Economic policy

Alan Fenna

Key terms/names

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It is 'the economy' that provides the goods and services we consume. It is also the economy that provides the jobs and business opportunities that enable us to purchase those goods and services. And it is the economy that provides the tax revenue to fund the activities of government. It is easy to see, then, why managing the economy is one of the most important tasks of government. At the *macroeconomic* level, the task is to keep economic growth up and unemployment and inflation down. At the *microeconomic* level, the task is to optimise the structure of the economy for longer-term performance, ensuring that it remains internationally competitive.

In a 'market', 'free enterprise' or 'capitalist' system, dominated by private ownership and free exchange such as Australia's, the government can only *influence* how well the economy functions. Moreover, a small national economy such as Australia's is often at the mercy of events in the world economy. The main tools government has at its disposal to influence the economy are:

- *fiscal policy*: the way it taxes and spends
- *monetary policy*: setting official interest rates
- *financial regulation*: the rules governing banking and investments

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- *trade policy*: regulation of the flow of goods, services and capital in and out of Australia
- *industry policy*: support and promotion of particular economic sectors or activities.

In Australia's federal system, most of these functions – particularly the main fiscal ones – are the responsibility of the Commonwealth government. The Commonwealth Treasury is the lead agency, and treasurers are the central figures.[1] Monetary policy is decided by a separate Commonwealth agency, the Reserve Bank (RBA). In some important microeconomic areas, the states retain a significant role, with each state promoting its own economic development as best it can.

While there is little opportunity to explore the broader context of economic policy here, it must be remembered that other policy areas, such as social policy and labour market policy, have direct implications for the economy and, reciprocally, social policy has a strong economic rationale.[2] Among other things, 'human capital', or the quality of the workforce and business people, is an increasingly important factor in economic performance.[3] Likewise, the tax and expenditure systems that are key instruments of economic policy have direct implications for the distribution of economic wellbeing or levels of economic inequality in society.[4]

The market economy

The challenges of economic policy are defined by the nature of the economy itself – a system of production and exchange that has, to a large extent, its own dynamics.[5] In tandem with the development of industrial capitalism has been the development of economics as a theory of how markets function.

The invisible hand

An economy such as Australia's is based on the free exchange of goods and services between businesses and individuals. This exchange is driven by the profit motive. What is produced and what price can be charged are not dictated by government (as they were under the communist system that once prevailed across a good part of the world but that has now retreated to Cuba and North Korea). Rather, they are determined by what demand exists or can be generated by the creation of new products or by advertising. The problem of balancing supply and demand is solved by the price mechanism: when demand exceeds supply, prices rise, prompting more production and reduced consumption, and when suppliers have too much stock,

1 Bowen 2015.
2 Barr 2012.
3 Becker 1994; Edwards 2016.
4 Fenna and Tapper 2015; Fenna and Tapper 2012; Tapper, Fenna and Phillimore 2015.
5 Lindblom 2001.

they can reduce the price until the surplus is cleared. Millions of economic activities are thus co-ordinated in the most efficient way possible by what the founder of modern economics, Adam Smith, called the 'invisible hand'.[6]

Innovation

Not only does the market system solve the economic co-ordination problem, it also has built into it a relentless drive to innovate, since there are potentially great profits to be made from developing new products or more efficient ways of producing existing products.[7] The epitome of this in today's world is, of course, information technology – where one hardly masters a new device before it is superseded by the next generation. The downside to continuous innovation is the 'gale of creative destruction' that relentless change brings: firms and industries die or decline as new ones push forward.[8]

In combination with the Industrial Revolution, which harnessed natural science and inanimate energy sources to create modern manufacturing and technologies, the market economy created the entirely unprecedented increase in wealth, living standards and social mobility in the past two hundred years.[9] These developments solved mankind's material needs problem, but created what many see as new issues of consumerism and environmental destruction.[10]

