation and solar panels
- This led to a drastic turn from a surplus of 1.8% of GDP, to a deficit of 2.1% in 2009 alone. However, it is expected to have increased GDP by 2%
- The 2016-17 Budget introduced a **10 Year Enterprise Tax Plan**, involving a cut in the tax rate from 30% to 25% for companies with a turnover less than $10M. This is expected to stimulate the eco by 1% of GDP
- The **Instant Asset Write Off Scheme –** Threshold increased from $25M to $30M, while the eligibility increased from businesses with a turnover of $10M to $50M – saves SMEs $700M + increased I in eco. Now includes 97% of businesses in the Aus eco

UNEMPLOYMENT

- Using FP, the gov can target specific types of U/E in the eco
- An increase in gov spending on active labour market programs of 1% of GDP is likely to ↓U/E by 2%

CYCLICAL

- The policies used to reduce cyclical unemployment = the policies used to increase eco growth (above)

STRUCTURAL

- Gov also influence structural U/E through their policies relating to education/training, social security and employment services to ↑ PR and prod (through ↑ skill) --> investment in human K. Can also target certain groups or certain types of U/E

SKILLS AND TRAINING

- (Youth) 2016-17: **Youth Employment Package** that aims to assist 120,000 U/E young people. Its centrepiece **is a $752M Youth Jobs PaTH**, aiming to ↓ youth U/E by combining training obligations with incentives for employers
  1. Jobseekers < 25 required to undertake 6 weeks of employability skills training within 5 months of registering for U/E benefits
  2. Young jobseekers have the option of a voluntary 4-12 week internship placement, working 15-25 hours per week + $100 per week in benefits – employers get $1000 payment for taking each intern
  3. Employers are given a wage subsidy between $6500-$10,000 if they employ an U/E

person < 25 who has been out of work for more than 6 months
- Effective – partially effective as only 60,000 youth were hired, with many employers just accepting incentives and firing workers

• 2017-18: Employers who bring overseas workers into Aus on temporary work visas would be required to pay a levy to a new '**Skilling Australians Fund'** to fund skills training and apprenticeships for Aus

• Over 4 years, an estimated $1.5B will be provided to state govs to support up to 300,000 trainees --> priorities to emerging industries and regional areas

• 2019-20: **$525M Skills Package called 'Delivering Skills for Today and Tomorrow' –** Ensures that the VET system can deliver the skills critical needed for the eco both present and future • $525M for 80,000 apprenticeships – to target skills shortages
- Doubling incentive payments to employers to $8000 per placement + new apprentices will receive $2000 incentive

TO ADDRESS THE AGEING POPULATION

• 2018-19: Wage subsidies of up to $10,000 for employers who take on older workers. • 2018-19: $17.2M Skills Checkpoint for Qlder Workers --> job creation

• Will support up to 20,000 Australians with up to $2,200 over 4 years by ensuring that 'older Aus who need some help to stay or get into the workforce have the targeted support they need' – Aus Dep of Ed. and Training

EDUCATION

• **2019-20**: **$300B to all schools,** a total ↑ of 63%
- Average funding per student ↑ from $3755 in 2014 --> $5097 in 2019

• 4720 scholarships to encourage students to enrol at rural universities and training providers. • Gonski reforms (improves education in disadvantaged areas by aiming for national equality, aim to increase school retention rates) --> ↑ employability of individuals

• **2017 - GONSKI 2.0:** Plan to increase funding by up to $23.5B over 10 years, while replacing 27 separate school funding arrangements between states with a nat consistent funding system that is expected to bring $2300 per student

HIDDEN UNEMPLOYMENT

• 2018: Gov introduced an integrated **child care subsidy** that pays for 85% of child care costs for families earning up to $65,000.

