2: Economic performance and living standards

2.1 Overview

2.1.1 Material and non-material living standards

You have probably heard the phrase ‘standard of living’ (or ‘living standards’) before, but do you know what it means? Most people would say that living standards refers to how ‘well off’ they are or how much they own or are worth. To some extent these concepts are linked to the concept of living standards, but there is much more to it. The first thing to note is that there are two types of living standards: material living standards and non-material living standards.

Video

Living standards around the world

Figure 1. Living standards can be measured by our access to goods and services.

What are living standards?

Living standards refers to how well off a nation or country is overall. The most common types of living standards are the material (or economic) living standards. Material living standards relate to the level of economic wellbeing, influenced by annual levels of Gross Domestic Product (GDP) per capita, incomes, and consumption of goods and services.
Figure 2 Material living standards refers to the number of goods and services we can afford to buy.

The second type of living standard is referred to as non-material living standards. Non-material living standards are value-based elements of human wellbeing that are not connected to material possessions. They affect the quality of our daily lives. Elements of non-material living standards include our level of personal happiness and self-fulfilment, the crime and death rates, the absence of pollution and political freedom. Many of these are difficult to measure precisely.

Some of the goods and services we buy can negatively impact our non-material living standards

These two living standards also affect each other in compatible and conflicting ways. For instance, increased economic living standards may cause a decline in our non-material living standards. Increased production could cause more pollution, longer hours of work and stress. Alternatively, efforts to reduce environmental damage, such as introducing a carbon tax, may slow the growth of some industries and the economy, increase costs to consumers and undermine material living standards.

In this topic we will more closely examine the different types of living standards, how they are measured and how Australia has performed in terms of improving the living standards of Australians.

2 Economic performance and living standards

2.2 Living standards related to economic performance

2.2.1 Getting the balance right

Economies measure their economic performance to determine how well the economy is providing for its citizens. Measures such as unemployment rates, inflation rates and the rate of economic growth, however, do not provide information about living standards.
Changes in the performance of an economy as measured by indicators such as inflation and unemployment rates and the rate of economic growth can have an impact on both material and non-material living standards. As such it is important that the government — which is responsible for managing economic performance — takes changes to living standards into consideration when implementing policies and strategies to improve economic performance.

As we will see, this can require a delicate balance in policy implementation as some policies may improve material living standards but may negatively impact non-material living standards, and vice versa.

Let’s examine the link between the indicators of economic performance and material and non-material living standards.

### 2.2.2 Living standards and economic growth

Improvements in material living standards are most often measured by changes in Gross Domestic Product (GDP), the same measure used to calculate the economic growth rate of an economy. The difference in the calculation is that the value of GDP is then divided by the number of people in the economy (GDP per capita). This measure aims to calculate the value of goods and services each member of the economy has access to. If there is an increase in the value of GDP per capita, it is assumed that the material living standards of each individual in the economy have improved. However, this is not always the case.

Strong and sustainable economic growth

It is expected that economic growth will be both strong and sustainable. Strong economic growth is defined as a growth rate of between 3 per cent and 4 per cent on average. At this rate of economic growth, goals such as low inflation, full employment and external stability should be achievable. However, a higher rate of growth — such as 5 per cent, for example — would lead to economic problems,
and living standards would ultimately suffer. At a rate of 5 per cent per year, the pace of the economy would be pressed beyond its productive capacity. The producers of goods and services would not be able to keep up with the demand. This would cause cost and demand inflation due to general shortages of resources and of finished goods and services. It would also cause spending on imports to grow quickly.

However, an economic growth rate of less than 2 per cent per year would also see the government’s economic goals endangered. The unemployment rate would rise since there would not be enough jobs and incomes created for a growing labour force. Higher unemployment would lead to poverty and falling material living standards because living standards suffer unless economic growth takes place at the right speed.

Growth should also be sustainable. Sustainable refers to the rate at which Australia’s economy can grow its production of goods and services without jeopardising the living standards of future generations. The obvious problem in this context is that our demand for non-renewable natural resources (water, minerals, forests, oceans and air) is creating very serious environmental problems such as pollution, global warming, resource depletion and loss of biodiversity. For example, clearing old growth forests and land, discharging waste into our waterways and the atmosphere, building in sensitive areas, building more freeways, and encouraging excessive consumerism may maximise our short-term living standards and lifestyles, but what future will our children have? Will they be able to enjoy the same material and non-material living standards as we do? So, in this sense, the rate of economic growth is only sustainable in the long term if it does not deplete non-renewable resources, degrade the environment and reduce the ability of future generations to meet their needs and wants. In some ways, a trade-off exists between economic growth and some aspects of current and future living standards.