Trade

The market economy places a premium on exchange or trade, the logical extent of which is global free trade and integrated global economy. Recognition of the value of international trade was integral to the postwar international order, as leading Western countries signed up to the General Agreement on Tariffs and Trade (GATT) – now the World Trade Organization (WTO) – and set about progressively dismantling barriers to trade in the 1950s and 1960s. Tariffs had been implicated in the economic difficulties of the prewar period.[11]

International trade has, however, been a contentious issue since long before Adam Smith, with governments often under pressure to protect the local economy against 'unfair' competition or international divisions of labour that leave them producing less valuable goods or lead to the painful demise of existing industries. Sometimes government action takes the form of outright 'protectionism', through such measures as import tariffs, as US President Donald Trump has recently been

6 Smith 1776.
7 Baumol 2002.
8 Schumpeter 1942.
9 Appleby 2012; Clark 2007; McCloskey 2016; Mokyr 2016; Pomfret 2011.
10 See, for example, Hamilton 2003; Hamilton and Denniss 2006.
11 Irwin 2012

implementing in the world's leading economy. Other times it takes the form of subsidies for local industry and other assistance measures.

Role of government in a market economy

Few people have any illusions that the market economy works perfectly, and economists have long recognised the tendency towards various forms of 'market failure'.[12] One form of failure is the inability of the market to supply those goods for which it is difficult to charge – what Adam Smith referred to as 'public works' and 'public institutions' – such as roads or schools.[13] Another is insufficient competition in some industries. And a third is the problem of 'externalities': the tendency for the costs or benefits of an economic activity to spill over onto third parties or be left for future generations to deal with.[14] Since the Industrial Revolution in the 19th century, the most significant negative externality has always been the pollution that an individual firm may inflict on the environment and society.

The consequence of such market failures, as Adam Smith originally suggested, is the need for some government intervention. Sometimes that means government stepping in to provide essential infrastructure. Other times it might involve protective or prudential regulation, such as environmental protection laws or financial systems regulation. How active a role government should play is, however, unavoidably an ideological question of individual values and preferences, ranging from those on the left supporting intervention to those on the right opposing it.[15]

Ideologies and the mixed economy

As market failures have increased in modern industrial society, so has the role of government. Since the mid-20th century, it has been common to refer to the resulting state of affairs as the 'mixed economy' – one combining both market and government. The mixed economy is based on the free exchange of goods and services in 'the market', but the market is supported, regulated, moderated and, in some areas, replaced by government action.

The balance between the private and public sectors is always going to be contentious and shifting. From a left-wing or social-democratic viewpoint, market failure is widespread and serious, requiring extensive governmental correction. From a right-wing, or liberal (sometimes 'neoliberal') viewpoint, market failure is often less of a problem than 'government failure' resulting from intervention.[16] The left's support for intervention is reinforced by their conviction that market outcomes are unfair and lead to gross inequalities in income, wealth and wellbeing.

12 Pigou 1932; Quiggin 2019.
13 Smith 1776, book V, chapter 1.
14 Coyle 2011.
15 On ideologies, see Fenna 2013a.
16 Anomaly 2015; Cowen and Crampton 2002; Winston 2006; Zerbe and McCurdy 1999.

The right's scepticism about government, meanwhile, is reinforced by their belief that those inequalities reflect the way the market rewards effort, ability and investment. A related philosophical debate takes place around the question of what aspects of life should be insulated from the market.[17]

The 'dismal science'

By postulating economic actors as rational, self-interested individuals, economics has developed a framework for understanding the functioning of markets based on a handful of simple but powerful concepts and propositions.[18] That framework plays a central role in government decision making in the area of economics – generally considered to be the area most central to perceived success or failure of governments.[19] In the 19th century, economics was dubbed 'the dismal science' because it insisted that public policy could not avoid the implacable realities of economic life.[20] To this day, one of the challenges of economic policy making is the extent to which voters are 'deeply resistant to the messages of mainstream economic analysis'.[21]

