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# 1 The market system and government



## 1 The market system and government

### 1.1 Overview

#### 1.1.1 The Australian economy

##### Development of the market economy

On television news, current affairs programs and throughout the media, we frequently hear politicians and commentators referring to the 'Australian economy'. What is the 'economy' and how does it work? In simple terms, the Australian economy is the total of all activities undertaken for the purpose of producing, distributing and consuming the goods and services we require to satisfy our needs and wants.

Let us look at this definition in more detail. As human beings we all have needs and wants. *Needs* can be described as those things that are essential for our survival. They include food, clothing and shelter. *Wants* include those things we desire, but which are not necessary for survival or to meet the basic standard of living in a community. They can include everything from TV sets, to motor vehicles, to mobile phones.

We satisfy our needs and wants by acquiring goods and services. *Goods* are physical, tangible items that can be seen and touched. They include all those products we actually buy from shops. *Services* are the actions done for you by others that are designed to satisfy needs and wants. They include the services provided by doctors, dentists, banks, telephone companies, entertainers, mechanics and teachers, among others. Whenever we make use of goods and services we are said to *consume* those goods and services, and so are regarded as *consumers*. The process of using goods and services is known as *consumption*.

Goods and services have to be provided by someone, and we usually expect businesses to do this. Any activity within the economy that results in the provision of goods and services is known as *production*. Economists do not limit this term to the manufacture of goods in a factory, as many of us might think, but use it to include all goods and services. To the economist, the activities of a dentist filling teeth, a band performing at a venue, or a teacher in a classroom, are all included in the definition of production.

In order for us to be able to consume the goods and services that have been produced, we need systems of *distribution*. This means that the goods and services have to be supplied at locations that are convenient for consumers. This could mean a local shopping mall, an office block in the city centre, or even through a website. The distribution process also includes the setting of prices to be paid for goods and services.

In Australia we live in a market economy. In this topic, we will examine what this means. What is a market economy? How well does a market economy perform the activities of producing, distributing and consuming the goods and services we require to satisfy our needs and wants?

**Figure 1** Consumers will seek to buy the goods and services that satisfy their needs and wants.



## 1 The market system and government

### 1.2 Who is involved in the market system?

#### 1.2.1 Consumers and producers

What do we mean when we speak of markets? In simple terms, markets consist of **producers**, who make and sell goods and services; and **consumers**, who buy the goods and services. Producers rely on consumers to buy from them, and consumers rely on producers to provide the goods and services they want. A market refers to the relationship between the buyers and sellers, rather than to any physical location. Of course, a shopping centre is a large market because it brings together significant numbers of producers and consumers in one location. However, as we can see with the growth of online shopping, a market can consist of buyers and sellers in cyberspace, where physical location is irrelevant.

Consumers and producers are at the centre of Australia's market system. All of us are consumers, and those of us who are employed are also producers. We satisfy our needs and wants by working to earn money, and then buying goods and services from businesses that produce those goods and services. When we are working, we are providing our **labour** to contribute to the process of producing goods or services for other consumers to buy. When we are spending our money, we are consumers, purchasing goods and services that others have produced, in order to satisfy our needs and wants.

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**Figure 1** People who are employed are considered to be producers.



The total of all consumers in the economy is sometimes called the **household sector**. The total of all producers is sometimes known as the *business sector*.

We can examine the relationship between the business sector and the household sector by looking at the following model. It demonstrates how labour is exchanged for money, and how that money is used to purchase goods and services.



**Figure 2** Model showing the flow of money, goods and services between households and businesses

[Interactivity: Figure Model showing the flow of money, goods and services between households and businesses](#)

We can simplify this model by removing the flow of goods and services, and simply showing the flow of money between households and businesses, as in [figure 3](#). This tells us about the financial relationship between consumers and producers in our market system. Economists sometimes refer to this as the circular flow diagram, because it illustrates how money circulates in a simple market economy.



**Figure 3** The circular flow of money between households and businesses in our market system

[Interactivity: Figure 3 The circular flow of money between households and businesses in our market system](#)

## 1.2.2 The financial sector

Do you spend every cent you receive in pocket money, or in return for any work you do, or do you set some aside as savings? While most people of your age don't save much, many others in the economy do put aside some of their income as savings. This money is usually deposited in a bank or similar **financial intermediary**.

Are you a saver or are you a spender? Would you like to be able to save more money? What advantages do people who save their money have over those who spend their money? [Personal and social capability]

Banks and other financial organisations receive deposits, and use this money to lend out to others who need to borrow money. Most businesses will borrow money, particularly when they need to expand the business. This may involve buying new equipment, or even moving to bigger premises. Money spent in this way is

known as **investment**. Financial intermediaries collect the savings of thousands of depositors, and then have large sums available for businesses to invest in growth.

These financial intermediaries make up what we sometimes call the *financial sector* of the economy. They perform an important role in our market system because they enable accumulated savings to be directed towards business growth. As businesses grow, they are able to employ more people, who in turn have more money to spend on goods and services.

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**Figure 4** Financial intermediaries are able to direct savings into investment in the growth of businesses.



Banks and other financial intermediaries also play an important role in providing credit for households. When consumers make large purchases, such as a house or a car, it is usually easier to borrow the money to pay for these than to save up for years to pay cash for them. When purchasing a house or land, most people take out a **mortgage loan**. This enables them to borrow to pay for the property, and pay back the loan over a relatively long period of time. The housing market depends on the amount of money available for mortgage loans. If more people are able to buy houses, more new houses are built, creating more jobs in the construction industry.

We can see how the financial sector plays its role in the market system by adding financial intermediaries to our basic circular flow diagram. As we can see, banks and other financial intermediaries receive savings from households. They use this money to lend to businesses for investment, and they lend back to households in the form of credit.