Video
Clearing forest for an oil well in the Amazon

As mentioned above, many non-renewable natural resources are being used up to maintain our current living standards. Should tighter restrictions be placed on using these resources even if it means that economic growth will be damaged as a result? [Ethical capability]

2.2.3 The weaknesses of GDP per capita as a measure of living standards

An increase in the value of goods and services produced per year divided by the number of people in the economy does not necessarily mean that people are better off or that their standard of living has improved. There are a number of things to consider when using GDP per capita as a measure of living standards.

GDP per capita is an average

GDP per capita only gives a rough idea about average material living standards, provided there is also a fairly even distribution of the goods and services produced, and provided the extra production makes people happier. There is no evidence to suggest that an increase in GDP is shared equally among the people in the economy. These are assumptions that can make rises in GDP per capita quite meaningless.
GDP per capita assumes improvements in living standards

It is assumed that an increase in GDP per capita results in better employment opportunities, an increased life expectancy, increased consumer choice, improved provision of government services, and better health and education services. These improvements should help to raise both material and non-material living standards. However, there is no information that tells us whether these improved GDP figures and employment figures have resulted from people working longer hours or from machinery and computers being introduced to replace labour in performing some jobs.

These factors can reduce our leisure time and perhaps the quality of family life, as well as resulting in increased unemployment and an increased need for welfare.

GDP per capita doesn’t measure the environmental impact

Pollution and environmental damage, resource depletion, stress, urban problems, overcrowding and possible increases in crime and divorce rates are not measured by GDP per capita, yet they have a significant impact on our living standards. Money spent on dealing with crime, legal fees involved in family divorce and the costs of dealing with pollution are actually recorded as additions to GDP’s value. GDP does not distinguish between good economic activity and bad activity or negative externalities.

2 Economic performance and living standards

2.3 Measuring living standards

2.3.1 Alternative ways to measure living standards

GDP is the total value of goods and services produced by the economy in a given period (usually a year). By calculating GDP per capita (per head of population) we can use this figure as a measure of changes to living standards. If this figure rises, it can be argued that living standards have risen because we all have more goods and services.

However, GDP has limitations as a measure of living standards because some production is not included, no measure is taken of the quality of changes considered, and GDP provides no information on how the goods and services are distributed. In addition, non-material living standards are not accounted for.
There are alternative measures that can be used to better measure living standards.

2.3.2 Genuine Progress Indicator (GPI)

The GPI index of overall living standards or progress evolved in the 1980s from a measure called the index of sustainable economic welfare. It is similar in some ways to GDP in that it uses some of the same consumption data involved in calculating GDP, but it then makes both negative and positive adjustments to some of the values calculated. The changes are designed to reflect the positive or negative effects on society and our living standards of certain types of activity and spending.

Negative adjustments are made to consider the impact on living standards of activities such as:

- environmental damage due to air, noise and water pollution, and the loss of wetlands, farmlands and forest-road accidents
- depletion of non-renewable energy resources
- reduced leisure time due to increased hours of work
- inequality in the distribution of income
- dependence on foreign debt to finance consumption
- expenditure on items referred to as ‘defensive’ such as spending on repairs and medical expenses following road accidents and spending on security monitoring needed to maintain our lifestyle
- increased crime, which reduces the benefits gained by present and future generations.

Positive adjustments are then made to consider the impact on living standards of activities such as:

- the ongoing services provided by consumer durable household items and public infrastructure with relatively long life spans. An example would be the benefit to society of a new cross-city freeway which would reduce travel times and congestion for many years
- contributions derived from performing housework, parenting, completing unpaid community voluntary work and other socially productive uses of time.

Supporters of the measure argue that these adjustments make the statistics a far better indicator of the sustainable level of economic welfare or living standards than simply using GDP.
2.3.3 Human Development Index (HDI)

The United Nations’ Human Development Index (HDI) is a measure that compares the wellbeing of people in different countries. It is a composite statistic of positive and negative indicators. These indicators are combined into a single statistical index number. When a country’s index rises, it means there has been progress and living standards have increased.

Calculating the HDI

The HDI is calculated using the following three indices:

1. A long and healthy life: Life Expectancy at birth:
Life Expectancy Index (LEI) = LE – 2082.3 – 20

2. Education Index: Mean Years of Schooling Index and Expected Years of Schooling Index:

   Education Index (Ei) = MYS · EYS \cdot 0.951

   a. Mean Years of Schooling Index (MYSI) = MYS13.2
   b. Expected Years of Schooling Index (EYSI) = EYS20.6

3. A decent standard of living: Gross National Income per capita ($US)

   Income Index (II) = \ln(GNIpc) – \ln(100) \cdot \ln(107,721) – \ln(100)

Finally, the HDI is the geometric mean of the previous three normalised indices:

   HDI = LEI · EI · II3

LE: life expectancy at birth
MYS: mean years of schooling (years that a 25-year-old person or older has spent in school)
EYS: expected years of schooling (years that a 5-year-old child will spend in education over their lifetime)
GNI per capita: gross national income at purchasing power parity per capita

In 2014 Australia was ranked second in the HDI with an index of 0.935, an increase of 0.002 from 2013.