Smith's *An inquiry into the nature and causes of the wealth of nations* was a treatise in favour of minimal government – or what became known as laissez faire. The story of economics over the past century has been, in many ways, the story of the clash between that free market perspective and more interventionist approaches.[22] Each new economic crisis presents the discipline with fresh challenges of explanation and sometimes with accusations that it has failed public policy, often by placing too much faith in the benign operation of markets.[23]

Macroeconomic policy

Government's most prominent concern today is with macroeconomic policy – or the short- to medium-term performance of the economy as a whole. Macroeconomic policy has three aims. First and foremost, ideally, everyone who wants or needs a job should have one – full employment. Second, prices should be stable over time – low inflation. Third, the value of what the economy produces must increase by at least a few per cent each year – economic growth.

17 Barber 2008; Sandel 2012; Satz 2010.
18 For example, Coyle 2004.
19 Kane 2016.
20 Groenewegen 2001. Cf. Coyle 2010.
21 Garnaut 2013, 79.
22 Backhouse 2010; Backhouse 2002; Wapshot 2011.
23 For example, Balogh 1982; Blanchard et al. 2016; Cassidy 2009; Easterly 2014; Krugman 2018; Quiggin 2012; Rodrik 2015; Stiglitz 2018; Taylor 2011.

Economic growth

Economic growth is an increase in gross domestic product (GDP) – a flawed but essential measure of economic activity.[24] A rapidly developing economy, such as China's, might grow at 6 to 9 per cent per year, while a typical developed economy, such as Australia's, can be expected to grow at a much more modest 2 to 3 per cent per year. Even that can exaggerate the degree of 'real' growth, since it may simply represent population growth. When there is *per capita* increase in GDP, we can say that the 'standard of living' is going up. Over the longer term, growth and the resulting increase in the standard of living is driven by the economy's increased *productivity* – more is being produced for the same amount of effort or input. If productivity is increasing, there is room for workers to receive increases in their real wages. The main factor in increased productivity is innovation – its dynamic contribution to capitalist economies was noted above.

Growth and the business cycle

Growth rates vary from year to year, often building to a high point and then stalling, in a pattern referred to as the 'business cycle'. When growth slows, unemployment rises; if growth ceases altogether and the economy shrinks, the result is an economic recession, or, if it persists, an economic depression. The most recent recession globally was the 'great recession' in the USA and other advanced countries of the Organisation for Economic Co-operation and Development (OECD) that was set off by the Global Financial Crisis (GFC) of 2008.[25] The great recession resulted in burdensome government debt loads in a number of OECD countries; those, in turn, led to politically, and perhaps economically, painful spending cuts referred to as 'austerity' policy.[26] Australia narrowly escaped that recession; its last serious downturn was in 1990–91 and its last depression was in the 1930s.[27]

The financial sector and the 'real economy'

The GFC of 2008 was a crisis not in the 'real' economy, where goods and services are traded, but in the financial sector, where money is traded. The financial sector – with its periodic banking crises and speculative investment 'bubbles' – has always been a weak point in the capitalist system, and that weakness sparks efforts to

24 Coyle 2014; Stiglitz, Fitoussi and Durand 2018.

25 Garnaut and Smith 2009; Lybeck 2011. The OECD is a club of 36 mainly developed economies including Australia that undertakes shared research to enhance economic performance and social welfare.

26 Atkinson 2014; Blyth 2013; Clark 2015; Quiggin 2018; Tooze 2018; Wanna, Lindquist and de Vries 2015.

27 Macfarlane 2006; Keating 2015.

impose more effective regulation.[28] Australia escaped the great recession in no small part because, by dint of good fortune, it avoided a financial crisis.[29]

Growth and inflation

If the economy grows too quickly, demand for certain goods and services starts to exceed supply, forcing prices to rise in a process known as *inflation*. A low and stable rate of inflation, where prices increase by a few percentage points a year, is fine – indeed, quite healthy. If inflation starts to spiral upwards, however, difficulties quickly emerge. Along with a number of other OECD countries, Australia had difficulty containing inflation through the 1970s and 1980s. Economic policy making is heavily constrained under such circumstances, since, rather than stimulating the economy, further spending simply stokes inflation. Ideally, an economy stays in the sweet spot, where everything is in balance – but we don't live in an ideal world.

