

Aggregate Supply Policies

- Government initiatives that improves AS conditions for businesses to increase Australia's productive capacity
 - It is important to adjust AD in the short term in the management of economic growth. However in the long run, increasing AD will not benefit the economic without corresponding growth in AS as it will cause upward pressure on demand inflation (productive restraint).
- ❖ Answering AS policy questions:
- Outline AS policy
 - How it affects efficiency, availability of resources or cost of production
 - Increase productive capacity, firms' ability and willingness to produce
 - Increase AS, potential for GDP growth if there is corresponding growth in AD
 - Impact on government economic goals
 - Impact on living standards

Productivity and Efficiency

Efficiency: How well factors of production combine to produce goods and services. This is measured by productivity.

Productivity: The total output gained from a set quantity of inputs. How efficient is the process of production.

Productivity growth: the rate at which the total output gained from a set quantity of inputs increases.

Production: the process of converting resources into goods and services, or the total volume / value of goods and services produced over a given period of time.

Types of Efficiency

Allocative efficiency

- Ensuring resources are used in a manner that maximises living standards, through producing products that most satisfy society's needs and wants.
Efficient allocation of resources occurs when living standards and society's wellbeing are maximised and it is not possible to further increase living standards (material) by changing the way resources are allocated.

Productive (technical) efficiency

- Where firms and industries can produce maximum output at the lowest possible cost (when it is not possible to increase output without increasing input).

Dynamic efficiency

- How quickly an economy can re-allocate resources to respond to changing market conditions, in order to achieve allocative efficiency.

Inter-temporal efficiency

- Using resources in a manner so that there is a balance between resources used for current consumption and those required for future generations.

Policies to improve efficiency (note: not all of the followings are AS policies)

Allocative efficiency:

- excise tax on undesirable production.
- fund ACCC to improve competition and allocation of resources.

Technical efficiency:

- education and training
- labour market reform (wages linked to productivity RULCs)
- encourage workforce participation

Dynamic efficiency

- grants for innovation, research and development
- education and training

Inter-temporal efficiency

- prices on carbon / ERF
- solar panel rebates
- Kyoto agreement to reduce emission

Now we finally look at some major AS policies

Environmental policy

Government strategies that are designed to mitigate and adapt to damage on the environment from economic activities. They are designed to limit negative externalities resulting from market failure.

Climate change: global warming caused by pollution from the production and consumption of goods and services. Climate change is a form of market failure as it poses negative externalities

- Financial and social impact on those relying on nature for livelihood.
 - Reduction in food production.
 - Increase number of natural disasters.
 - Loss of animals and species
- ❖ Environment is a form of public good.

Immigration policy

Immigration: when people enter and settle in a country where they are not native.

Skilled immigration: migrants that have skills or experiences beneficial to Australia's labour market.

Immigration policy grants entry to Australia migrants who possess skills that are lacking in the domestic labour market. As such, these migrants are highly employable.

- Improves availability of resources, increase willingness and ability to produce
- Skilled migration brings skills, knowledge and ideas, improves efficiency (technical).

Sustainable economic growth

- Increased AS and skills/knowledge, increase productive capacity, increase GDP.

Low inflation

- Increased productive capacity, lower demand inflationary pressure.
- More labour, reduce wage rates.
- However increased population can increase AD.

Full employment

- SKILLED MIGRATION only allows professions currently lacking in Australia, therefore limit competition with locals, increase employment.

Equity in income distribution

- Efficiency, reduce COP (wage), increase employment.
- However higher AD from population consumption can lead to greater demand inflation.

External stability

- Can improve efficiency, innovation and quality from new skills, more competitive, less CAD.

Microeconomic reform policy – Trade Liberalisation

The removal of trade barriers between Australia and other countries to allow imports and exports flow more freely, such as removal of tariffs and imported products.

Sustainable growth

- In the short term, cheaper imported items create fierce competition resulting in business closures, decreasing AS and GDP.
- In the long term, Australian firms that survived had become more efficient and internationally competitive; resources are allocated to areas of comparative advantage.

Full Employment

- Short term, structural unemployment rises due to business closure.
- In long term, structural unemployment decreases as firms are more competitive, greater production = greater demand for labour.

Low inflation

- Lower price for imported resources, lower COP for firms, decrease cost inflation
- Efficient allocation of resources to comparative advantageous areas, more efficient, lower cost inflation.

Equity in income distribution

- Short term wise, greater competitive lead to business closure and greater unemployment, less income.
- Long term wise, competitive firms hire more and decrease structural unemployment.

External stability

- In the short term, cheaper imports will increase M, increase debits on goods and service account.
- In the long term, efficiency and international competitiveness increase X and decrease M, increase credit and decrease debit, decrease CAD.

Example of trade liberalisation

Malaysia- Australia Free trade Agreement:

- Signed in 2012
- Include markets such as automotive, agriculture and textile.

Past Exam Questions

2013, Question 3

Which one of the following policy decisions is likely to have a different effect on aggregate supply from that of the other three? (2 marks)

- A. an increase in the pension qualification age from 65 to 70 years
- B. the payment of a subsidy to parents to cover the cost of childcare
- C. an increase in the minimum school leaving age from 15 to 17 years
- D. relaxation of the criteria that need to be met in order to qualify as a skilled migrant to Australia

2012, Question 4

Explain the difference between productivity and production. (2 marks)

2013, Question 2

Explain how each of the following might influence Australia's future rate of economic growth. 6 marks

- an ageing population (3 marks)
- the effects associated with climate change (3 marks)

Discuss how trade liberalisation might operate or has operated to increase productivity and thus promote the achievement of the key economic goal of low inflation. (4 marks)

Challenge

Budgetary policy and immigration policy can operate to influence aggregate supply. Discuss how these policies might be combined in the policy mix to influence aggregate supply in order to improve Australia's long-term economic prosperity and living standards. (6 marks)