The issue that economists have wrestled with throughout the ages, the economic problem, stems from the problem of choice created from unlimited wants but limited resources to satisfy these wants. Humans are greedy by nature and it is because of the need to satisfy needs and wants that economies like Australia exist.

Economics is fundamentally concerned with the way in which people and society can best allocate the scarce resources to produce goods and services to satisfy our unlimited wants, and then distribute them among various groups in society. The resources, otherwise known as the factors of production – natural resources, labour, capital and enterprise – are limited, and can be used in different ways, and it is important for them to be used to maximise utility. On the other hand, there is a limitless list of wants, because when we have satisfied one want, we will want to satisfy another. All of this leads to choice, a need to decide which of the alternative uses will be satisfied. Scarcity underpins the whole concept of the economic problem; scarcity is considered a relative concept, because infinite supplies of resources do not exist, although some individuals and societies are able to satisfy more goods and services than others are.

Our economic life is one that is full of making choices, weighing up the desirability of satisfying one want by sacrificing another, or satisfying one want less fully in order to satisfy another want more fully. The ‘real’ cost – opportunity or economic cost – is not measured in monetary terms of the good or service, but is the next best alternative foregone. Opportunity cost applies to individuals, who are limited by their income; to business firms, which have limited resources to produce goods and services; and to governments, which must decide which community wants to satisfy.

Opportunity cost is best illustrated using a production possibility frontier or curve (Figure 1). The production possibility frontier is a straight line sloping downwards or a curve concave to the origin. Assuming that only two goods are produced, this simple economic model demonstrates the ideas of economic problem, choice and opportunity, as it shows that to produce more of one good (say cheese) while using the same quantity of resources and the same level of technology, society must produce less of some other good (say yoghurt).

Economies exist in order for societies to solve the economic problem. All economies must find a solution to the economic problem and answer the four basic questions: what to produce, how much to produce, how to produce and how to distribute production. There are two theoretical extremes of how these questions may be answered – the planned economies and the market economies. These do not exist in reality though.

The planned economies had their theoretical basis in communist Marxian thought, with a central government undertaking the overall planning and setting of goals and targets.
for production and distribution. However, the few remaining communist countries – notably China, Vietnam and Cuba – have been encouraging a more market-orientated approach lately.

On the other end of the economic spectrum, the market economy – also called capitalism, free enterprise or laissez-faire – is characterised by individuals and private firms are motivated by self-interest and the profit motive. It denotes an economic system with a high degree of economic freedom and minimalist government intervention. The role of government in economic life is restricted to the provision of infrastructure required for economic activity and welfare. In the classical model of capitalism, almost all of the property, in the form of land and capital, are owned by individuals and business firms, giving individuals the right to earn incomes in the form of rent, interest and profit from their own business. Freedom of enterprise in a market economy allows anyone to undertake any production of goods and services they wish.

Above all, consumer sovereignty most defines a market economy. A market economy consists of commodity and factor markets each with buyers and sellers (the more the better). Consumer preference is the main factor deciding upon the pattern of production: what and how much to produce. This is because producers only produce what consumers are willing to buy, as it can be safely assumed that all producers aim to maximise profits.

The essential element of the market system is the price mechanism, whereby prices adjust to ensure that the supply of goods and services is equal to the demand; this is known as market equilibrium (where Qe meets Pe in Figure 2). When there is surplus production, prices fall, resulting in an increase in quantity demanded until all the output is sold. When there are shortages, prices rise, reducing quantity demanded until it equals the supply available.

The Australian economy is neither of these two extremes. Although the private sector makes most of the economic decisions, the government plays an important role in providing collective goods, redistributing income, regulating, and stabilising economic activity through macroeconomic and microeconomic policies. It is in between the two main forms of capitalism, the Continental European and Anglo-American models. In Australia, governments have traditionally played an active role in economic life, although this has been declining towards a market with a smaller role for government. In addition, Australia’s corporation model focuses on providing the most profit for shareholders.

The reason for government intervention is that, in practice, market economies are not entirely successful in achieving maximum satisfaction. This is due to market failure, which arises when the market system fails to achieve efficient outcomes. There are income inequalities when dealing with a market economy. The classical model says nothing about what determines a fair distribution of productive resources. If it were left entirely to the market, the rich get richer while the poor get poorer. Some people have a lack of opportunities and income. Freedom of enterprise, the profit motive and consumer sovereignty lead to the wasteful and unnecessary production of non-essential goods. Community goods are not produced because they yield no profit to producers. Hence, if governments play the minimal role in the classical view, there would be inadequate provision of education, health care, public transport, or protection of disadvantaged groups. Externalities are inflicted on the community by firms in their pursuit of maximum profits; governments need to force firms to reduce those externalities. In addition, the market system may lead to the emergence of monopoly power in markets where effective competition between firms is weak or absent.
and if abused, this can result in a reduction of consumer sovereignty through controlled output and higher prices, and less choice. Finally, the regular fluctuations in economic activity, known as the business cycle, may cause excessive levels of unemployment in recessions and excessive inflation in booms, leading to lower community living standards. All of these form the basis of government intervention.

In Australia, there are three levels of government: federal, state and local. All three of these intervene in the economy to varying degrees. The three main tasks of any government in modified market economies are the reallocation of resources, redistribution of incomes, and economic stabilisation and growth.

The government reallocates resources in order to alter the shortcomings of the price mechanism in the marketplace. It reallocates resources to areas that it believes is beneficial to Australian society, because the government’s aim is to achieve the optimum allocation of resources that satisfies the community’s most important wants at the lowest possible cost.