The two main weaknesses of the HDI are the subjective nature of indicators used to compile the index and the unreliability of the statistical data for some countries.

2.3.4 Quality-of-life index

The quality-of-life index is a measure calculated by a private organisation that attempts to measure which country will provide the best opportunity for a healthy, safe and prosperous life in the future. It is based on a method that links subjective life-satisfaction surveys and objective determinants of the quality of life across countries.

The index was calculated in 2013 for 80 countries and territories using ten quality-of-life factors along with forecasts of future GDP per capita to determine a nation’s score.

The ten quality-of-life factors are:

- material wellbeing as measured by GDP per capita
- life expectancy at birth
- the quality of family life based primarily on divorce rates
- the state of political freedoms
- job security as measured by the unemployment rate
- climate, measured by two variables: the average deviation of minimum and maximum monthly temperatures from 14 degrees Celsius; and the number of months in the year with less than 30 millimetres of rainfall
- personal physical security ratings based primarily on recorded homicide rates and ratings for risk of crime and terrorism
- the quality of community life, based on membership in social organisations
- governance, measured by ratings for corruption in public office
• gender equality, measured by the share of seats in parliament held by women.

In 2013 Australia was ranked second with a score of 8.18 out of 10. Switzerland ranked first with a score of 8.22 and Norway was third with a score of 8.09. Norway ranked first in the HDI calculated in 2014.

2.3.5 Other indicators

A range of other indicators are used by some countries to measure the changes in living standards of society. These include:

• the Green Gross Domestic Product (green GDP)
• the Happy Planet Index (HPI).

Green Gross Domestic Product

The green GDP is an index of economic growth with the environmental consequences of that growth factored into a country’s conventional GDP. The green GDP places a price/cost on the loss of biodiversity, environmental damage and climate change. When calculating the green GDP the net natural capital consumption — including resource depletion, environmental degradation, and protective and restorative environmental initiatives — is subtracted from the traditional GDP.

Happy Planet Index

The HPI is an index designed to measure human wellbeing and environmental impact. It was introduced by the New Economics Foundation (NEF) in July 2006, which aimed to give progressively higher scores to nations with lower ecological footprints. It was developed in response to the belief that measures such as GDP and HDI were seen as not taking sustainability into account.

The index is made up of three components:

• experienced wellbeing
• life expectancy
• ecological footprint.

In 2012, 151 countries were surveyed, with some ‘poor’ countries scoring high due to their low ecological footprint and high life expectancy. Australia ranked seventy-sixth, with a score of 42.0 (up from a ranking of 102 in 2009), while Norway ranked twenty-ninth.

2 Economic performance and living standards

2.4 Macroeconomic policy options

2.4.1 The bigger picture

Macroeconomics refers to the branch of economics that involves the level of expenditure or aggregate demand. It involves looking at the general influences on national spending, national output, national income, employment and overall material living standards. It emphasises the need for some degree of government involvement and manipulation of aggregate demand and economic activity demand-side policies.
Macroeconomic policies involve two key areas of influence by the government: budgetary/fiscal policy and monetary policy. Each of these policy areas attempts to manipulate the level of demand and spending in the economy to achieve the economic goals of the government. Let's examine each of these policies.

2.4.2 Budgetary/fiscal policy

Budgetary policy (also called fiscal policy) is a government economic policy that involves altering the level of government spending and government receipts. Each year the government prepares its budget, which outlines its priorities for the coming year and, in some cases, for the years ahead. The budget is a document outlining where the government plans on receiving money from (receipts) and where it intends to spend that money (expenditure).

The difference between the receipts of the government and the expenditure by the government is known as the budget outcome. There are three possible budget outcomes:

- **budget deficit**, where the level of government receipts is less than the level of government expenditure
- **budget surplus**, where the level of government receipts is greater than the level of government expenditure
- **balanced budget**, where the level of government receipts equals the level of government expenditure. This is a rare event and the government usually aims for a fiscal balance, where the
value of budget deficits equals the value of budget surpluses over the business-cycle period (seven years).

To better understand how the government uses the budget to achieve its economic goals, it is important to understand the two components of the budget: budget receipts and budget spending.

Government budget receipts

Budget receipts are the government’s incoming receipts of money that pay for budget spending. The most common form of government receipt is taxation. There are generally considered to be two types of taxes:

- **direct taxes** are those that refer to levies imposed directly onto the incomes of individuals and companies
- **indirect taxes** are those placed on the sale of goods and services and added onto the price of items.