• 2017-18: Provided $37.3B in funding for the **'Jobs for Families'** childcare package- removed annual limits on families of Y up to $187,000 and introducing hourly rate caps --> puts ↓ pressure on childcare costs, allowing parents to return to work

FRICTIONAL U/E

• Job Services Australia – Federally funded network of employment agencies that provide assistance to job seekers --> ↓ frictional U/E --> ↓ NAIRU
- Jobactive, had $1.3B budget in 2018/19.

 Tightening eligibility requirements for social welfare payments --> 23 hours per week actively seeking work – made compulsory for all unemployed people in 2015 before

being eligible for transfer payments

INFRASTRUCTURE TO CREATE JOBS

- Infrastructure can both influence structural U/E and cyclical U/E (PICK AND CHOOSE, not all of them are required)
  - Structural --> greater capacity for eco growth/AD --> greater U/E in LT
  - Cyclical - ↑ injections in the eco
- **2019-20: Record transport infrastructure I through the $100B Ten Year Infrastructure Plan** to ↓ congestion, with new road/rail projects targeting the worst affected areas of Aus to get workers between job sites quicker --> ↓ delivery times --> ↑ efficiency
  - $1B --> $4B to the **Urban Congestion Fund** targeting Aus' gridlocked cities to ↓ travel times - $1B to improve freight routes and access to ports
  - $7.3B in new roads and railways including $1.6B to extend the Pacific Motorway

  - $6.2B worth of projects in Victoria
    - $2B for fast rail between Melbourne and Geelong
  - Strengthening freight/supply chains that Aus bus rely on + planning for Aus future population •

2018-19: Wide range of transportation infrastructure

- Rail projects between Melb & Brisbane/Western Syd airport, West Connex etc) - $3.5 billion for a Roads of Strategic Importance initiative upgrading key freight routes. - **Infrastructure in NSW**
  - $971 million for the Pacific Highway to bypass Coffs Harbour.
- **Infrastructure in Victoria**
  - $5 billion for Melbourne Airport rail.

- 2018-19: $16.7B spending on healthcare (National Disability Insurance Scheme)--> 100,000 jobs

MIGRANTS

- 2019-20: Nothing for Aus' large migrant community
- 2018-19: Migrants/refugees must now wait 6 months instead of 2 to receive help finding jobs if they receiving welfare payments. --> $68M in cuts for the gov

YOUTH – AFOREMENTIONED

INDIGENOUS

- 2019-20: Record funding for Indigenous Aus
  - Additional $5.3B to support more than 225,000 Aboriginal/TS Islander students through the Indigenous loading component of the gov's schools funding package (to 2029)
  - $276M for the Indigenous Youth Education Package to give more Indigenous students the support/mentoring required through secondary schooling

REGIONAL

- 2018-19: Building Better Regions Fund $200m to support regional infrastructure and investment - $100M for regional airports
- 2018-19: A new scholarship program for over 1,000 students a year to study in regional Aus •

2018-19: Supporting rural/remote areas through ↑ targeting of rural bulk bill incentives - Workforce Incentive Program – streamlining GP training to produce Aus GPs where needed

INFLATION

• FP is not focused on achieving P stability (stable inflation), as it is the role of MP. However, it may, in times of extremely high or low inflation, assist MP in stabilising fluctuations in the eco • If needed, FP can also be used to lower cost push inflation through infrastructure spending that will increase the prod capacity of our eco + schemes such as the instant asset write off scheme that will lower cost of prodn

DISTRIBUTION OF INCOME AND WEALTH

• FP, in achieving an improved dist of Y and W, plays a redistributing role, taxing the wealthiest groups more heavily via the PAYG system and **redistributing Y** to ↓ socio-eco groups through transfer payments

- Recently, budgets have contained fewer proposed spending cuts that could negatively impact ↓ Y earners, with some measures aiming to ↓ entitlements for ↑ Y earners instead. • Changes in tax, transfer payments and other assistance have the most **direct** impact on inequality in Aus - Y inequality is significantly reduced through gov intervention