Keynesianism and the economic cycle

Until the Great Depression of the 1930s, it was an article of faith that, if left to their own devices, markets would function to keep unemployment and prices stable. The economy should naturally move towards 'equilibrium' through the action of the price mechanism. That did not seem to happen in the Great Depression, and since the revolution in economic thinking sparked by English economist John Maynard Keynes,[30] it has generally been accepted that governments have an essential role to play in smoothing the economic cycle.[31] They must counteract tendencies towards either unemployment or inflation by adjusting levels of effective demand. When economic activity slows and unemployment rises, demand needs to be stimulated by putting more money into people's hands. Conversely, when the economy is in danger of overheating and causing inflation, demand needs to be reduced by tightening the supply of money.

Counter-cyclical demand management is known as 'Keynesianism' and is implemented through some combination of monetary and fiscal policy. Reducing interest rates, reducing taxes and increasing government spending are the three mechanisms for stimulating the economy by increasing demand. In Australia, as in many other Western countries, responsibility for monetary policy has been assigned to the Reserve Bank – the banker to the banks. Under legislation, the RBA is tasked with keeping inflation within a 2 to 3 per cent band, raising interest rates when the inflation rate threatens to rise above that and lowering them when inflation

28 Arcand, Berkes and Panizza 2015; Minsky 1986; Rajan 2006; Reinhart and Rogoff 2009; Shiller 2016.
29 Bell and Hindmoor 2019.
30 Keynes 1936.
31 Backhouse and Bateman 2011.

threatens to fall below. Fiscal policy, meanwhile, is up to the government of the day, which may decide to increase or decrease spending or taxation at any point.

Monetary policy has three great advantages: raising or lowering the official interest rates (the 'bank rate') costs nothing, takes immediate effect and can be reversed or fine-tuned at any time. However, it may not always be effective and is constrained by the 'zero-bound' limit – interest rates can only be lowered so far. In the past few years, official interest rates have been close to or at zero in several countries. Once rates are that low, central banks can only stimulate the economy by printing money – 'quantitative easing', as it is somewhat euphemistically known.

Co-operation or conflict?

Ideally, fiscal and monetary policy work together, complementing and reinforcing one another. However, this is not always the case. There are times, for instance, when central banks respond to what they see as economically reckless fiscal policy by raising interest rates even though such a move might be unpopular and embarrassing to the government. Given that it is almost always politically easier to spend money than to make budget cuts, the ability to play this role is precisely why many countries, such as Australia, moved towards central bank independence in the 1980s and 1990s. The RBA thus operates independently from the government of the day to insulate rate-setting from political pressures.[32]

Even when acting in concert, it is not easy to get the balance between fiscal and monetary policy right. Australia, for instance, used aggressive fiscal policy to fight off recession in 2008–09, but it might have been better off spending less and lowering interest rates further instead.[33] Meanwhile, both fiscal and monetary policy have difficulty addressing conditions that vary across the country. They represent a 'one-size-fits-all' approach that creates dilemmas if one region or sector is booming and others struggling, as is sometimes the case in Australia.

Keynesianism in practice

In many cases, what sounds good in theory may be rather more difficult in practice. In the Keynesian view, there are times when risk of an economic downturn is so great that governments should not hesitate to run deficits and accumulate debt to stimulate the economy. This is particularly the case when, as happened in some countries during the GFC of 2008–09, interest rates have been lowered as far as they can go. When times are good, governments need to be running equivalent surpluses to stop the economy from overheating and to pay down that debt.

To some extent this happens automatically. In today's world, with substantial levels of taxation and an extensive 'welfare state', government spending goes up and

32 Bell 2004.
33 Walter 2017, 125.

tax revenue goes down when the economy declines, and the reverse occurs when the economy improves. However, these 'automatic stabilisers' may not be sufficient on their own, and economic fluctuations still may require 'discretionary' policy decisions to increase or cut spending or taxes.