A third type of government receipt is non-tax revenue; that is, receipts from a source other than taxation, such as asset sales, interest, the repayment of HECS debts by university students and profits from government business enterprises such as Australia Post.

Direct taxes

Examples of direct taxes include:

- **personal income tax.** This is a direct tax paid by individuals who earn incomes in the form of wages, salaries, rent, interest and dividends. For most people, income tax is deducted by their employer from their pay packet before they are paid (pay-as-you-go or PAYG). However, for self-employed individuals, a different system exists for estimating income and tax that must be paid.
- **capital gains tax (CGT).** This tax is levied on the real profits made from the sale of capital assets such as land and shares purchased after 1985.
- **the Medicare levy.** This direct tax is designed to provide medical insurance to help cover the basic costs of family healthcare. It is normally levied at a rate of 2 per cent of personal taxable incomes.
- **withholding tax.** This is applied to individuals who fail to register their tax file number when receiving income such as dividends and interest. It is currently levied at the top tax rate of 46.5 per cent (including the Medicare levy).
- **company tax.** This is a flat or proportional tax levied directly on business profits. In 2015–16, the tax rate was 30 per cent of company profits. In the 2016 budget this tax was proposed to be cut to 25% by 2020.
- **fringe benefits tax (FBT).** This represents a direct tax paid by firms on the value of ‘perks’ provided to employees, such as a company-provided car or house. It is currently levied at 47 per cent of the taxable benefit.
- **superannuation fund tax.** This tax is levied at 15 per cent of most contributions as well as on the interest from fund investments. People aged over 60 can currently withdraw their super tax-free.
- **petroleum resource rent tax (PRRT).** This is levied at 40 per cent of the profits made from petroleum operations.

Indirect taxes

Examples of indirect taxes include:

- **excise duty.** This is an indirect tax imposed on selected, locally produced goods such as petrol, LPG, beer, spirits, wine and tobacco. It is a flat percentage added to the cost of the product. For example,
the excise on unleaded petrol is about 30 per cent of the price of each litre sold. The precise rates applied are adjusted twice a year and are generally linked to changes in the Consumer Price Index.

**Figure 3** The tax on petrol provides the government with a significant source of revenue.

- *customs duties*. These are taxes levied on certain imported goods to raise revenue and protect local producers from foreign competition. Since the 1970s governments have had a policy of reducing tariffs to increase competition in Australia and to reduce prices for consumers.

- *goods and services tax (GST)*. This tax was introduced in July 2000. It is a broad-based, indirect tax levied at the rate of 10 per cent on many goods and services in the economy.

**Figure 4** summarises the sources of government revenue in 2015–16. Income tax on individuals is easily the main source of receipts, followed by revenues from company and resource rent tax.
Government budget spending

Budget spending is how the government uses the receipts it collects to provide certain goods and services for the community. Government spending is designed to affect the incomes of consumers, the level of demand and economic activity in the economy, inflation, trade and living standards. Government budget spending is allocated mainly to:

- **social security and welfare.** These payments go to the neediest groups in society including the unemployed, aged pensioners and people with disabilities. The main aim is to redistribute income, thereby helping to reduce poverty and improve general living standards.
• health. This involves providing medical attention to consumers, paying wages and salaries of hospital staff, and outlays on building and furnishing hospitals.

• defence. This money is used for the payment of staff and day-to-day running expenses for the armed services, which includes payments for peacekeeping activities.

• education. Public education is provided by paying staff at universities, supporting state and non-government schools; vocational education and training; and building programs.

• transport and communications. This involves spending on government infrastructure such as roads, shipping, aviation and rail services.

• housing and community amenities. This includes spending on public housing and the First Home Owner Grant.

• public-debt interest. This is the cost to the government of paying interest on its debts or borrowings. Much of the debt incurred by the government comes from having to finance a budget deficit.

• net payments to other governments. These are federal payments to state and local governments to enable them to provide community services including public education, health, housing and transport.

Other areas to which government budget spending is allocated include mining, manufacturing and construction, other economic affairs, agriculture, forestry and fishing, recreation and culture, public order and safety, and fuel and energy.

Figure 6 shows the relative importance of the government’s main areas of spending in 2015–16.

Interactivity: Sources of government spending for 2015–16
Impact of the budget outcome

When the government delivers its budget it has an outcome in mind.

Budget deficits are designed to be expansionary; they encourage spending through tax reductions and increased government spending. It is expected that the increase in spending by the government and by consumers (due to lower taxation payments) will lead to increased economic growth and consequently increased living standards.

Budget surpluses are designed to be contractionary; they discourage spending through tax increases and decreased government spending. It is expected that the decrease in spending by the government and by consumers (due to higher taxation payments) will lead to a slowing of the economy.

2.4.3 Monetary policy

In addition to altering the level of spending in the economy through taxation and direct government spending, the government can also manage the economy through monetary policy.