**Figure 5** The circular flow of money between households, businesses and financial intermediaries in our market system

[Interactivity: Figure 5 The circular flow of money between households, businesses and financial intermediaries in our market system](#)

### 1.2.3 The government sector

Another element involved in the market system is government. In Australia this refers to the federal government based in Canberra, state and territory governments based in capital cities, and local councils. As well as spending money on consumption and investing in savings, households and businesses pay money to government in the form of taxes and rates, and receive particular types of goods and services back from government. A detailed examination of the role of government can be found in [subtopic 1.5](#). Government plays an important role in the market system for a number of reasons:

1. The level of taxation taken by government can affect the amount of money consumers have available to spend on goods and services. High levels of taxation can mean that consumers spend less, businesses cannot grow as quickly, and cannot employ as many people.
2. Money collected in taxes can be spent on providing welfare payments. These payments, in the form of pensions and unemployment benefits, allow many people to purchase more as consumers, providing more income to businesses, and creating more jobs as businesses grow.
3. Government also provides services such as schools and hospitals and these are paid for from taxes collected from both households and businesses.
4. When government spends money on building roads, schools and hospitals, it is providing money to the businesses that do the actual building, helping those businesses to grow and employ more people.

**Figure 6** When a government pays businesses to construct roads it helps those businesses to grow and employ more people.



The involvement of government in our market system can be illustrated by adding government to our circular flow diagram. We can see that both households and businesses pay taxes to government. Some of this comes back to households in the form of welfare payments such as pensions, or as services such as education and health services. Some of it is spent on buying goods and services from businesses, or paying businesses to build roads, schools or hospitals.

**Figure 7** The circular flow of money between households, businesses, financial intermediaries and government in our market system

[Interactivity: Figure 7 The circular flow of money between households, businesses, financial intermediaries and government in our market system](#)

### 1.2.4 The overseas sector

Australia is an open economy, in that we trade goods and services with other countries. Australian businesses **export** goods and services to both consumers and producers in other countries. Australian consumers buy many products that have been manufactured in other parts of the world and **imported** into this country.

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**Figure 8** Australia imports many goods from overseas and exports to many other countries.



International trade can affect our market system in a number of ways:

1. Australia has a relatively small population, so if overseas consumers are willing to buy the goods and services we produce, this can help our local businesses to grow, and employ more people.
2. There are some products that we are unable to produce with the same efficiency as can be achieved in other countries. A lot of the highly sophisticated machinery used in factories is imported, helping the factory to produce goods more cheaply.
3. Imported goods are sometimes cheaper than locally produced goods, which can make it difficult for local producers to compete with the imported products. This can lead to local producers going out of business. Australian clothing and footwear manufacturing has declined over the last thirty years as cheaper imports from Asian countries have increased dramatically. While this may not be good for those Australian manufacturers, it is a positive trend for consumers, who have access to cheaper clothing.

We can see the effects of overseas trade on the flow of money by adding overseas consumers and producers to our circular flow diagram. We can see that households spend money buying imports from overseas businesses, while businesses can earn money from exporting goods and services to overseas consumers. Exports are good for the Australian economy because they bring money into our market system, while imports take money out of the country and pay it to overseas businesses.

**Figure 9** The circular flow of money between households, businesses, financial intermediaries, government and overseas consumers and businesses in our market system

[Interactivity: Figure 9 The circular flow of money between households, businesses, financial intermediaries, government and overseas consumers and businesses in our market system](#)

We can see that there are five main sectors involved in our market system: the household sector, business sector, financial sector, government sector and overseas sector. The circular flow diagram allows us to see the financial relationships between each of these sectors.

1 The market system and government

## 1.3 Different types of markets

### 1.3.1 Retail, labour, financial and stock markets

As we have seen, a market exists in any situation where buyers and sellers come together to exchange goods and services for money. A market can exist in a physical location, it can be spread across a number of locations, or can have no physical location at all, when buying and selling happens in cyberspace. It is the act of buying and selling, not the actual location, that creates the market. We will now look at a number of different markets that exist within the Australian economy: retail markets, labour markets, financial markets, and stock markets.

### 1.3.2 Retail markets

We are all very familiar with retail markets. These are the markets that allow us to buy most of our goods and services. They include:

- the shopping areas in the central business districts (CBDs) of our large capital cities
- the huge suburban shopping malls such as Chadstone in Melbourne, or Westfield centres at Parramatta in western Sydney and Chermside in northern Brisbane
- local shopping centres with a supermarket and a number of specialty stores
- shopping strips located along major roads and near public transport hubs
- the groups of shops gathered in the main streets of country towns and regional centres
- online shopping websites.

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**Figure 1** Large shopping malls provide a wide range of retail businesses.



The past fifteen years has seen a huge increase in online shopping. In 2015, online shopping in Australia was worth more than \$19 billion, an amount equivalent to 6.6 per cent of all retail sales. About 80 per cent of this online shopping involved purchases from Australian retailers, and therefore around one-fifth of all online shopping in Australia saw goods imported directly from overseas businesses. Online shopping is likely to continue to grow, and the proportion of goods being bought from overseas businesses is likely to become larger as more people become aware of the wide range of choices available around the world.

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**Figure 2** Online shopping has increased rapidly over the last 15 years.



### 1.3.3 Labour markets

At any given time there will be people who are looking for a job. Some of them are people who are unemployed and want to find work; some of them already have a job and are hoping to move to new or different work. At the same time there will be many businesses who are looking to employ new people to work for them. Prospective employees are hoping to *sell* their labour to employers. Those employers wish to *buy* the skills and effort of suitable employees. This combination of buyers and sellers of labour constitutes the labour market.

