Employment, inflation, growth, and equity. Is Australia meeting the four macroeconomic goals?

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PHOTO: Treasurer Scott Morrison releases latest GDP figures (ABC News)
Current status of the four macroeconomic goals

In late 2017 Australia broke the world record for the longest period of economic growth ever recorded in modern history. Through 26 years of continuous growth, over 104 quarters without a recession, the Australian economy has navigated through difficult times to become the thriving nation we all know and love today. However, this economic growth has not been without drawbacks and strain on other aspects of the economy as the ‘success’ of an economy is not solely based off GDP growth. Instead, we refer to four macroeconomic goals which serve as objectives that governments and banks strive to achieve in order to ensure long-term (and stable) economic growth. In the following article we will look at how the Australian government is taking efforts to achieve each of these goals, how successful they have been, and how we could improve several policies to accomplish the goals.

1. Full Employment

The first macroeconomic objective is full employment wherein all available labour resources (both skilled and unskilled) are being efficiently used in an economy. However, this does not
mean that every member of society has a job, instead, there is a healthy level of unemployment (around 3 to 5%) of which includes those (who can, but) who are not actively seeking work. Should the unemployment rate increase beyond three to five percent, one would expect to see certain side effects occurring at both an economic and societal level. Economically, unemployment represents the underutilisation of our full resources - there is a loss of tax revenue, income for individuals, and there is an increased cost of unemployment benefits as well as a greater disparity in the distribution of income (referring to equity, the fourth macroeconomic goal). Socially, the costs of unemployment range from lower self-esteem, increased stress levels, increased indebtedness, homelessness, and family breakdown.

As shown on the graph above, Australia’s unemployment level currently resides just a fraction over the acceptable level. After a drop from from 5.6% in July 2017 to 5.4% in October 2017, the unemployment rate has been steadily increasing back up to 5.6% as of April 2018. Though the unemployment level as of right now seems to be within acceptable standards, the rate seems to be increasing at a constant rate, and we should expect unemployment to continue rising in the future.

Possible explanations for unemployment could be the higher average wages relative to the labour productivity level of full employment, or the rigid nature of the wages. The lower labour productivity levels and high wages means that firms are paying more for labour than they are gaining in terms of production efficiency. This means that firms cannot afford to hire more workers at their current wage and productivity level without losing revenue - thereby causing unemployment. The second cause of unemployment can be traced back to the increased demand of skilled labour. The lack of sufficient demand for unskilled labour could either cause wages to fall or unemployment (as firms seek to maximise efficiency and revenue at the expense of workers), and given the relatively high wages, it appears the latter (unemployment) may have arisen, causing unemployment rates to increase in the past year.

Eric Abetz, the Australian Minister for Employment, spoke at the 2014 Labour and Employment Ministerial Meeting to discuss viable solutions to improve unemployment rates to be implemented in the next ten years. The government’s strategy is centred around improving business opportunities and increasing jobs. In terms of job availability, the goal is to provide a thriving labour market wherein two million new jobs will become available in the following years.
The government is planning to increase spending on quality infrastructure and promote policies on innovation and entrepreneurship. By eliminating carbon and mining tax rates and by reducing the company tax rate, the government is working to reduce relative burdens on Australian businesses and reducing their production costs. In this way, the Australian government’s efforts aim to increase their ability to compete in global markets and provide more jobs for Australian citizens.

In the future, the government should continue emphasizing unemployment training so that these workers can re-enter the labour market which is in need of efficient, highly skilled workers. Wages need to be moderated so that firms can continue to higher workers at reasonable rates and promote growth within the business and labour sectors.

2. Price Stability

The second macroeconomic goal is to achieve a stable, healthy level of inflation. Inflation refers to a sustained increase in the average price level of goods and services in an economy. Practically, this translates to an inflation rate of around 1-2%, any more risking the devaluation of currency. As shown on the graph, the inflation rate, despite normal fluctuations, tends to stay between one and two percent - ie. in the healthy range. As of January 2018, the inflation rate is 1.9%. This suggests that not only are average price levels in the Australian economy being maintained at an acceptable rate, but also that the government and bank’s policies intended to control inflation rates are succeeding.

In 1993, an inflation target was first introduced by the Reserve Bank in order to best meet the price stability goal. The goal was to achieve an inflation rate of 2-3%, yet a major concern for
policy makers was the flexible nature of this target. Essentially, by allowing the inflation level to drift around two percent away without triggering a monetary policy response from the government, the banks can control inflation from a distance, without worrying about slight deviations from the goal. To avoid larger deviations than two percent, central banks employ three basic strategies to reduce inflation to an acceptable rate. These strategies are: exchange-rate pegging, money targeting, and inflation targeting.