Monetary policy is a policy operated by the Reserve Bank of Australia (RBA) that seeks to manage the level of spending in the economy. It involves controlling the money in the economy and the rate at which money flows around the economy. The primary instrument of monetary policy is the manipulation of interest rates to alter the cost, availability and demand for borrowing money. Because interest rates have the capacity to alter the level of spending in the economy, they can help to achieve the government’s goals of low inflation, strong and sustainable economic growth and full employment, ultimately improving Australia’s living standards. Monetary policy operates without the approval of parliament and can be altered quickly through changes to the cash rate by the Reserve Bank of Australia at its monthly meetings.
The RBA has three means of influencing the flow of money, which affects how money is spent in the economy. These are:

- **changing interest rates**: it does this through market operations
- **influencing the exchange rate**: it achieves this by buying and selling Australian dollars
- **persuasion**: it uses its influence to achieve the desired direction of lending activities.

**Changing interest rates**

Interest rates represent the cost of borrowing money. Whenever you borrow money you are required to repay that money, generally with interest. There is a price for borrowing money and that price can change. An increase in the price of borrowing money will generally see a decrease in the demand for money. The opposite is also true.

The official price of borrowing money is called the **cash rate**. The cash rate is the interest rate that applies to a specialised market called the short-term money market. This cash rate depends on the overall deposits of cash in the short-term money market, which, in turn, is controlled by the RBA through its market operations. Market operations involve the Reserve Bank of Australia either buying back or selling second-hand government bonds through the short-term money market. Whether the cash rate rises or falls depends on the Reserve Bank of Australia’s decision to either buy back or sell these bonds.

**Increasing interest rates — a contractionary stance**
If the Reserve Bank of Australia (RBA) wanted to slow inflation, it would encourage interest rates to rise. This would discourage borrowing and spending. How would this happen? First, the RBA would announce a rise in the cash rate target at its monthly meeting (held on the first Tuesday of each month) and provide the reasons for its decision. This sends a signal to the economy of the direction in which the RBA believes the economy is heading. It would then set out to achieve this target by selling government bonds in the short-term money market. Financial institutions such as banks — which are keen to make a profit — would enter the short-term money market and buy these bonds because they are selling at a lower price with an attractive rate of interest. This creates a situation where financial institutions earn a better return, increasing their profits. The RBA achieves its aim as money is withdrawn from the market leaving less money available for borrowing and interest rates — the cost of borrowing — rise as there is a reduced supply. Financial institutions buying these bonds would then transfer deposits to the RBA to pay for the bonds. This directly reduces deposits or the supply of cash held by financial institutions.

The opposite is true if the Reserve Bank wishes to lower interest rates to stimulate demand. Buying back bonds from the banks and other financial institutions provides additional funds for the banks to lend, which would lower interest rates and encourage borrowing from consumers.

Higher interest rates make borrowing more expensive because the amount of interest to be repaid increases. Borrowing would mean a greater percentage of a person’s income is required to repay debt — and that’s money that could otherwise be used to buy goods and services. This is particularly true for home loans. Due to the high amounts borrowed, interest-rate rises can mean more income is needed to maintain repayments on home loans, increasing the financial stress on families. At the extreme end, it can lead to mortgage defaults and families losing their homes.

![Figure 9](image) Higher interest rates can lead to mortgage defaults, causing families to lose their homes.

At a time when interest rates on borrowings are higher, interest rates on deposits will also be higher. This is good for people with excess cash, who may choose to deposit their money in a bank account and earn interest on it rather than spending this excess cash.

Overall, spending falls, aggregate demand falls and economic growth slows down. The negative impact can be a decline in material living standards as consumers have less access to goods and services. Unemployment can also result from decreased spending, leading to negative effects on non-material living standards through financial stress, marriage breakdowns and increased bankruptcies.

Influencing the exchange rate

The exchange rate is the price at which the Australian dollar is traded against other currencies. When the Australian dollar appreciates in value, our currency is able to buy more of another currency. In effect, this means imported goods and services become cheaper as fewer Australian dollars are needed to buy the same quantity of imports.

The RBA can influence the value of the exchange rate by entering the foreign exchange market and buying or selling Australian dollars. If the RBA wanted to increase the level of economic activity and employment it would sell Australian dollars, increasing the supply and lowering the price. Imports would
become more expensive and consumers would switch to locally produced goods and services. The opposite is also true.

While influencing the exchange rate is an instrument of monetary policy, it is seldom used now and is generally reserved for times when the Australian dollar is changing erratically.

Persuasion

Persuasion is a strategy used by the RBA to talk up or down the level of borrowing, spending and economic activity. As a result of this, consumers and investors react and change their level of spending and borrowing. Statements by the RBA that suggest the economy is performing well will see an increase in consumer and business confidence and therefore an increase in the level of economic activity.