Like many other markets, the labour market does not operate in a particular physical location. The labour market relies on a variety of means of communication between the sellers of labour (potential employees) and the buyers of labour (employers). These allow employers to advertise vacancies in their businesses, and potential employees to find out about job opportunities. The operation of the labour market can involve the following:

- The simple placement of a sign in a shop or café window indicating that the owner has a job vacancy
- Advertisements in newspapers, advertising job vacancies. This method has declined significantly in recent years, with relatively few vacancies advertised in this way today.
- Online 'jobs boards' such as Seek, Adzuna and Australian JobSearch are the fastest growing source of job advertisements, updated every day. Employers pay a fee to advertise their vacancies, and in many cases it is possible to apply online for the vacancies advertised.
- Any person receiving **unemployment benefits** from government is usually required to take an active role in looking for work. The government pays independent agencies to assist unemployed people to find work. Many of these are run by community organisations such as MatchWorks, Salvation Army Employment Plus and CVGT Australia.

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**Figure 3** Online job boards such as SEEK are the fastest growing source of job advertisements.



The price paid by the employer as a buyer of labour is known as a wage or salary. Wages and salaries are quite highly regulated in Australia. There is a **minimum wage** that must be paid to all employees over the age of 21 years. It is adjusted every year to account for rises in the **cost of living**. At July 1, 2016, this was set at \$17.70 per hour, or \$672.60 for a standard 38-hour working week.

### 1.3.4 Financial markets

Just as there are a number of markets for goods and services throughout the economy, there is also an important market for money. While households earn money in the form of wages and salaries, they will often choose to borrow money to buy larger items such as a car or a house. Businesses make money from selling goods and services to consumers, and generally try to make a **profit** by doing so. Sometimes part of that profit will be invested in expanding the business, but if the profits are not large enough to do this, the business may also want to borrow money to help it grow.

#### The functions of money

Money performs four very important functions in our market system:

1. *Medium of exchange* – Money allows us to exchange goods and services using a common means of exchange we all accept. Employees exchange their labour for money, and all businesses accept money in exchange for the goods and services they supply.
2. *Measure of value* – We use money to put a price on the goods and services we exchange. The price is a measure of what we believe the goods or services to be worth, when compared with other goods and services.
3. *Store of value* – We are able to save our money to spend at a later date.
4. *Standard of deferred payments* – Using money allows us to purchase goods and services on credit, with both buyer and seller knowing how much has to be paid at a later date.

**Figure 4** Money performs important functions in our economy.



#### The working of financial markets

Just as all goods and services have a price, so too does money. The price of having access to money that actually belongs to someone else is known as **interest**. When you deposit your money in a bank account, the bank will pay you interest on your savings. This is usually based on a percentage figure. If you deposit \$100 in your account, and the bank is paying three per cent per annum (per year), the bank will pay you three dollars in interest after a year. Interest is often calculated monthly or even daily, so that if you withdraw your money before the year is up, you will be paid a lesser amount to cover the time the bank had the use of your money. Banks then lend out the money that they have deposited with them to other consumers or to

businesses. They will usually charge a higher rate of interest to borrowers than they pay to their depositors. This is how they make a profit.

If you have money to deposit, it is often worth shopping around to get the best rate of interest. Sometimes it is possible to earn a higher rate of interest if you agree to leave the money in the bank for a fixed period of time. This is known as a *term deposit*, because the money is deposited for a fixed *term*, or period of time. When borrowing money you want to pay the lowest possible rate of interest, so it is also worthwhile to shop around a number of lenders to get the best deal.

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**Figure 5** A bank account allows us to earn interest, while the bank can lend the money deposited to other individuals and businesses.



Financial markets operate like any other market, with sellers wanting to charge the highest price they can for their goods and services, and buyers wanting to pay the lowest price they can. If you are selling the use of your money (i.e. you are a depositor), you want to get the best price (interest earnings) you can for allowing someone else to use that money. If you are buying the use of someone else's money (i.e. you are a borrower), you want to pay the lowest price (interest payments) you can.

### 1.3.5 Stock market



#### Share market basics

Like other markets, the stock market is simply a relationship between buyers and sellers. In this case it is shares in companies that are bought and sold. A share is a unit of ownership in a company. Large companies divide their ownership into thousands of shares, which can be bought and sold through the stock market, known in Australia as the Australian Securities Exchange (ASX). The ASX was formed in 1987 by amalgamating the six capital-city stock exchanges. Today the ASX is based in Sydney, but also has offices in Melbourne and Perth.

There are over 2000 companies listed on the ASX. They include large retailers such as Woolworths and Wesfarmers (owners of Coles); the four big banks – ANZ, CBA, NAB and Westpac; and large mining companies such as BHP Billiton and Rio Tinto. The value of shares can go up and down, depending on the demand for those shares. When a company reports that it has had a successful year, many people may want to buy shares in that company. If there are more people wanting to buy than to sell, the price tends to rise. If the company appears to not be performing well, there may be more shareholders wanting to sell their shares than there are buyers, so the price is likely to go down.

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**Figure 6** Buying shares listed on the ASX enables you to become a shareholder in a variety of different businesses.



As the price of a company's shares goes up or down, so too does the value of a shareholder's investment. The value of most shares has tended to rise over the past 50 years or so, even though they can fluctuate in price on a daily or weekly basis. People who hold shares for long periods of time generally benefit from **capital growth**. The ownership of shares means you can also benefit when the company makes a profit, as profits can be distributed to shareholders as **dividends** or in extra shares.

The buying and selling of shares is usually handled by stockbrokers. These are licensed agents who have access to the ASX, and who conduct share transactions on behalf of the general public in exchange for a small fee. Most stockbrokers will recommend that their clients buy shares in a variety of different companies. If you only buy shares in one company and that company experiences problems, the value of your shares can drop and you lose money. Buying shares in a number of different companies reduces the risk, and you have a better chance of having some shares that will perform well. You have probably heard the saying 'don't put all your eggs in one basket', which means you should spread your risks among a number of ventures.