- Gov payments to the U/E, ↓ Y earners and the elderly, the provision of services such as health, education and housing are the **primary mechanism for ↓ inequality**

• **The combined effect of taxes and transfers is a ↓ in the Gini coefficient from 0.52 --> 0.34**

• Without any taxes or gov benefits, Y for the highest quintile from private sources is around 22 X the average for the lowest quintile (most of whom are pensioners and those on disability support) With gov intervention, the highest Y quintile have Y 6 times higher

FISCAL POLICY – AUTOMATIC STABILIERS

• The non-discretionary component of the FP, automatic stabilisers, lower inequality by taxing the wealthiest group a greater proportion of their Y via the PAYG system.

- The gov, with this revenue can fund transfer payments, effectively redistributing Y to lower socio-eco groups
- Transfer payments accounts for 36% of G

  Age pension - 2018-19: $47B – largest proportion. Spent $725M into aged care services

  U/E benefits

  Disability benefits - $22B to NDIS but $4.6B underspent

  Carers payment – 2018-19: $9B

• Aus' Gini Coeff before taxes and transfer payments is 0.52 --> 0.34, also, Y for the highest quintile would be 22x higher than the lowest. With gov intervention, it is approx. 6x greater.

FISCAL POLICY – TAXATION REFORMS

• The gov can also make discretionary, structural changes to the progressive, PAYG taxation system to improve the equitable dist of Y

• In 2019-20, as an extension of the 2018-19 Budget's tax cut, the gov has announced $158B in tax relief, from the previous $144B
  - This involves up to $1008 Y tax offset for low to mid Y earners
  - However, by 2024, with the elimination of the $87,000 to $180,000 (37%) tax bracket, tax payers earning between $45,000 --> $200,000 will have their rate cut from 32.5% to 30%
  - This has been criticised, with an approx. 62% of benefits going to the top 20%, while the bottom 30% receives 7%
  - Also, this will reduce revenue by $158 billion from 2019-20 to 2029-30

SOCIAL WAGES

• Refers to the amenities provided by the gov to society. They tend to improve the dist of Y as lower Y earners receive proportionately, the most benefits

PUBLIC FREE EDUCATION

• 2018-19: Expanded the **Universal Access to Early Childhood Education Program** by announcing $428M I --> will benefit 350,000 children and allow more women to return to work

MEDICARE

• **2019-20:** $1.1B boost to Medicare over 5 years for primary care and frontline health services - Gov will end the indexation on Medicare rebates a year earlier than planned – will make it cheaper to access 119 GP services --> will cost gov $187M

PBS

• 2018-19: To ↑ access to medicine - $1.4bn to PBS + e-prescribing for safer medicine • $331m funding for new and amended listings on the PBS, including medicines to treat cancers - reduced prices from $55,000 to $40.

CHILDCARE REBATES

• 2018: Gov introduced an integrated **child care subsidy** that pays for 85% of child care costs for families earning up to $65,000.

• 2018-19 – Expanded the **Universal Access to Early Childhood Education Program** by announcing $428M I --> will benefit approx. 350,000 children and allow more women to return to work

BACKGROUND

• 2019-20: ABSTUDY – Assistance to families of Aboriginal students who need to stay away from home to study

• 2018-19: **A Stronger Rural Health Strategy:** Focusing on improving the health of people living in rural, regional and remote Aus --> through better teaching, training etc.