2 Economic performance and living standards

2.5 Microeconomic policy options

2.5.1 The smaller picture

Microeconomics involves examining the operation of the smaller fragments or units making up the whole economy, such as a particular business, an industry or a specific market or small sector of the economy.

Microeconomic policies involve government actions to assist industries or markets with improving their productivity to make them more competitive and to improve outcomes for consumers through lower prices, greater choice and increased employment opportunities. All of these outcomes should lead to an improvement in the living standards of Australians. This is generally known as microeconomic reform. In recent years the microeconomic reform policy has centred around four main areas:

- trade liberalisation
- labour market reforms
- market deregulation
- the National Competition Policy (NCP).

In addition to these areas, microeconomic policies have also been specifically directed at small areas of the economy such as:
• Immigration
• the environment.

Let’s look at these areas in more detail.

2.5.2 Trade liberalisation

Trade between nations has often been subject to protection from governments. The imposition of tariffs and quotas and the provision of subsidies have all worked to protect local industries from overseas competitors.

Tariffs are a tax on imports that raise the price of those imported goods, making the locally produced goods more price competitive. Quotas are a limit on the number of goods allowed into Australia. This meant at some point locally produced goods had to be purchased as there were no imports available to purchase. Subsidies were an amount given to local producers to help them lower their price and compete with imports.

Trade liberalisation works to reduce these protection mechanisms, making it necessary for local businesses to improve their productivity so they can lower their costs and improve their ability to compete with overseas products on a level playing field. The result should be reduced prices for locally made goods and services so consumers benefit from choice options and lower prices. This enables more goods and services to be purchased and so material living standards are raised.

Figure 2  Trade liberalisation has had some negative effects on Australian manufacturers, particularly in the motor-vehicle industry.

Trade liberalisation operates through:

• cutting tariffs
• reducing subsidies
• abolishing import quotas
• increasing the number of bilateral free-trade agreements.

Figure 3 summarises changes made to Australia’s level of protectionism since 1970.
Figure 3  Indicators of the Australian government’s adoption of trade liberalisation measures between 1970 and 2010

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Reducing the level of protection has had some negative impacts. Industries where local manufacturers were unable to significantly change have ceased to operate, causing unemployment (the motor-vehicle industry is an example). The rise in unemployment has negative impacts on non-material living standards because stress, financial pressures, mortgage defaults and marriage breakdowns often result.

2.5.3 Labour market reforms

The labour market is the market where wage levels and working conditions such as hours of work, leave and terms of dismissal are determined. Over the past 20 years various governments have introduced major microeconomic reforms by reducing their control over wages and wage determination. In tandem with trade liberalisation, these policies were aimed at lifting labour efficiency (a higher level of GDP per hour worked), keeping labour costs down and increasing our productive capacity.

This was done by way of a shift from the centralised wage system to a system involving greater deregulation of wages based on collective bargaining or individual workplace agreements. In most cases this created a situation where wages were linked to efficiency and determined at the workplace level, rather than by the government. Since 2010 more than 85 per cent of workers have been covered by enterprise bargaining or other arrangements.
The deregulation of the labour market enabled some workers to access wage increases as a result of their increased productivity. This benefited both employer and employee as increased productivity meant lower costs and improved competitiveness. Wage increases could then be sourced from improved profits.

Improved competitiveness can also lead to increased employment levels and improved material living standards. On the other hand, non-material living standards may fall because increasing productivity usually means working more hours.

2.5.4 Market deregulation

Deregulation is the removal of unnecessary government controls, restrictions and supervision in various areas of the economy. In Australia this has seen progressive changes to key markets such as telecommunications, airlines, ports, shipping, primary produce and retail. Because economists believe that markets allocate resources most efficiently, a deregulated market should lead to lower prices due to stronger competition.

Figure 5 Market deregulation has led to increased competition in markets previously dominated by one company.
Market deregulation is seen as an important area of government microeconomic reform because it is a way of promoting many government economic goals including:

- *lower cost inflation* through lower prices due to competition between firms
- *strong and sustainable economic growth* through increased spending on goods and services due to lower prices (meaning higher demand)
- *higher employment in the long term* because new businesses will open in markets previously blocked, creating new jobs
- *external stability* through increased exports and less reliance on imports as locally produced goods become price competitive.

The end result is that both material and non-material living standards will improve over time as the new competitors establish a share of the market.

### 2.5.5 National Competition Policy (NCP)

The National Competition Policy (NCP) is a broad collection of microeconomic reform measures designed to strengthen the level of competition and efficiency in markets. Strong competition results in greater efficiency, lower costs of production, cheaper prices and better quality of service and product. In 1995, the Australian Competition and Consumer Commission (ACCC) was established to help prevent powerful companies from artificially raising prices to exploit consumers. The ACCC now enforces the *Competition and Consumer Act 2010*, under which a number of anti-competitive practices are illegal, including the following:

- **price fixing.** This is when firms collaborate to set common or similar prices that are higher than normal.