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**Figure 7** Stockbrokers buy and sell shares on behalf of their clients.



1 The market system and government

Learn MORE

Go to your Resources section for

**Worksheet 1.1:** Share market basics

## 1.4 Key economic questions for business

### 1.4.1 Market forces

A key factor in any market is the price charged for the goods and services sold in that market. Sellers will generally decide how much they wish to charge for the goods or services they are supplying, but they cannot do this in isolation. They must take into account the price that consumers are willing to pay. If there are a large number of sellers in any market, prices will tend to be lower because these sellers have to compete with each other to attract customers. When prices are influenced by the interaction between buyers and sellers, they are said to be influenced by *market forces*. These market forces can also have an impact on what goods and services producers choose to supply and methods they choose to produce these goods and services. Market forces can also determine who the ultimate buyers of these goods and services will be.

### 1.4.2 Influencing prices

The prices paid for goods and services can be influenced by both sellers and buyers. Sellers can adopt a number of strategies to determine prices, including:

- applying a retail price recommended by the manufacturer of the goods being sold. Although it is illegal for a manufacturer to enforce such a price, it can provide a useful guide for the seller.
- following the prices set by other sellers in the same market. This may involve matching those prices, or setting a slightly lower price to attempt to attract more customers.
- adding a **percentage mark-up** to the cost of the goods to the business. The seller may calculate a sale price by adding a fixed percentage to the price that they paid for the goods. The selling price needs to be enough to help cover all the business expenses, and also provide a profit.

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**Figure 1** Sellers must set a price that will not turn customers away.



Whatever method is used, it is a general rule in all markets that sellers will attempt to charge as high a price as possible, while buyers will look for the lowest price they can find. A seller who attempts to charge too high a price will find that buyers will not buy from their business. The seller must cover all of his or her business expenses and make a reasonable profit, but cannot afford to charge too high a price if competitors are

selling the same product at a lower price. A buyer who expects to pay too low a price may find that there are no sellers willing to sell at that rate, so has to be realistic about what constitutes a fair price.

A good example of the way in which markets operate can be found at large fruit and vegetable markets such as Paddy's Markets in Sydney, or the Queen Victoria Market in Melbourne. In these marketplaces, there are large numbers of different fruit and vegetable stalls, all competing with each other. Sellers can see what their competitors are charging for their stock, while buyers can move easily around the different stalls to compare the quality and prices of produce on sale.

**Figure 2** Buyers can easily compare prices at a fruit and vegetable market.



We can see how the interaction between buyers and sellers can influence prices by taking an example from one of these markets. Imagine each fruit and vegetable stall sells apples, and most sellers agree that if they could charge \$10 per kg, they would happily supply 100 kg of apples for sale each day. If they could only charge \$5 per kg, they would only be prepared to provide 50 kg a day. If they could only charge \$2 per kg, they would only supply 20 kg for sale, and concentrate instead on selling other fruit and vegetables that would make a bigger profit.

Buyers have a different point of view. They want to purchase at the cheapest price possible. If apples cost \$10 per kg, only a small number of people would buy them, and then only in small quantities — a total of 20 kg on any given day. If the price dropped to \$8 per kg, buyers might be prepared to purchase a total of 30 kg a day. If the price fell to \$6, they might buy 40 kg, at \$4 they would buy 60 kg, and at \$2 they would buy 80 kg.

How will the interaction of the different preferences of buyers and sellers help produce a price and a quantity for sale that is acceptable to both groups? We can start to answer this by putting the above data into tables.

**Table 1** Sellers' preferences

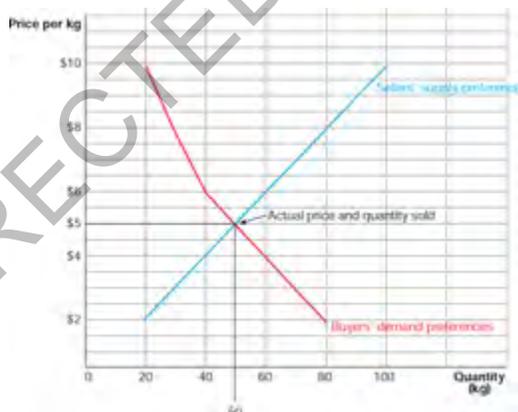
Price per kg	Quantity supplied
\$2	20 kg
\$5	50 kg
\$10	100 kg

**Table 2** Buyers' preferences

Price per kg	Quantity purchased
\$10	20 kg
\$8	30 kg
\$6	40 kg
\$4	60 kg
\$2	80 kg

The data from these tables can now be entered into a graph. If we place the different prices along the vertical axis, and the different quantities along the horizontal axis, we can plot the preferences of both buyers and sellers on the graph (see [figure 3](#)). The sellers' preferences are shown by the blue line, while the buyers' preferences are shown by the red line. The point at which the two lines intersect will give us the price and quantity at which the preferences of both buyers and sellers are matched.

**Figure 3** Supply and demand for apples



The market for apples will settle at a point where 50 kg of apples will be sold each day at a price of \$5 per kg. Sellers know that if they have 50 kg of apples in stock on any given day, they will be able to sell them all at this price. If one seller decides to sell below this price, he or she will be likely to sell out his or her stock more quickly, but will make a smaller profit. If he or she wants to cover costs and make a profit, it is unlikely that the lower price will be maintained for long. A seller attempting to sell above the price of \$5 per kg will be likely to sell less and so will be forced to bring the price down.

The interaction between the different quantities sellers are willing to supply and buyers are likely to demand at various prices can have an impact on a range of markets for many different goods and services.