- Also addressing doctor shortages across rural/remote areas by strengthening bonded programs

REGRESSIVE TAXES

• C taxes such as the GST and excise tax on tobacco means that the lowest 40% of Y earners have a higher tax burden – 12% of Y is tax, but with C taxes, it is 15%

LABOUR MARKET POLICIES

• Decentralisation of the labour market has greatly widened Y inequality, as under enterprise agreements, workers with grater skills and bargaining powers have achieved higher Y • Also, as the allocative efficiency of the eco has increased, so has specialisation, leading to a greater D and hence pay for skilled workers

• However, modern awards, minimum wages and NES of $19.49 sets a safety net •

Include MER U/E policies used in the U/E essay

- PaTH 2016-17 ($752M)

14. LABOUR MARKETS

Q. EXPLAIN HOW LABOUR MARKET POLICIES CAN BE USED TO AUSTRALIA'S ECONOMIC OBJECTIVES

INTRODUCTION

- Labour market reforms refer to microeconomic policies that are targeted specifically at the labour market in order to improve the productive capacity of the Aus eco through increased competition and efficiency/productivity.
- These reforms involved a shift from the centralised industrial relations system to one that is largely decentralised, as the market forces of S and D along with enterprise agreements playing a greater role in determining wage outcomes.
- Since the introduction of the Ps and Ys Accord in 1983 to currently, where Aus' relations framework is established and enforced through the Fair Work Act 2009, the Aus gov has been able to greatly improve the AS of the eco along with the flexibility of the labour market.
- This has enabled the gov to achieve its eco objectives of eco growth, sustaining it for a record period of 28 years, full employment along with P stability, averaging 2.6% in the past 30 years. It has also been successful in achieving ~~stable~~ external stability. This has been assisted through various labour market policies in recent times, designed to improve the workforce of Aus.
- However, in pursuing these objectives through greater decentralisation, it has, to an extent, compromised its objective of an equitable dist of Y and W

CENTRALISED SYSTEM - PRICE AND INCOME ACCORD

- Prior to 1983, Aus' labour market existed under a heavily centralised industrial relations system, where wages were determined by a central body.
- Under this system, pay and conditions existed in centrally determined awards that encompassed whole industries, with little scope for wages to vary according to an industries' profitability or productivity. This process involved wage indexation where quarterly, the central governing body would observe the inflation rate/cost of living, and increasing or decreasing wages correspondingly.
- However, during the 1970s, as a result of increased pressures from trade unions, wages significantly outstripped productivity, culminating into a real wage overhang. During this period, U/E rose to over 10% while int comp also suffered. Inflation also rose to 11% as employers simply absorbed these wage rises in the form of higher P for their G/S. Hence this system greatly hindered Aus from achieving its eco goals
- In an attempt to subdue inflationary pressures and to improve the productivity of the Aus labour force, the 1983 Prices and Incomes Accord was established between gov and unions, as unions agreed to contain their wage D in return for means of compensation by the gov through social wages such as superannuation (1992) and HECs (1989)
- The gov developed a 2-tier system consisting of industry awards, along with the introduction of enterprise bargaining/agreements, through the Accord Mark III in 1987, allowing unions to negotiate at enterprise level for higher wages, based on productivity levels.

WORKPLACE RELATIONS ACT

- The 1996 Workplace Relations Act accelerated the shift towards a decentralised labour market, which embarked on further simplification and the implementation of **Aus Workplace Agreements**, or individual contracts, along with the **No Disadvantage Test.** This test states that an individual contract must prove to

be more beneficial to an employee than their corresponding industry award conditions.

- Under these policies, the fed gov further moved employees away from a reliance on industrial awards and Union Collective Agreements to individual workplace agreements and Non-Union Collective Agreements

FAIR WORK ACT

- Established in 2009, the Fair Work Act, enforced by the Fair Work Commission, is Australia's current industrial relations framework, and is largely decentralised, promoting greater productivity in the Aus labour market, hence allowing Aus to achieve its eco objectives.
- The FWA streamlined over 4300 awards to 122, while also stablishing various safety net/minimum standards for employees in Aus through the National Employment Standards and the minimum wage, which is currently at $19.49 per hour
- The FWA also placed greater emphasis on collective enterprise agreements and modern awards - Also developed the BOOT test