- **exclusive dealing.** This occurs when companies refuse to supply their products or services to one or more firms.

- **collusive bidding.** This is when supposedly competing firms that are submitting a tender or quote for the completion of works or to supply goods or services meet secretly beforehand to agree whose tender should be most attractive, cheapest and likely to win the contract.

- **predatory pricing.** This is when dominant firms conduct a price war involving big cuts in selling prices with the intention of driving rival firms bankrupt, then later enjoying the market without competition.

- **market zoning.** This happens when competing firms in a region divide the market into zones, areas or regions within which they agree not to compete with each other over prices.
2.5.6 Immigration policy

Australia’s immigration policy has been used as an approach to managing the number and composition of migrants coming to Australia from overseas. In other words, apart from important humanitarian and family considerations, the federal government’s current immigration program tries to attract young and suitably skilled people who are likely to make a very valuable and ongoing economic contribution to the labour force and the Australian economy.

By prioritising skilled persons as the majority of our yearly immigration intake, Australia is able to fill vacancies in industries where local skills are lacking. This can result in improved productivity, leading to expansion in those industries as they increase their profits.

These migrants also assist in improving non-material living standards as they further develop our multicultural society, bringing elements of their culture to Australia.

It can be argued, however, that if money was spent on training within Australia, we could fill these skill vacancies with people who are currently unemployed, raising their incomes and living standards.

2.5.7 Environmental policy
Environmental policy refers to specific policies created by the government to improve the quality of our environment and move away from traditional power generation methods by promoting industries that offer an alternative. Some measures introduced include:

- a government scheme that provides rebates for households that install domestic water tanks to preserve rainwater and cut down on water usage from dams
- a government scheme that provides rebates for households that install insulation in their homes to reduce power bills
- a government scheme that provides rebates to households that install solar panels to provide their household with solar power and possibly return unused energy into the power grid, reducing reliance on fossil-fuel generated power
- the creation of the Renewable Energy Target (RET) scheme whereby 23.5 per cent of Australia’s electricity will come from renewable energy sources by 2020
- the signing of the Kyoto agreement in 2008 to commit Australia to reduce emissions
- the imposition of a carbon tax (repealed in 2014).

Figure 8  Our environmental policy has led to the creation of a number of new industries.

These policies, among others, aimed to create new industries and provide a cleaner environment for future generations — a means of improving our non-material living standards. They also create jobs in new industries and make it important for traditional energy providers to become more efficient to remain competitive.

2 Economic performance and living standards

2.6 Direct government intervention in the market

2.6.1 Reasons for government intervention

So far we have identified the economic goals of the government, how it measures its performance in relation to those goals and the impact that achieving or not achieving those goals has on the living standards of Australians.
Setting economic goals and implementing policies to achieve them is one key way the government is actively involved in the economy. However, the government also intervenes in other areas.

The reasons governments directly intervene in the market are:

- to stabilise the economy
- to reallocate resources
- to distribute income.

![Figure 1](image)

**Figure 1** The government plays an important role in the market.

2.6.2 Stabilisation of the economy

The level of economic activity involves the overall pace or speed at which the economy is performing and production is growing. The speed at which this occurs can affect:

- *inflation*. If the economy is moving too quickly, inflation will result as demand will pull prices upwards.

- *unemployment*. If the economy is moving too slowly, demand will fall and businesses may be forced to lay off workers or close down, leading to rising unemployment.

If the economy is unregulated, it can be very unstable and it can sometimes experience large and sudden changes to production and activity. It is the government’s job to directly intervene in the market to stabilise the level of economic activity. As we have seen, the government does this through the implementation of budgetary, monetary and microeconomic reform policies.
2.6.3 Reallocation of resources

If left to itself, a market can be a very efficient allocator of resources. This is because the owners of those resources are always seeking to maximise their profits and incomes. They do this by producing only those goods and services that are likely to deliver the most profit because they are the most in demand. However, this is not always the case and it is possible to identify a number of circumstances where the market does not use resources efficiently; for example:

- the market may produce socially undesirable items. Some products are deemed to be undesirable but can be profitable for those who produce them. However, the government does not want these goods to be produced at all, or to be produced in the quantities they currently are. The production or provision of illegal drugs, gambling, guns and pollution often has negative effects on families’ and communities’ living standards so the government tries to reallocate resources away from the production and provision of such goods and services.
The government helps stop the production of certain illegal products such as drugs.

- **The market may not produce enough socially desirable goods and services.** The government intervenes to ensure an adequate supply of these products. The private sector may under-produce these goods because they are expensive to produce and it is difficult to make a profit from them. Such items include products related to health care, education, public housing and public transport.