### 1.4.3 The key economic questions

The aim of any economy is to provide goods and services to consumers in as efficient a manner as possible. We would expect consumers to buy goods and services that will satisfy their needs and wants, and that producers will want to make a profit by selling them those goods and services. In order for both consumers and producers to be satisfied, the economy has to answer three basic questions:

1. What goods and services should be produced, and in what quantities?
2. What methods should be used to provide those goods and services?
3. To whom should those goods and services be distributed?

Because the Australian economy operates largely as a market system, we would expect the interaction between buyers and sellers in a variety of different markets to answer these questions.

#### What to produce?

How does our market system help producers to decide exactly what goods and services to supply, and in what quantities to supply them? Up to a point, the market system operates largely by trial and error. A producer may make certain goods or services available to consumers and hope that these will satisfy the needs and wants of those consumers. If the goods or services fail to sell, the producer will probably go out of business. In Australia about 40 per cent of all businesses fail during their first four years – over half of them in their first year. This means that a lot of potential producers are entering the marketplace, but not selling the goods or services necessary to satisfy the needs and wants of consumers.

The market largely determines which businesses are likely to be successful. Some factors that can influence markets include:

- *established habits and experience.* Producers know from People's existing behaviour that there will always be a demand for certain types of goods or services. Families need to buy food on a regular basis, so a supermarket in a new suburb may well be successful. In any new shopping centre, businesses such as cafés and hairdressers will probably meet a demand from consumers if there are no similar businesses nearby. If a second or third café or hairdressing salon is established in the same shopping centre, the success of these businesses will depend on whether the level of demand from consumers is sufficient for all of them to survive. If not, then one or more will close. The operation of the market for those goods and services will determine how many similar businesses can survive in the same marketplace.
- *changing tastes and preferences.* An example of this is the market for Australian-made cars. For many years, family sedans and wagons such as the Holden Commodore and Ford Falcon were Australia's best selling cars. Car manufacturing was so successful that other manufacturers such as Toyota also set up factories in Australia. Over time, consumers' preferences have changed, and smaller imported cars have been preferred in the marketplace. This has led to a decline in car manufacturing in Australia to the point that it will cease altogether by 2017. Changing consumer tastes and preferences have influenced what is produced, and in what quantities.

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**Figure 4** Changes in the market will see the closure of the three remaining car manufacturing businesses in Australia by 2017.



- *marketing and advertising.* Any business introducing a new product or service into the market needs to ensure that consumers are aware of its availability. Television, newspaper and radio advertising have been used extensively for many years to persuade consumers to buy particular goods and services. Online advertising through search engines such as Google has increased dramatically, and today an online presence is essential for almost any business.
- *technological change.* Over the past twenty years, as a society we have become very enthusiastic about new technology. Whenever a new model iPhone is released into the marketplace, consumers queue up outside their nearest Apple store to be one of the first to buy it. Consumers monitor new developments in technology, and many will quickly replace outdated products with newer models. Producers can be quite confident that improvements in technology will quickly attract buyers to new goods and services.

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**Figure 5** Improvements in technology soon attract consumers.



## How to produce?

The production of goods and services generally involves a combination of labour, equipment and raw materials. These are known as **inputs**, and any production process will involve different types and combinations of these three inputs. A factory producing frozen vegetables will be set up with different types of equipment, such as the machines that chop the vegetables, pack and seal them in plastic packaging, and freeze them. The same factory will employ workers to control those machines, and perhaps carry out some other tasks, such as management of the process. The raw materials are the vegetables that are processed during production.

At different times, the managers of the factory will have to make decisions about the best methods of producing their final product, and the operation of the market can influence these decisions. Competition from rival frozen vegetable companies will mean that the business will wish to keep its costs as low as possible. If new equipment becomes available that works more efficiently, it may be worthwhile changing the methods of production to take advantage of this new equipment.

Over the past fifty years or so, the use of robotics-based equipment has increased dramatically in most factory production. In most cases it enables a factory to employ fewer workers, saving in wages costs and allowing the prices of products to be kept at a level where they can compete in the marketplace. When one

business in a particular market is able to cut costs by changing its methods of production, usually other businesses in the same market will make changes also, in order to remain competitive.

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**Figure 6** The use of robotics has changed the way manufacturers produce goods.



### For whom to produce?

A business owner will make some decisions about who he or she intends to supply with goods and services. The market can also influence who receives these goods and services because purchasing will be affected by the level of prices when compared with the level of income of consumers. As seen in our circular flow diagram in [subtopic 1.2](#), household income can consist of wages and some government welfare payments. Households can also gain access to credit for the purchase of some goods and services. Taxes and desired levels of savings result in a reduced amount available for spending.

The amount actually available for households to spend is known as **disposable income**. All consumers make decisions about what to buy by comparing their disposable income with the prices they will have to pay for the goods and services they want. The prices of different products can influence who buys them. Luxury motor vehicles cost much more to produce, but the manufacturers are not attempting to sell to the mass market. Their product is aimed at those with a high enough level of disposable income to be able to afford such a vehicle. Fast food restaurants such as McDonald's and KFC provide relatively cheap meals designed to appeal to large numbers of consumers. Other, more exclusive, restaurants charging \$100 or \$200 per meal are producing for a completely different market.

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**Figure 7** Luxury motor vehicles cost much more to produce, but the manufacturers are not attempting to sell to the mass market.



## 1.5 Government involvement in the market

### 1.5.1 Law and justice

Governments at all levels involve themselves in the market in a variety of ways. Politicians, commentators and the media often refer to the issue of 'economic management' as a responsibility of government. It is expected that government will take action to encourage growth in the economy and to avoid high levels of unemployment. Government activity within a market economy goes well beyond these aims. The successful operation of markets often depends on the level of government involvement.

Government provides a legal framework that allows the buying and selling in the marketplace to occur within a set of rules that should be fair to all participants. Australian Consumer Law protects consumers from unscrupulous businesses that could try to cheat them. Laws relating to the enforcement of legal contracts ensure that all buyers and sellers will be able to enforce their rights before the courts. The criminal law aims to provide protection from threats and intimidation in any business dealings. Our court system gives everyone the right to take legal action to enforce their rights.