When Australia faced what looked like an economic abyss with the GFC in 2008, the circumstances were highly favourable for a Keynesian response, and the newly elected Labor government, led by Kevin Rudd, launched a series of spending initiatives to boost demand.[34] That vigorous response seemed to be vindicated when Australia emerged as one of the very few OECD countries to avoid recession. To what extent the policy initiatives themselves can be credited with that success, and to what extent they were well calibrated and designed is, however, difficult to judge.[35]

Economists debate how effective or realistic Keynesian notions of 'demand management' are, and some also point out that how well the economy performs may be influenced as much by supply-side factors as by demand-side ones. If taxes are too high or hiring and firing regulations too strict, for instance, businesses will be less likely to respond to increased demand by hiring more workers. Keynesianism has experienced its own ups and downs, depending on how well it seemed to be working. It was broadly accepted in the postwar boom conditions of the 1950s and 1960s; but it fell out of favour when Western economies experienced simultaneous slowing growth, rising unemployment and high inflation – 'stagflation' – in the 1970s. It then enjoyed a great revival with the onset of the GFC and ensuing recession in 2008.[36]

Ideology again

While the discussion so far could give the impression that managing the economy is a technical question of pulling the right levers to get the optimal outcome, the reality is far more complex and contested. Macroeconomic policy is a deeply political issue, where perspectives and priorities are unavoidably shaped by interest, ideologies and values. As with interventionism generally, the Keynesian demand-side approach has always been favoured by the left, while supply-side considerations have typically been prioritised by the right.

It is not surprising, then, that the Rudd Labor government enthusiastically embraced a Keynesian solution in 2008–09. Likewise, it is unsurprising that the Liberal–National (Coalition) parties warned that the result would be wasteful spending and a large increase in government debt, which represented an ongoing constraint for future governments. The Coalition parties tend to favour supply-side measures, such as tax reductions, particularly for business enterprises, on the basis that this will create greater incentives for investment, innovation and job creation.

34 Fenna 2010.
35 Fenna and 't Hart 2019.
36 Clarke 2009; Fenna 2010; Macfarlane 2006; Skidelsky 2009.

Microeconomic policy

In addition to the challenges of managing the economy over the cycle, there are the questions of how the economy is structured, how competitive local industries are internationally and how well the economy can be expected to perform over the medium to long term. These microeconomic issues have been a major focus of policy in Australia throughout the country's history. They are important because our standard of living – how wealthy we are as a country – depends on our ability to sell into export markets and attract investment capital in a way that finances the goods we import. Some of those imports are for Australian businesses to use for their own production, such as machinery for factories or mines. Many imports, though, are consumption goods bought by individuals.

The resource economy dilemma

Since European settlement, Australia has developed via the export of primary products. In other words, Australia exploited its resource and agricultural wealth – most famously in the form of gold and wool. Those exports financed the import of investment capital and of the wide range of manufactured goods integral to an advanced economy and society. Consistent with the teachings of classical economists such as Adam Smith and David Ricardo,[37] Australia thrived by exploiting its *comparative advantage* – focusing on what it could produce most profitably and importing the rest. A country is seen as having a comparative advantage in primary products if it is abundant in resources, or a comparative advantage in manufactured goods if it is abundant in capital and labour. Australia's situation remains similar today. 'After more than 150 years of sustained high incomes, the comparative advantage of this economy still lies in its resources'.[38] Eight of Australia's top 10 exports today are primary products: iron ore, coal, natural gas, gold, aluminium ores, beef, wheat and petroleum. The two exceptions are services: tourism and education.