IMPACTS

ECO GROWTH

- As a result of the decentralisation of the labour force, wages have become more reflective of productivity growth in the eco, rather than increases in the cost of living. Thus, this has had the effect of incentivising individual workers to adopt more efficient means of production or work practices, as they will be rewarded by higher output, through greater wages.
- This was evident as productivity growth almost doubled from 1.1% in 1970s to 2.1% in 1980s. • On a larger scale, more profitable, efficient firms that have a greater capacity to pay, were able to attract more skilled labour. This contributed greatly to an improved allocative efficiency in the eco as efficient businesses were able to grow, ultimately allowing them to reach economies of scale and hence also, technical efficiency. This contributed greatly to an increased level of output in the eco and hence AS, ensuring LT eco growth, shown through an increase in the AS curve from AS_1 to AS_2
- It is estimated that increases in productivity from 2000-13 were responsible for 60% of growth, hence it can be said that labour market reforms has significantly enabled and equipped the Aus eco to meet its eco objective of eco growth for a record period of over 28 years

INFLATION + EXTERNAL STABILITY

- Furthermore, under the previous, centralised wage system, Aus fostered a highly uncompetitive

with little rises in productivity.

- Growing pressures from unions contributed to extremely high inflation in the 1970s, averaging over 10%
- The introduction of the Ps and Ys Accord in 1983 was successful at easing the pressures of inflationary rises, effectively reducing the influence of unions in bargaining for wages, resulting in a decline in real wage growth over its 12 years of enforcement 7% average in 90s
- Further advancements towards decentralisation through the Workplace Relations Act 1996 and ultimately, the Fair Work Act 2009 placed greater emphasis on negotiations for wages based on productivity improvements at an enterprise level. As a result, cost-push inflationary pressures in the form of destabilising wage rises has been greatly contained, evident through the average inflation rate of 2.5% since 1990s, in comparison to 12% in 1983.

- Furthermore, the aforementioned improvements in AS as a result of an increase in productivity in the eco has resulted in lower levels of capacity constraints in the form of D-pull inflation. • Therefore, reforms to the labour market reform has equipped the Aus gov to subdue unsustainable wage growth and hence inflation, allowing it to effectively achieve its goal of P stability.

EXTERNAL STABILITY

- External stability refers to the ability of an eco to services its foreign liabilities over the MT-LT while also engaging suitably in trade with the global eco.
- While Aus' success in maintaining its external stability over the past 3 decades can be largely attributed to favourable outcomes in the global eco such as the rise of the mining boom, MER indirectly, has equipped Aus to best meet the growing D for its X, while also improving its int comp.
- This is as the decentralisation of the labour market has allowed profitable and efficient firms to continue growing by attracting skilled labour with higher remuneration, thereby improving the allocative efficiency of the eco. This has allowed these firms to continue growing on larger scales, achieving technical efficiency through economies of scales. This effectively improved their ability to compete with foreign competition, especially necessary with Aus opening its borders to foreign M through trade liberalisation in 1988.
- Furthermore, the sustained low cost of G/S along with a rise in productivity has allowed Aus to remain internationally competitive, leading to more frequent and greater BOGS surpluses since the end of 1990s.
- This is evident through the drastic improvement of the CAD from 6% of GDP in the 80s to Aus' CAS of 1.2% in 2019, for the first time since 1975

UNEMPLOYMENT

- Labour market reforms has also allowed Aus to achieve its objective of full employment through

the improved flexibility of the labour force, alongside greater prod and hence D for labour • Okun's law states that in the LT, greater productivity growth will lead to greater eco growth and hence job creation.

• The converse was evident prior to labour market reforms, with low prod growth along with the inefficient allocation of resources lead to U/E of beyond 10% in 1983, thereby necessitating MER • The implementation of an IR system that promoted wage growth through individual/enterprise bargaining for higher productivity levels lead to a fall in U/E to 6% in 1989, as employers were greatly incentivised to hire labour.