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**Figure 1** Australian Consumer Law protects consumers from unscrupulous businesses that could try to cheat them.



### 1.5.2 Welfare

Government provides financial and other support to the disadvantaged in the community. The aged pension supports those who are beyond retirement age and no longer working. Unemployment benefits are designed to support those who cannot find work. The disability support pension assists those who are unable to gain employment because of physical or mental disability. Not only are welfare payments designed to provide fairness and support to those who need help, but they can also have a positive economic effect on markets. Those receiving welfare are likely to spend most of their money and so their spending adds to the circular flow of income throughout the economy. Businesses gain revenue from selling additional goods and services. This can in turn allow them to employ more people, who also spend their money buying goods and services.

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**Figure 2** Welfare payments help those who are not able to earn an income.



### 1.5.3 Provision of infrastructure

Government has a major responsibility for providing the **infrastructure** for the economy. This includes roads, railways and ports, and has traditionally included other means of communication, as well as energy supplies. Roads and railways are essential if goods are to be transported from place of manufacture to the shops where they are sold. Ports are not only required to allow for the import and export of goods in and out of Australia, but also for the transport of goods within Australia. Tasmania relies on shipping across Bass Strait to bring goods from mainland Australia, and to transport goods produced within the state to consumers in other states.

The government provides a postal service that supports correspondence between businesses, as well as the delivery of goods through a parcel delivery service. The telephone service was originally provided by government before Telstra was **privatised** and other providers were permitted to enter the market for telephone services. Even today, the national broadband network is an important infrastructure project being funded by government. Markets cannot operate without efficient systems of communication between consumers and businesses.

Traditionally, energy supplies such as electricity and gas also have been provided by government. These are not only essential for the domestic uses we are all accustomed to, but also for the functioning of businesses. In some states of Australia, electricity and gas supplies have been privatised and are now run by businesses rather than by government. Even where this has occurred, the original infrastructure was usually built by government before being sold to the business sector.

Privatisation of essential industries, such as electricity and gas supplies, can lead to increased prices as the companies that provide these services seek to make larger profits. Do you think these essentials should be sold for profit? [Ethical capability]

---

**Figure 3** Government provides infrastructure to enable markets to function more efficiently.



### 1.5.4 Economic management

Government has a responsibility for ensuring that Australia experiences a sustainable level of economic growth from year to year. Growth is important because as the population increases, it is necessary to ensure there are sufficient goods and services for all consumers to buy. There also needs to be an increase in the number of jobs available to provide employment for a growing population.

Governments can encourage economic growth by spending money, injecting more into the circular flow. This can provide more for consumers to spend, encouraging business to increase the supply of goods and services, and thus provide more job opportunities. However, if too much money is injected into the economy there may not be enough goods and services readily available to meet the increased demand. This is likely to force prices up, leading to **inflation**.

When this occurs, government will usually cut back on spending, which removes the excess money from the economy, and hopefully slows down the rise in prices. Governments use their annual **budgets** to influence the flow of money in the economy. They will aim to encourage growth, while trying to avoid the risk of inflation. Governments can use statistics gathered by the **Australian Bureau of Statistics** to assist them in their decision-making. These statistics can include figures relating to the levels of employment in the economy, as well as those tracking price rises.

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**Weblink:** Australian Bureau of Statistics

**Figure 4** Governments will use a variety of statistics to assist with decision-making.



### 1.5.5 Wages and employee relations

As we have discussed, there is a market for labour in which workers offer their skills and experience for sale to businesses and businesses buy that labour by paying wages and salaries. In order to ensure that the labour market functions fairly, it is regulated by laws passed by governments. The major law dealing with wages and working conditions in Australia is the *Fair Work Act*, a federal government law.

State governments provide regulations to ensure safe workplaces through Work Health and Safety laws. Both federal and state governments have also sought to prevent discrimination in the workplace by passing laws supporting equal employment opportunity. These make it illegal to discriminate against someone in any workplace on the basis of gender, race, age or ethnicity.

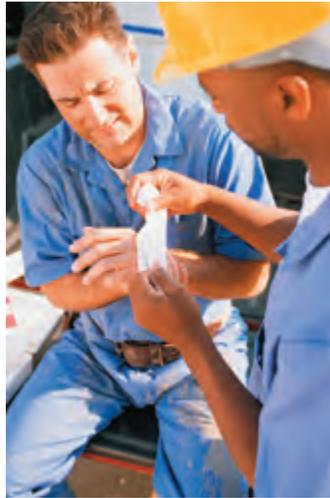
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**Weblink:** Fair Work

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**Figure 5** Work Health and Safety laws are designed to prevent injuries at work.



### 1.5.6 Provision of goods and services

Governments can also become involved in the marketplace as actual suppliers of goods and services. Every state and territory government provides an education system. In addition, state governments provide hospitals and other health services. Although many of these services are also provided by other organisations, such as private schools and private hospitals, it is considered a responsibility of government to ensure that everyone has access to education and health services. Ambulance services and fire fighting and emergency services are similarly considered to be the responsibility of state governments.

Public transport systems also are mostly provided by state governments, and those public transport systems that are provided by non-government businesses usually receive large amounts of money from government to assist in their running. Public transport does not make a profit, so no business would want to run it without such funding. Further, without this government assistance, for public transport to be profitable fares would have to be so expensive that many people could not afford to use it. Public transport is recognised as an essential service, so governments either provide it themselves or pay businesses to provide it at a reasonable price.

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**Figure 6** It is a responsibility of government to provide hospitals and health services.