Firstly, it can alter resources use by making large annual outlays on the provision of collective goods and services. It benefits the whole community as it provides collective goods that are not adequately provided by the private sector. It provides the basic infrastructure for the economy, such as roads, railways, communications and electricity. The government may also choose to influence the private sector through grants and subsidies. For example, specific sectors of the Australian economy that are in need of assistance can be assisted through industry assistance and development spending. The government also allocates resources to public sector agencies that provide services to the community, such as the Australian Competition and Consumer Commission and the Australian Bureau of Statistics.

The government can influence what people buy as levels of taxation can influence the price of goods and services. The government may choose to tax some goods and services differently to alter the pattern of consumption, such as the excise on cigarettes and alcohol. By attracting resources towards a specific sector, the government can indirectly reallocate resources.

Obviously, government intervention in the activity of the private business sector will change the way resources are used there. The firms sector must comply with rules and regulations that have been imposed on their industry, such as fire and safety regulations.

Market-determined income is inequitable because people own different factors of production. The Australian government redistributes income from people with higher incomes to those with lower income, promoting a more equitable distribution of income. Apart from an awards system to protect low-income workers, redistribution mainly occurs through a progressive income tax system and social welfare.

Tax policy can be used by the Australian government to correct inequalities in the distribution of income and wealth in the economy. Australia has a progressive income tax system (direct tax) in order to lead to a more equitable distribution of income. The average rate of taxation increases as income rises. Indirect taxes are not as progressive, but wealthier people pay more direct taxes anyway because they spend more.

<table>
<thead>
<tr>
<th>Current tax schedule</th>
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<tbody>
<tr>
<td>Taxable Income $</td>
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<tr>
<td>0 to 6,000</td>
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<tr>
<td>6,001 to 20,000</td>
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<tr>
<td>20,001 to 50,000</td>
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Table 1: Personal income tax scale

On the 1 July 2000, there was the introduction of the personal tax reform package, comprising of the GST and huge income tax cuts. The GST will have an impact on income redistribution in Australia, because a tax like the GST must be paid by everyone at the same tax rate, regardless of income.
Welfare is designed to ensure a minimum standard of living for people who cannot work, or cannot find work. The system transfers income from taxpayers through taxation in the form of transfer payments. These include unemployment benefits, pensions (such as to the aged), and sickness and disability allowances. In recent years, the level of welfare spending by many developed countries has reduced, and although the Australian government has maintained a strong safety net, many of them are now means tested, so they are paid to only those people with low income and assets. This further evens the distribution of income by targeting welfare assistance.

Economies change and grow in an unstable way. The government can use monetary and fiscal policies in its macroeconomic stabilisation methods. This is to attempt to achieve full employment, price stability and economic growth, by countering the effects of severe fluctuations in the business cycle. The economy is stabilised, leading to higher living standards overall.

Monetary policy, involving action taken by the Reserve Bank of Australia (RBA) on behalf of the government, tends to be the main stabiliser. The RBA can affect the cost and availability of funds through changes to the interest rate, for cash in the short-term money market. It can affect the cash rate of interest and the level of interest rates in the economy by buying and selling government securities, thus affecting the demand for credit, which results in changes to levels of spending and economic activity. This can be seen in the graph, where interest rates were lowered substantially during the recession from 1990-1992. Hence, through this outlet, the government can control the level of economic activity, inflation and unemployment.

Fiscal policy refers to the use of the Federal government budget to achieve economic objectives, through its level of spending, taxing and borrowing. By varying its expenditure and revenue (thus the injections and leakages in the economy as represented in the circular flow of income), the government has indirect control over economic activity, unemployment and inflation. It can stimulate the economy through a budget deficit and it can dampen the economy by running a budget surplus. For example, the underlying cash surplus fell from $12.7bn in 1999-00 to an estimated $2.3bn in 2000-01; this was an appropriate counter-cyclical measure in light of the downturn in the economy (Figure 4).
The first homebuyers’ grant was a scheme introduced because of the sharp drop in the housing and construction sectors caused by the introduction of the GST and interest rate increases. Now $10,000, it stimulated the economy by making the purchase of a house a better alternative to renting. It will be reduced to $7,000 by mid-year because the housing sector has been largely revived.

![Figure 4: Budget outcomes and GDP. Source: Budget Paper No. 1 2000-01](image)

Public trading enterprises (PTEs) have always been an important part of the Australian economy. Many PTEs, such as the Commonwealth Bank and Qantas, have been privatised because it is believed that they would be run more efficiently as private rather than public enterprises. Some government owned enterprises, such as Australia Post, have been corporatised. Reforms to PTEs over the past 15 years has led to increased productivity through increased competition by opening up markets such as electricity and communications.

One form of government intervention in the economy is designed to promote competition by restricting businesses. The government uses competition policy in the Trade Practices Act 1974 to ensure fair business conduct; prohibiting practices that restrict competition, such as price collusion and misleading advertising; and imposing penalties on firms breaching these guidelines. The government can exercise influence over pricing through the Australian Competition and Consumers’ Commission (ACCC), which administers the Trade Practices Act. ACCC is able to conduct inquiries into pricing in industries.

Besides, the government attempts to control environmental externalities through laws and regulations. It can tax polluters, issue pollution quotas, or impose fines for contravening legislation. Recently, there has been the introduction of subsidies to firms to encourage them to use recycling, clean technologies and alternative sources of energy.

In conclusion, all societies must come to grips with the economic problem. Over time, different societies have developed their own solution – from the planned economies, to the market economies, and the mixed economies that lie in between. In particular, one model has worked well for over a century in one nation, Australia. The right mix of free market forces and the guiding hand of the government have produced a system that can last for centuries to come.
Bibliography