- Aus has benefitted greatly from MERs, with prod growth in 1990s --> 2000s averaging 2.4%, compared to the OECD av of 2.1%

• Furthermore, as wages and working conditions are now negotiated between employees and employers in individual business through enterprise bargaining, the flexibility of the labour force has improved. In the event of a recession, as experienced during the GFC in 2009, businesses are able to negotiate and adjust wages and working hours with greater flexibility, instead of resorting to retrenching workers. This improved the dynamic efficiency of the labour market, enabling the eco to absorb negative eco shocks. This has greatly benefitted the labour force in the GFC, where U/E only rise to 6.2%, compared to an expected 10%.

• Hence this improved productivity of the workforce has allowed Aus to continue striving for its goal of full U/E over the past 3-4 decades, while the increased flexibility of the labour force has mitigated extreme U/E during recessions.

DISTRIBUTION OF Y AND W

• While greater decentralisation has allowed the Aus gov to achieve a wide range of its eco objectives, it has done so at the expense of contributing to a worsened inequality of Y and W in the Aus eco.

• Wage dispersion has become more prominent, where workers completing the same job in different industries receive different levels of pay.

• This is as, under a decentralised system based upon enterprise bargaining, industries or firms where unions have little presence or power are less likely to achieve wage rises regardless of their prod.

• Similarly, those with higher Y jobs or higher skilled jobs will also have better bargaining power, in comparison to those with casual/part-time jobs that generally have low Y thereby worsening the dist of Y and W in the eco, with the Gini Coefficient increasing from 0.3 in 2000 to 0.33 currently

LABOUR MARKET POLICIES

• The gov has also implemented policies through the Federal Budget relating to education/training and employment services, in order to increase the participation rate along with prod to achieve all of the same objectives as MER + to address Y inequality + Underutilisation etc

• Education and training – improving the quality and responsiveness of the education system link these education and training programs explicitly to increase eco growth by increasing the productive capacity of the economy, and also how they can help reduce Y inequality.
  - Gonski 2.0
  - PaTH
  - Others in the U/E essay

15. MICROECONOMIC REFORM

Q.1 – GENERIC: DISCUSS THE CONTINUING ROLE OF MICROECONOMIC REFORM IN ACHIEVING AUSTRALIA'S ECONOMIC OBJECTIVES.

INTRODUCTION

• MER refers to LT strategies which improves the efficiency and prod of individual industries, leading to structural change within the S side of the eco, and hence increasing AS

• By doing so, the prod capacity of the eco improves, allowing Aus to achieve a sustainable rate of growth while subduing inflationary pressures.

• MERs also causes structural change in the eco, whereby the pattern of prodn changes in response to changing consumer D, as new industries rise, and others decline.

• The objectives of MER are to improve resource allocation, raise labour/K prod and encourage greater comp in both factor and product markets --> link to any eco objective

• Since the 1980s, Aus has undergone intensive MERs such as financial deregulation, trade liberalisation and NCP, as well as taxation reforms.

• However, as of recently MER has been used in order to address concerns surrounding an ageing population, as well as slow progress in infrastructure and ↓ education.

RATIONALE FOR MER – PRODUCTIVITY, EFFICIENCY

• MERs are conducted to encourage the efficient operations of markets, achieved when resources flow to where they are most valued, and when the P mechanism of S&D can operate with limited gov intervention. The 3 different types of efficiencies involve

• Allocative efficiency, referring to the ability of an eco to shift resources to where they are most valued or will be used most efficiently, achieved by a greater level of comp to attain specialisation • Technical efficiency, referring to the maximisation of output at a given level of input. This is to be achieved through a greater use of tech and EOS

• Dynamic efficiency – the ability of an eco to move resources between industries in response to changing patterns of consumer D, achieved through BOTH tech and comp.

• The gov focuses on MERs in the factor market, where factors of prodn are sold as it can improve the efficiency of all markets that use that certain factor of prodn.