### 1.5.7 Planning and the environment

State governments and local councils have powers to control the type of buildings and other developments occurring within their borders. Governments establish building standards to ensure that all buildings are

structurally sound, and not likely to fall down or cause a hazard in any other way. Anyone wishing to build a house or other structure on vacant land must gain a building approval. This is to ensure that the building conforms with certain standards. Councils and the state government can also determine whether or not a particular type of building is appropriate in a particular area. For example, it would usually be considered inappropriate to build a large factory in the middle of a residential area.

Since the early 1970s, state governments have also introduced laws to protect the environment. These place restrictions on both businesses and individuals in relation to what they can release into the atmosphere and waterways. These laws can affect markets because they can increase costs for some businesses. Businesses that may once have simply released waste material into a creek, river or drain now have to dispose of it in an environmentally responsible manner. Smoke and fumes have to be properly filtered before being released into the atmosphere. Motor vehicles have emission controls to limit the levels of harmful chemicals in exhaust fumes.

**Figure 7** Governments have introduced laws to prevent businesses from polluting the environment.



Environmental laws have also created new business opportunities, with waste management and recycling businesses providing services for a variety of different customers. As with most government involvement in the economy, while some businesses may appear to be disadvantaged, opportunities are often created for new and different businesses to grow.

### 1.5.8 International trade policies

Governments have the power to regulate what comes into and goes out of the country. Customs and quarantine laws can have an influence on the markets for a number of products. Australia had a ban on the importation of apples from New Zealand for many years because of fears that these apples carry a disease known as fire blight. Such a regulation would obviously have an impact on the market for apples throughout Australia.

Traditionally governments have also attempted to protect goods produced by local industries by imposing special taxes on similar goods imported from other countries. These taxes are known as **tariffs**. The clothing and textile industries were once protected in this way. In the early 1980s there was a 28 per cent tariff on all imported clothing. This made these imported goods more expensive than locally produced clothing, thus encouraging consumers to buy the Australian-manufactured product. Over the next thirty years this tariff was reduced, making imported clothing much cheaper than the local product.

As a result of reduced tariffs, many local clothing manufacturers have been unable to compete with cheaper imported clothing and consequently have had to close. While this has been a negative for the Australian clothing industry, the positive impact for consumers is that clothing is much cheaper as a result of the reduction in tariffs. Since the 1980s Australian governments have also negotiated trade agreements with

other countries. We agree to reduce tariffs on imports from those countries, and in return they agree to reduce tariffs on goods they import from us. Although this can make it difficult for some local manufacturers who have to compete against cheaper imported products, it can be good for our export industries and for consumers paying lower prices.

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**Figure 8** A reduction in tariffs has increased the quantity of imported clothing sold in Australia.



### 1.5.9 Immigration policies

As well as controlling the goods that come into and go out of Australia, governments can regulate the movement of people. This particularly applies to immigration into the country. Immigration allows the population to rise faster than would occur through natural increases in the birth rate. Rapid population increases can provide more consumers for businesses to supply with goods and services. Further, new arrivals add to the workforce, providing new employees with new skills for expanding businesses.

Governments can also affect the market for particular goods and services through decisions made about who is encouraged to migrate here. If particular skills are required in certain industries and there are not enough people in Australia who have the required qualifications, governments can allow employers to bring in migrants with the necessary skills. This can have an impact on the labour market in that industry. Australia has also become a major provider of tertiary education for our region. Encouraging students to come here from Asian and Pacific Island countries provides additional income for our universities, as these international students pay fees to study here.

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**Figure 9** Australia has become a major provider of tertiary education for fee-paying students from Asian countries.



## 1.6 SkillBuilder: Contesting and debating ideas

### 1.6.1 Tell me

When you open a newspaper or watch the news on television, you are exposed to many economic and business issues. These issues are complex and diverse in nature. A study of such issues may require you to examine a range of things including:

- events - such as the Global Financial Crisis (GFC)
- individuals - such as famous entrepreneurs or world leaders
- policies - of Australian governments or overseas governments
- business decisions - of either Australian or overseas businesses
- agreements - such as free trade agreements between Australia and other countries.

When studying such issues, it is important to be able to *contest* and *debate* different ideas related to each issue. These important skills are defined as:

- *contesting* - coming up with opposing ideas on an issue
- *debating* - the process of communicating about these opposing ideas with others.

In order to *contest* an idea, you must examine an issue from many different perspectives, not just from your own point of view. You must also consider the impacts of an issue on all stakeholders.

For example, if a business was considering moving their factories from Australia to Indonesia, you would have to consider the impact of this decision on each of the following stakeholders:

- owners/shareholders
- employees - both in Australia and Indonesia
- suppliers
- the Australian federal government
- the Indonesian government
- consumers.

Each of the above stakeholders may have a different view on the planned relocation. They may engage in *debate* in order to *contest* or challenge the perspective of the other stakeholders.

As a student of economics and business, it is important for you to be able to *contest* and *debate* issues and to express your own ideas clearly, in written, verbal and multimedia form.

### 1.6.2 Show me

Read the following case study.

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## Case Study

### Car manufacturing in Australia

For over ninety years cars have been manufactured in Australia. The car manufacturing industry has been an important source of employment for Australian people and has contributed to Australia's export earnings. By the end of 2017, Toyota, Holden and Ford will cease production in Australia.

There are two main perspectives on this issue:

- Perspective 1: Some people have argued that the federal government should have provided more money to the car manufacturers to help keep them in Australia. These people worry that many thousands of jobs will be lost and that the suppliers of these businesses will also be affected.
- Perspective 2: Others argue that the car manufacturers in Australia are inefficient and therefore should not be propped up (supported) by the government. These people believe that the high production costs in Australia mean that it will never be viable to produce cars in Australia.

Consider the facts in [table 1](#).