Although 'Australia prospered' from its primary products, as McLean puts it,[39] a major theme of Australia's economic policy has been the concern that resource exports provide an unreliable basis for long-term wealth and that the country should diversify to establish a more 'normal' export profile for an advanced economy. That, however, requires the development of a manufacturing sector that is capable of competing, first, in the domestic market against imports, and second, in overseas markets. The limitations of resource dependence first became apparent when the colonial gold rush ended in 1860. In response, Australia turned to a policy of tariff protectionism, beginning in the colony of Victoria and subsequently implemented

37 Ricardo 1817; Smith 1776.
38 McLean 2013, 5.
39 McLean 2013.

on a national scale immediately after Federation This was intended to shelter the country's 'infant' manufacturing industries and thereby diversify the economy.

Tariff protectionism complemented a heavy reliance on government for the provision of key infrastructure, which was inevitable in a developing country such as Australia.[40] It was reinforced by the introduction of provisions such as centralised wage fixing and the principle of the 'living wage' through the arbitration system and of the White Australia policy protecting Australian workers from an influx of low-wage Asian labour. It was 'a strategy of *domestic defence*'[41] that has also been called 'the Australian Settlement'.[42] Diversification was also encouraged by the two world wars, which reduced access to imported manufactured goods and increased the demand for military materiel.

The end of the protectionist road

While the 'fortress Australia' model was highly successful for several decades, it became anachronistic by the 1960s and untenable by the 1980s.[43] Other advanced countries were signing up to the GATT and reducing tariffs on manufactured goods. Then, from the 1970s, the value of Australia's primary product exports relative to the country's manufactured imports started to languish. The result was rising current account deficits, showing that Australia was failing to earn enough to cover its import costs. At one point, the Labor government's treasurer, Paul Keating, declared that Australia was at risk of becoming a 'banana republic' if the slide was not averted.[44] Government control of the Australian dollar's exchange rate with overseas currencies had only recently been removed, and market sentiment was decreasing the dollar's value by the minute in response to Australia's poor trade performance.

Almost all elements of the fortress Australia model have been dismantled, with much of the reform being introduced under the Hawke–Keating Labor governments that held office from 1983 to 1996. Extensive privatisations of major government-owned businesses, the progressive removal of protective tariffs, liberalisation of the wage bargaining system, introduction of National Competition Policy and a variety of other reforms shifted the balance much more towards an open market economy.[45] This was controversial at times and a focus of ideological debate.[46] However, it has been credited with underpinning the extraordinarily strong performance of the Australian economy in the last quarter of a century – 'the longest unbroken period of economic expansion of any developed country ever'.[47]

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40 Butlin, Barnard and Pincus 1982; White 1992.
41 Castles 1988, 93.
42 Kelly 1992. See also Fenna 2012.
43 Fenna 2013b.
44 Kelly 1992, 196–7.
45 Borland 2015; Fenna 2019.
46 Fenna 2013b.
47 Garnaut 2013, 5. For a contrary view, see Cahill and Toner 2018.

The end of protectionism exposed Australia's extensive manufacturing sector just as globalisation was increasing the quality, quantity and competitiveness of overseas manufacturers. A range of *industrial policy* initiatives sought at first to assist with the necessary restructuring, but in the end many firms, and indeed entire industries, shut down. This was particularly the case in the labour-intensive textile, clothing and footwear sectors, where advanced countries struggled to compete against Asian manufacturing at the best of times, and in the 'metal bashing' industries such as whitegoods and motor vehicles. In 2017, Australia's last car manufacturer closed its doors, and an industry that had begun with great fanfare in 1949 came to an end. Australia still manufactures sophisticated industrial goods as well as some traditional core industrial goods, such as steel. However, manufacturing now contributes only a small part of Australia's overall GDP, and even then, what is officially counted as 'manufacturing' is often merely the processing of primary materials.

Back to the future

The difficulties of a declining manufacturing sector prompted questions about why governments were not pursuing more imaginative and ambitious industry policy.[48] However, the need for active intervention to promote manufacturing was swept aside by the extraordinary recovery in Australia's traditional area of comparative advantage that occurred from 2004. After a long period of stagnation or decline in the 'terms of trade' (the value of one's exports versus the cost of one's imports), Australia's mineral wealth suddenly became the road to riches again with the mining boom. Other than requirements for local construction of major new defence acquisitions, such as submarines and destroyers, there remains little by way of national industrial policy in Australia. That is likely to remain the case for as long as Australia continues to prosper from its agricultural and natural resource wealth.