- **The government may intervene to provide goods that the private sector won’t supply.** These are services such as defence, public toilets and street lighting, which are not profitable because it is not possible to make users pay for such services.

- **The government may, in some instances, intervene to allocate resources.** These resources may be used for producing goods and services that compete with the private sector to ensure the product is available to everyone, not just to those who can afford it. One example is the ABC (Australian Broadcasting Corporation). This company initially provided television and radio services to all Australians because commercial television channels (7, 9 and 10) did not provide a service to remote areas. The same applied to telephone services through Telecom (now Telstra) and banking services (the Commonwealth Bank was originally established to compete with private banks before it was privatised).

### 2.6.4 Distribution of income

In a market economy, people earn an income according to the demand and supply of the labour they offer. Some people earn high incomes and some earn low incomes. We also know that because of changes in the level of economic activity some people lose their jobs and spend some time earning no income.

The private sector does not provide for people who don’t, can’t or are limited in their ability to earn an income. In these circumstances the government intervenes to provide these people with a minimum level of income through welfare payments.

Modern Australia (and society in general) recognises that it has an obligation to look after the more vulnerable in our society and that those who can most afford to should carry the majority of the burden for providing for these vulnerable people. As a result, the following government measures are used to redistribute income and provide support to some groups in society.
Figure 4 The government uses taxation and its budget to ensure a minimum level of income for all Australians.

- **Welfare benefits.** The government provides direct payments through its welfare system to vulnerable Australians. Unemployment benefits are the most visible payment made, but the government also makes welfare payments to aged pensioners, disabled people, veterans and indigenous Australians. The government also makes payments to certain groups for various reasons from time to time. Examples include:
  
  1. **the First Home Owner Grant.** This helps young people move into their first home and out of renting or public housing.
  
  2. **an extra Family Tax Benefit payment.** This is an extra amount for eligible families when a child is born. It helps with the cost of raising children.

- **Progressive taxes.** Income tax is applied progressively. Higher income earners pay a larger percentage of their income in tax than low-income earners. The money collected from this taxation can be used to pay for welfare benefits to those in need and to provide necessary government services such as health care, education and housing. Taxation rates change periodically according to government policy and aims for the economy.

- **Provision of essential services.** The government does not only pay money directly to underprivileged people. It also redistributes income by providing services to low-income earners, giving them benefits such as health care, public education, concession travel cards for school children and rental assistance.

- **Compulsory superannuation.** To protect the future of Australians and reduce future reliance on government pensions, the government introduced a compulsory national superannuation scheme for all employees through a levy (currently 9.5 per cent of wages earned) on employers. The objective is for workers to be able to live off this superannuation and have less need for welfare when they retire.

Income inequality has risen substantially in Australia over the past two decades, even with the current distribution-of-income methods in place. Do you think the Australian government should do more to try to reduce income inequality? [Personal and social capability]

2 Economic performance and living standards

2.7 **SkillBuilder: Preparing a budget**

2.7.1 **Tell me**
A budget is defined as a plan for the future. The government plans for the future of the economy on an annual basis by preparing and releasing its budget each May. The budget establishes the sources of the government’s expected revenues or receipts; that is, the amount of money it is expecting to receive and from where that money will be sourced. It also establishes where (location) and in which areas of the economy the money will be spent.

Figure 1  A budget can be used to assist with finances and planning.

The government is not the only group that prepares a budget. Many businesses prepare budgets to provide information about their future and to assist them in deciding on a course of action.

Many families also prepare budgets to enable them to better plan for a holiday or a new car, or in preparation for one member of the family to give up work to start a family.

It is not uncommon for teenagers to prepare a budget when they start working part time and want to save to buy a car.

2.7.2 Show me Activity

2.7.3 Let me do it Activity

2 Economic performance and living standards

2.8 Review

2.8.1 Summary

Living standards are very important to individuals and families. There are two different types of living standards: material and non-material.

Material living standards refers to the acquisition of material goods and services while non-material living standards refers to the qualitative elements of human wellbeing, which influence the part of our living standards unconnected with material possessions.

How an economy performs in terms of achieving its economic goals will impact the living standards of citizens of that country. Achieving full employment, low inflation, strong economic growth and external stability through balanced trade will work to improve our living standards.

The government is involved in assisting the economy in order to improve living standards. By adopting macroeconomic and microeconomic policies it aims to keep inflation under control, minimise
unemployment, create a sustainable level of economic growth and keep our trade situation balanced.

Policies are strategies that the government implements to achieve these goals. For example, encouraging spending by lowering taxes and interest rates can lead to employment and economic growth. This can also lead to inflation if microeconomic policies aren't introduced to raise productive capacity.

2.8.2 Your turn

Activity