**Exchange-rate pegging**

In this strategy, a country fixes its currency value to that of a lower-inflation country so that its inflation rate gradually decreases to match that of the other country. One major advantage of this strategy is that it instills a clear incentive in policy makers that almost guarantees monetary policy to be employed, should there be enough commitment to the goal. Both the government and the public appreciate the simplicity of this strategy and are able to make clear efforts to obtain this goal after the target has been established. However, with this policy, a country will feel constrained by the economic growth of the anchor country. If this strategy is implemented, Australia might not be able to react to problems that may arise domestically, and not in the anchor country as their currency and exchange rates are linked with the anchor. By restricting the inflation rate to that of the anchor country, Australia will not be able to adjust policies and the rate according to its own needs or shocks to supply that do not occur in the anchor. Additionally, Australia may find that it is equally affected by the anchor country’s problems, since their exchange/inflation rate will follow the ups and downs of the anchor, slowing the economic growth in the Australian economy.

**Money targeting**

In this strategy, the bank’s intervention is solely concentrated on the money markets. The bank will set interest rates in order to regulate monetary aggregates (amount of money in circulation in an economy) since these are considered to be the main determinants of inflation in the long run. By controlling these monetary aggregates, one
therefore stabilises the inflation rate around the target value. Similar to exchange-rate pegging, this strategy is easily understood by the public, but prevails over exchange rate pegging in that it enables a central bank to adjust its monetary policy according to fluctuations in the Australian economy. However, this is only true should there be a strong relationship between inflation and targeted aggregate so that reliable signals will be able to be received by the banks to adjust their monetary policy.

**Inflation targeting**

In this strategy, the central bank has an explicit target inflation rate and announces this to the public. The bank, in the long term, maintains price stability through monetary policies concerning interest rates. By raising interest rates, which are a determinant of aggregate demand, consumers are incentivised to consume less, therefore decreasing aggregate demand, and inevitably lowering prices. Conversely, lowering interest rates increases the real income of consumers, incentivising them to consume more goods and services and increasing aggregate demand along with prices. There is a clear inverse relationship between inflation rates and interest rates that the inflation rate targeting strategy uses to sustainably control the inflation rate. One benefit of this strategy is the transparency to the public and therefore the accountability of the central bank in remaining focused on achieving this goal. The bank is incentivised to concentrate on regulating inflation rates as they will feel pressured by both society and the government - political pressures. However, this strategy is not without disadvantages. Inflation is not as easily controlled by monetary authorities as the implemented policies have substantial delays - the signals from the markets and inflation outcomes are revealed only after an extended period of time. Nevertheless, the weak signals provided by monetary aggregates (money targeting) and the likelihood of a country to adopt the problems of its anchor in exchange-rate pegging, leads Australia’s best choice for monetary policy in order to control inflation to be inflation targeting given the ability for a country to respond to shocks in its domestic economy and the relative success of this policy in other countries.

Two of the first countries to adopt the inflation rate targeting strategy were Canada and New Zealand. As shown in the graphs below, both of these countries found this strategy to be successful for their economies. Implemented in 1990, New Zealand can be seen to have continued to disinflate initially, then remain

![New Zealand Inflation](image-url)
within the target inflation rate of 0-2% for the majority of the time. When implemented in Canada in 1991, despite being faced with a negative supply shock that increased the value-added taxes (VAT) within the nation were, there was a one-time increase in the average price level that did not pass on to a long-term increase in the inflation rate. The increase in VAT taxes should have led to a rise in the inflation rates as increased taxe decreases the real income of consumers which incentivises them to consume less and therefore decrease aggregate demand. A decrease in aggregate demand would therefore cause prices to increase as firms need to raise prices in order to keep up with their production costs and make revenue. Instead, the inflation can be seen to have started on a downwards trend and have fallen below 2% to remain under this level ever since. It is clear that a successful implementation of this strategy could promote long-term price stability in Australia given the success in the large, well-developed country of Canada. By following this strategy, Australia could better achieve, and experience less fluctuating results in the macroeconomic goal of a sustainable level of inflation.

3. Sustainable rate of economic growth
The third macroeconomic goal is to maintain a sustainable level of economic growth. Economic growth is defined as an increase in output of goods and services in a nation over time. However, it can also be described as an increase in the potential output of a nation - i.e. an increase in the production capabilities which cause an increase in the output of goods and services beyond the full employment level (measured through GDP growth). Using a business cycle graph, we can track the changes in GDP (gross domestic product, total output of a nation) over time. As shown in the business cycle above, the Australian GDP has been steadily increasing and is showing signs of long-term growth - the long-term growth trend line (black line) is upwards sloping.

Long-run economic growth means that there is an improvement in the quality and quantity of Australia’s factors of production - land, labour, capital, or entrepreneurship, as shown through improvements in physical capital, technology, human capital, and productivity.

While 3-5% GDP growth is considered to be the ideal rate, the Australian government no longer releases a target growth rate, instead simply aims for the highest rate possible without inflicting negative consequences on inflation, external stability, and the environment. A more holistic approach to economic growth should be implemented in order to take into consideration the depletion of our economy’s non-renewable resources (land, oceans, forests, etc...) Essentially, the government is aiming to achieve a sustained increase in the rate of production of goods and services without compromising the living standards of future generations.