FINANCIAL DEREGULATION – 1980S

• 1983 – Floating of the AUD --> opened eco to global financial flows

• Removed RBA's direct monetary control over banks --> controls on foreign K, forex, I/R and I were lifted. - Made MP more effective as it allowed RBA to implement it through I/R rather than bank regulations • Also, foreign banks were able to enter --> 16 entered.

• This had the effect of improving the level of comp in the market --> driving P down, while also improving allocative efficiency by ensuring K was directed to productive uses. This was particularly useful during the MIB

↓ PROTECTION – 1980S

• The MERs in the product market started with trade liberalisation in 1988, as tariffs and other modes of protection, especially in the manufacturing sector was removed as a part of a 4 year plan. - Tariffs over 15% --> 15%, until 1996, until all tariffs were reduced to 5% --> now 2%

• This move towards trade liberalisation is still continuing, with Aus now being one of the least protectionist ecos in the world with an av tariff of 2%.

• In the ST --> ↓ inflation as cost push and imported inflation ↓, reducing from an average of 6-10% in 1960,70s to now 2.7%, greatly benefitting individuals in their choices and SOL.

• BOGS improved by 20% in the early 1970s to 2003-2004, demonstrating Australia's improved trade performance due to ↑ X market opportunities

• Over time, this has led to sig structural change, as inefficient firms close/downsize --> ST U/E and ↓ eco growth. But eventually --> ↑ allocative efficiency as resources are made greatly available for productive firms
  - The inefficient manufacturing sector has ↓ in their contribution to GDP, from 13% --> 6%, while the recent removal of a $250M subsidy for PMV industry has led to a loss of 50,000 jobs. "Less skilled workers from the manufacturing reforms in the 80s and 90s, ended up on a disability

pension until they were old enough to move to age pension'

- EOS --> technical efficiency and hence ↑ I C --> ↑ growth and BOGS
- Dom firms are also forced to become int comp --> innovate, specialise, adopt new prodn methods etc --> ↑ dynamic efficiency --> ↑ prod and output levels --> ↑ AD & AS

LABOUR MARKET REFORMS – 1980S --> FAIR WORK ACT 2009

- The industrial relations system has also experienced extensive reforms since 1983, shifting from centralised --> decentralised, deregulated labour market
- **1983 – the Ps and Ys Accord** was established between trade unions who were rapidly growing in popularity, and the federal gov. The Accord consisted of awards and a centrally determined wage system, based on the cost of living – **wage indexation**. --> introduction of HECS in 1989 + super in 1992
- Further reforms accelerated with the **1987 Accord Mark III**, developing a 2-tier system consisting of industry awards, along with the introduction of enterprise bargaining/agreements --> decentralised • **Industrial Relations Reform Act 1993** – 1st move away from centralised wage fixing towards enterprise bargaining --> discouraging industry wide awards and encouraging use of firm level enterprise agreements/individual contracts
  - Employees on awards fell by 5% and those on enterprise agreements rose by 5% in the last 10 years
- This was furthered by the **Workplace Relations Act 1996**, introducing AWAs + no disadv test • The extent of decentralisation was taken to new lengths by the **Workchoices Act 2006**, which eased dismissals laws for employees, sparking dissent.
- Therefore, in 2009, the **Fair Work Act** was established and along with it, the FWC - Established NES, BOOT, min wage and 4300 awards --> 122 streamlined.
- This decentralisation has had positive impacts on the labour force, increasing their productivity as incentives ↑ + ↑ skills etc
- Also, it has led to a greater efficient allocation of resources as efficient/prod industries can attract skilled workers through ↑ wages
  - Aus has benefitted greatly from MERs, with prod growth in 1990s --> 2000s averaging 2.4%, compared to the OECD av of 2.1%
- Also, improved flexibility of the labour force as bus can cut back on hours/wages rather than firing workers --> improves the dynamic efficiency of the labour market --> enables the eco to absorb -ve eco shocks (prevents spikes in U/E) – epitomised by the GFC. U/E was only 6.2%
- RIGHT NOW
  - GIG ECONOMY
  - CASUALISATION/UNDEREMPLOYMENT – 8.3%
  - YOUTH UNEMPLOYMENT – 14%

PRIVATISATION – NCP – 1995

- National Competition Policy in 1995, an agreement between the State and Fed gov to encourage MERs aimed to use competitive pressures to drive innovation in the eco, ↑ eco growth and to ↓

inflation. This acted as a framework for reform in the essential services industry such as electricity,

transport.