**Table 1** Key facts relating to the exit of car manufacturers from Australia

Toyota	Holden	Ford
<ul style="list-style-type: none"><li>• Started manufacturing in Australia in 1963</li><li>• Will close its Australian operations by the end of 2017</li><li>• Employs more than 4000 people Australia-wide</li></ul>	<ul style="list-style-type: none"><li>• Began as an Australian saddlery business in 1856</li><li>• Will close its Australian operations in 2017</li><li>• Almost 3000 people in Australia will lose their jobs</li></ul>	<ul style="list-style-type: none"><li>• Opened in Australia in 1925</li><li>• Will close its Australian operations in 2016</li><li>• Closure of its operations to cost 1200 jobs in Australia</li></ul>

Source: Chris Uhlmann and Emma Griffiths, *Car industry funding*, ABC News, 10 March 2015

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The case study relates to a *contested* business and economic issue. Different stakeholders involved in this issue have very different perspectives. The two major political parties in Australia also engaged in lengthy *debate* in relation to this issue.

The following questions allow for a close examination of the case study so that issues can be contested and debated.

1. What are the main issues/ideas relating to this economic or business issue?
  - Why are car manufacturers choosing to close their Australian operations?
  - Should the Australian Government provide assistance to the car manufacturers?
  - How will different stakeholders be affected if the Australian operations are closed?

2. Who are the major stakeholders involved in this issue?

- Employees of Toyota, Holden and Ford
- Shareholders of Toyota, Holden and Ford
- Consumers
- The federal government
- Suppliers of parts and materials

3. What are the interests/perspectives of each of the stakeholders involved in this issue?

Stakeholder	Interest/perspective of this stakeholder
Employees	The main interest of employees is job security and well-paying, challenging work. They want production to stay in Australia.
Shareholders	The main interest of shareholders is maximising the return on their investment. Therefore, they may be happy about the closures if they result in increased profit for the business.
Consumers	Consumers want good-quality and reasonably priced cars. They may support the closures if it will result in cheaper cars.
The federal government	The federal government wants businesses to be competitive so would not want to keep providing financial support to inefficient businesses. However, the government would be very concerned about the job losses that would result from the closures.
Suppliers	Suppliers want to keep their customers, and the closures will force them to find new customers or move into new markets.

4. What is your view on this issue?

- Consider your view on the issue. Try to consider all the facts that are available before deciding on your view.

5. How does your view compare with the views of others?

- Compare your view on the issue with that of others. Are there any stakeholders who share or oppose your view?

6. How can you communicate your perspective to other people interested in this issue?

- It is often useful to debate your ideas/perspectives with friends, family members or as a whole class. Consider whether or not your perspective is influenced by the opinions of others.

### 1.6.3 Let me do it

Using the example above as a model, select another economic or business issue to investigate. Some examples of issues that you may consider include:

- Australia's involvement in a free trade agreement
- Penalty rates — are they still necessary in our current economy?
- Has technology ruined our 'work–life balance'?
- Any other economic or business issue you are interested in.

In relation to your chosen economic or business issue, answer the following questions (see the previous example if you are unsure how to answer any of the questions):

1. What are the main issues/ideas relating to your chosen economic or business issue?
2. Who are the major stakeholders involved in this issue?
3. What are the interests/perspectives of each of the stakeholders involved in this issue?
4. What is your view on this issue?
5. How does your view compare with the views of others?
6. How can you communicate your perspective to other people interested in this issue?

Once you have conducted your research, you could communicate your findings in a number of ways:

- Conduct a class debate so that you and your classmates can challenge and contest each other's ideas.
- Prepare a written report which examines your perspective and other perspectives on the issue.
- Use a multimedia platform (such as iMovie) to create a Q and A style program. This would allow for debate and contesting of ideas.

1 The market system and government

## 1.7 Review

### 1.7.1 Summary

In Australia we live in a market economy. We rely on markets to provide us with the goods and services we require to satisfy our needs and wants. All markets consist of buyers and sellers, who exchange goods and services for money.

- Consumers satisfy their needs and wants by working to earn money, and then buying goods and services from businesses that produce those goods and services.

- The basic circular flow of money is between the household sector and the business sector.
- Financial intermediaries, government and the overseas sector are all involved in the operation of the market system in Australia.
- There are a large number of different types of markets that make up the Australian economy. These include the retail market, the labour market, financial markets and the stock market.
- The interaction between buyers and sellers in the marketplace can influence prices charged for goods and services.
- Markets can also help determine what goods should be produced and in what quantities; how those goods and services are produced; and to whom they are distributed.
- Government performs a number of roles in the Australian market system including:
  - the provision of law and justice, welfare, and infrastructure
  - economic management
  - regulation of wages and employment conditions
  - provision of some goods and services
  - management of planning and the environment
  - regulation of international trade
  - setting of immigration policies and targets.

### 1.7.2 Your turn

Fresh 'n' Fruity is a small company supplying fresh fruit and vegetables for home delivery. Customers place their orders online, and orders are delivered within 48 hours. The company employs packers to pack each order and van drivers to deliver the goods, as well as office staff to process the orders and forward them to the warehouse. It also employs a website manager who ensures that all prices are regularly updated and displayed on the company website. Home delivery of fresh fruit and vegetables is a growing market, with an increasing number of suppliers. They all display their prices on their websites, so competition is very strong.

Complete the following tasks:

1. What type of market is this business involved in?
2. The business wishes to expand its warehouse. How could it find the money to do this?
3. Explain two methods that could be used to determine the prices of the goods sold.
4. How can the operation of the market help this company to decide what goods to provide (i.e. what to produce)?
5. What factors might influence the company in deciding their methods of operation (i.e. how to produce)?
6. What factors in this marketplace influence to whom the business sells its fruit and vegetables?

7. Identify and explain three ways in which this business might be affected by the activities of government.

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**Interactivity:** The market system and government crossword

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