

Structural Change and Microeconomic Policies

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Multiple Choice Answers

1	D	6	A	11	D	16	B
2	C	7	A	12	B	17	B
3	C	8	B	13	A	18	C
4	A	9	D	14	D	19	A
5	B	10	D	15	C	20	A

Short Answer Questions

Question 1

- a) Structural change refers to a change in the pattern of production in an economy over time. It may cause some industries to disappear and others to emerge in the economy.
- b) In the early 1980s, the financial industry in Australia was deregulated. The Australian dollar was floated, the distinction between savings and investment banks was removed and licences were given to overseas banks to enter the financial sector. These changes have contributed to the growth of portfolio investment into the Australian financial markets and the growth of Non Banking Financial Intermediaries.
- c) Increased levels of competition result in increased consumer choice as a larger number of firms are forced to compete for a limited market. This encourages firms to compete by improving the quality of their product. Firms may also compete in terms of price which results in lower prices for consumers. With greater levels of competition, firms are better able to adapt to changes in the pattern of consumer demand, which results in a higher level of dynamic efficiency within firms. This means that firms are better able to react to sudden shocks in the market, which increases their chances of long term survival. Also, firms outside of the industry which may use the product in their production will benefit from lower business costs and greater choice of inputs, e.g. greater competition in the telecommunications industry.

- d)** Microeconomic policies achieve structural change by raising the level of efficiency, productivity and international competitiveness. This results in an increase in the level of aggregate supply in the economy. Microeconomic policy can change the productivity of the factors of production. For example, labour market policy aims to tie increases in wages to increases in productivity, which gives workers an incentive to increase productivity. Firms will be able to produce more output with the same input, resulting in greater aggregate supply and structural change in the economy. Microeconomic reforms such as reductions in protection improve the level of allocative efficiency as inefficient import-competing firms close. This frees up resources which can flow to areas in the economy in which Australia has a comparative advantage. This also raises Australia's level of international competitiveness and leads to structural change in the form of new export industries. Microeconomic reforms such as privatisation and corporatisation of public trading enterprises can lead to improvements in technical efficiency as the profit motive of the new firm encourages it to adopt world's best production practices. Other microeconomic policies such as National Competition Policy can encourage firms to improve their dynamic efficiency in order to better react to changes in consumer demand and maximise market share. This would result in a more responsive aggregate supply.

Question 2

- a)** Productivity refers to the quantity of output which can be produced with a given level of input.
- b)** An increase in productivity indicates that the economy would be able to produce more output with the same number of inputs. This means that the economy is directly able to increase the level of aggregate supply. This increased value of production also increases the incomes of the factors of production. This increase in output and incomes reflects an increase in economy growth from the supply side of the economy.
- c)** Reforms to Public Trading Enterprises (PTEs) such as corporatisation and privatisation involve changing the organisational structure of a PTE so that it is run like a private firm with a profit motive. This forces the new management to reduce the number of inputs and improve their efficiency in order to maintain a profit or a lower loss. This would result in changes in the production operation to ensure that the same or greater output can be reached with fewer inputs, improving productivity.
- d)** Microeconomic reform usually results in a number of short term costs associated with the process of structural adjustment, but a number of long term benefits. The short term costs tend to be associated with a particular industry or firm which is affected by the policy. For example, reductions in protection expose inefficient import-competing industries to foreign competition. This forces the firms to downsize or closer, resulting in structural unemployment. Structural unemployment can turn into long term unemployment unless the government assists with labour market retraining programs. Additionally, the distribution of income is likely to worsen in the short run due to the increase in unemployment. However, in the long run the economy as a whole will benefit from higher rates of productivity and efficiency. Over time, resources will flow from inefficient to efficient industries, improving allocative efficiency and increasing aggregate supply. For example, National Competition Policy exposes firms to increased amounts of competition which ensures that those firms which are too inefficient to compete will be forced to close, whereas the most efficient firms will continue to operate in the long run. Higher aggregate supply creates sustainable economic growth and higher income levels without higher inflation. If aggregate supply is increasing, it is able to match increases in aggregate demand, achieving higher dynamic efficiency, which ensures that prices do not need to rise by as much in response to increases in aggregate demand and minimising demand-pull inflation. Finally, consumers will benefit from increased choice and reduces prices in the economy. For example, deregulation of financial markets has given individuals greater choice and flexibility in the financial sector.

Question 3

- a)** Direct trade policies are policies which directly advantage an export-competing firm such as protectionist policies and export assistance. Indirect trade policies are policies which seek to improve export performance on a general level by increasing efficiency and productivity within an exporting industry, such as microeconomic reform policies.
- b)** Indirect trade policy can be used as a form of protection to hinder foreign competition. For example, Australia's strict quarantine and customs rules are often regarded as a form of indirect protection because it prevents free trade in certain agricultural products which are seen as harmful to the environment. This prevents foreign producers from being able to compete directly against local products without the need to use direct protectionist measures such as tariffs.

- c)** Austrade administers the Export Market Development Grant (EMDG) scheme which encourages firms export new products in overseas export markets. The program provides assistance to firms by subsidising the cost of their overseas marketing, which is a significant non-production expense for many firms – particularly small businesses. Australia has also had a small number of strategic industry policies where the government has sought to provide grants to develop export industries in areas such as biotechnology, pharmaceuticals and renewable energy.
- d)** Microeconomic and trade policies have had a mixed impact upon Australia's trade performance. Reductions in protection aim to achieve allocative efficiency by forcing inefficient import-competing industries to close or restructure, freeing up resources for new export-competing industries in which Australia has a comparative advantage. However, Australia generally experiences a deficit on the balance on goods and services, with most surpluses caused by competitive exchange rates. The reduction in protection has made imports more competitive, which consistently outstrip exports. However, Australia has experienced a steady increase in manufacturing exports as new niche markets are created. In addition, specific industry policies, such as in the passenger motor vehicles industry, have helped to make the formerly inefficient industry a smaller export-competitive industry. For example, the Australian passenger motor vehicle industry sells significant car exports to the Gulf Cooperation Council region. Whilst the continuing trade deficit reflects a continued reliance on imports, the Australian economy has seen a steady broadening of the export base towards higher value-added manufactured products in recent years, which demonstrates that the benefits of structural change are occurring in the economy.