A negative growth rate refers to an economy in recession, a lower growth rate means that the economy is growing, but at a slower rate, and a positive growth rate means that the economy is increasing and likely in its recovery or expansionary phase of the business cycle. Currently, Australia seems to be experiencing a lower growth rate over the past few years, as shown by the dip in the graph, but has still not gone into recession, and continues on its world-record winning streak of the longest period without a recession.

It is clear that Australian government policies aimed at fostering a sustainable economic growth rate are succeeding, despite this slight fluctuation in recent years.

The government has successful strategies in place to avoid economic recessions (two or more quarters of negative economic growth) which have proven useful during difficult times. The Australian government’s implementation of both an expansionary monetary policy and fiscal policy incentivised consumption and confidence among consumers during the 2007-2008 crisis. In this strategy, the government increased their
spending on infrastructure, which, being a determinant of aggregate demand, increased consumers’ willingness and ability to consume goods, which, in turn, increased the real GDP of Australia, despite the recession hitting many other well-developed countries. In addition, the government implemented a fiscal stimulus package (The Government’s Economic Security Strategy Package) which gave $950 to low and middle income earners in order to stimulate consumer spending and increase aggregate demand. This payment increased low income earner consumers’ spending power, thus incentivising them to consume goods and boost the GDP. This consumption acted as an injection into the economy raising aggregate demand and the GDP - thus spurring economic growth.

Despite this economic success, however, certain aspects of the Australian economy have reached their “natural limits to growth”. This means that the depletion of environmental resources has halted further increases in economic growth to take place. For example, drought and water supply issues has reduced the capability of farmers to produce more goods. Climate change, which caused the floods and Cyclone Yasi in Queensland, had a negative impact on economic growth to local producers. One can see how such progress in economic growth has negatively impacted other aspects of the economy. In other words, Australia’s economic growth caused negative externalities in terms of the environment, which is a limitation of using GDP growth as a way of measuring economic growth for it fails to consider the potential implications on other strands of a nation.

4. Balance of payments in equilibrium

![Graph showing balance of payments in equilibrium](image-url)
Finally, the fourth macroeconomic goal is the equity of income distribution. This refers to the increased fairness within macroeconomic policies so that the richest population does not control too large a proportion of the total income within a nation. To measure equity, we can refer to a Lorenz curve. This diagram compares the proportion of income with the proportion of households (population). The Lorenz curve below allows us to quantitatively measure the level of equity compared to a "perfectly" equitable nation as represented by the line of equity. The further the curve is away from the line of equity, the less equitable a nation is. Furthermore, we use the Gini coefficient, which is derived by computing the areas beneath and between the curve and the line of equity, to mathematically associate a nation with a certain level of equity. The closer the Gini coefficient is to 0, the more equitable it is, while 1 represents perfect inequity.

As you can see in the graph to the left, the Gini coefficient for consumption (0.30) was lower than that of disposable income (0.32). This suggests that the economic inequality in Australia is reduced by the ability of households to borrow and save in response to temporary changes in income. The consumption Lorenz curve shows that the highest-spending households (in the top 20 per cent) accounted for approximately 39 per cent of total spending in the economy. The lowest-spending households (in the bottom 20 percent) accounted for about 8 percent of total spending. Furthermore, 20 percent of households earned approximately 42 per cent of total household income while the bottom 20 percent of households earned about 7 percent of income. Though this may seem far more inequitable, income inequality is reduced by government intervention causing the Gini coefficient for disposable income (0.32) to be lower than that of income (0.35).

The main form of government intervention in Australia to reduce inequity is through taxes. The three forms of taxes are: regressive (a flat rate of tax that hurts low income earners more than high-earners as it represents a larger proportion of their income), proportional (a flat tax -
everyone pays the same percentage - does not improve equity, but does not tend to worsen the disparity), and progressive (tax rates that increase as incomes increase). To reduce inequity, the government established income tax as progressive so that high income earners would be relatively more affected than low income earners. Yet, many of the government’s other taxes are regressive. Taxes on gambling, alcohol, and tobacco tend to be regressive because they disproportionately affect those on low incomes. The government, through these regressive taxes is incentivising low-income earners to spend their incomes on necessities, instead of these unnecessary goods by increasing their price through taxes. Additionally charges and fines such as motor vehicle registration are regressive. One possible improvement to government policy could be that traffic penalties are fined in a progressive manner so that a greater burden applies for offenders with higher incomes. In this way, higher-income earners will be relatively more affected by the fine than previously, adding incentive to high-income earners to not commit these crimes. Since the penalties are a flat rate or value, low-income earners are proportionately more affected by the tax - since it represents more of their real income. High-income earners may feel relatively unaffected by the small fine, and feel no need to obey traffic laws. It’s therefore important to tax traffic penalties progressively not only in terms of equity, but also in terms of enforcing laws and ensuring safety for Australian citizens.