• Promoted comp through deregulation and the corporatisation or privatisation of GBEs - Privatisation of Telstra (telecom Aus) from 1997 – 2006 --> decreased cost by 50%. Sig as telecom sector accounted for 3% of GDP
- NSW's electricity in 2014-15
- In the transport industry, the 1952 Two Airline Policy was abolished, with Qantas being sold in 1993 --> ↑ comp --> ↓ P
- Rail freight industry – Aus Rail Track Cooperation to manage national interstate rail network --> sells access to privately owned freight businesses --> fre/ight costs decreased by 42% • ACCC 1995 + Comp and Consumer Act 2010 --> prevents anti-comp behaviour such as price fixing and abuse of market power --> ↓ pressure on P

• Part of the NCP was the competitive neutrality principle --> no help for GBEs+ ACCC, prevented anti comp behaviour

TAX REFORMS

• Tax reforms were amendments to existing taxation policies to improve int comp and EG • Prior to the intro of the GST, the **Wholesale Sales Tax System** consisted of rates as high as 45% and only applied to 1/5th of C, creating distortions to prodn and C decisions lower eco efficiency and int comp

• Through the GST, more than 30 state taxes were removed improved AS through lower input costs for industry prodn, boosts in K prod and the creation of a more stable foundation for gov rev. - As a result, about 23% of total state rev comes from GST, with around 47% of Aus' nat C subject to GST, increased from 20%

• Capital Gains Tax (1985)
- Tax applied to capital gain made on disposal of any asset
  2018: Total 60% CGT discount --> ↑ C + I

• Company Tax
- Before 1987 –> classical dividend tax system --> double taxation
- Dividend imputation system introduced --> now bus with less than $10M receive 27.5%, with all others at 30%

 This has the effect of ↑ the capacity of bus to ↑ I in K goods --> ↑ AS + ↓ leakages in the eco

INFRASTRUCTURE SPENDING

• Aus has used infrastructure to increase the prod capacity of the eco --> ↑ AS + addressing bottlenecks in transport etc – increase output pp by 10% from 2010-18

- --> $100B 10 year infrastructure plan --> Fourfold increase --> $4B to Urban Congestion Fund • GONSKI 2.0 --> $30B as a needs based funding for public schools to improve the quality of the workforce

COMPULSORY SUPERANNUATION

• Has reduced inequality significantly since its implementation in 1992
- Employers must contribute at least 9.5% of wages to a super fund, which they cannot access until their retirement
- 2025 – will increase to 12%

• Particularly important for the bottom 20% of wealth-holders as it is one of the few sig financial assets

that they possess

- However, tax concessions to voluntary super contributions may benefit higher Y earners who can set aside extra Y at lower tax rats
- 2015-16 Budget: Stricter caps on tax concessions - $25K at tax rate of 15% rather than $30K + $0.5M lifetime cap

LIMITATIONS

- Worsens Y inequality + ST U/E due to structural change
- Political constraints
- Very long time lag due to extensive planning and detail (20 years)
  - Intro of a P on carbon emissions in 2012/13 occurred after a 4 year delay

EVALUATION

- Micro reform has been highly effective in achieving Australia's economic objectives through lower inflation, improved productivity, and decrease in long term unemployment etc.
- Micro reform functions best when fiscal policy is used with it, so the reforms can be executed through fiscal measures.