Trade agreements in lieu

In this context, it is not surprising that Australian governments have seen *trade agreements* as the way forward. Trade agreements are, in some ways, the industrial policy you have when you are not having an industrial policy – supporting local industry by enhancing its access to larger markets, but nothing else. Again, ideology plays a role here, with the tendency to equate industrial policy with trade policy being stronger on the Coalition than Labor side of politics.[49] As we noted earlier, Australia was reluctant to participate in the GATT process of multilateral tariff reduction that was such a large part of global economic relations in the 1950s and 1960s.[50] Australia's recently developed manufacturing sector was seen as too

48 Bentley and West 2016; Fenna 2016a; Fenna 2016b; Phillimore and Leong 2017; Stewart 2016.
49 Thurbon 2017.
50 Snape 1984.

fragile to face the world without tariff protection and, at the same time, the GATT was offering no reduction in tariffs for the goods that Australia could export competitively – agricultural products.

Australia is now a full participant in the WTO, the GATT's successor; however, most trade policy attention in recent times has been on *preferential trade agreements*. These are typically bilateral, rather than multilateral. Australia controversially entered into a bilateral free trade agreement with the USA that took effect in 2005. Since then, it has negotiated arrangements with individual Asian countries, such as Korea, Japan, China and Indonesia, and entered into the multilateral 'Trans-Pacific Partnership'.[51] The prospect of 'Brexit' – the UK's departure from the European Union – has led, in turn, to moves towards separate trade agreements with the EU and the UK.

Trade agreements liberalise trade between participating countries, but, at the same time, inevitably involve elements that tie the hands of participating governments in terms of how much support they can give their domestic firms. Governments might also exaggerate those limitations as a pretext for inaction on industrial policy.[52]

Conclusions

Economic policy lies at the heart of what government does, and no government can survive for long if the economy is not performing. Through a combination of demand- and supply-side measures, governments engage in *macroeconomic* management to maintain rates of growth that will keep unemployment to a minimum. At the same time, they also have to be wary about the danger of inflation. Ideally, a combination of low interest rates and increased spending and/or decreased taxation would increase effective demand and thus stimulate economic growth when the economy was slowing. And ideally a combination of rising interest rates and decreased spending and/or increased taxation would 'cool' the economy when it was in danger of 'overheating'. Ideally, too, any debt accumulated as a result of deficits incurred when trying to stimulate the economy would be paid down by equivalent surpluses achieved during the good times. At the same time, it must be remembered that this is a gross simplification of a very complex reality, where countless other factors intrude, including debates in economic theory, the overlap between economics and ideology, the intersection between economic policy and other policy areas, and the interaction between the domestic and the international economies.

51 The Comprehensive and Progressive Agreement for Trans-Pacific Partnership, which came into effect in late 2018 after the USA had controversially withdrawn from the original agreement.

52 Thurbon 2016.

And that's just macroeconomic policy. As discussed on at the end of this chapter, governments also have economic responsibilities of a more structural nature, concerning the operation of specific markets, the path of economic development and the industrial focus and international competitiveness of the economy. These *microeconomic* issues confront policy makers with a fundamental question of whether market forces should generally dominate or whether government should seek to play a strategic role. The latter requires considerable political will and entails a number of difficult questions about what tools and approaches work best to foster innovation, retain and promote investment and achieve export success.

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About the author

Dr Alan Fenna is professor of politics at the John Curtin Institute of Public Policy, specialising in Australian government and politics, Australian and comparative federalism, public policy, economic policy and social policy. He is co-author of *Comparative federalism: a systematic inquiry* (2015) and *Interrogating public policy theory: a political values perspective* (2019); co-editor of *Australian government and politics*, 10th edn (2014); and author or co-author of a range of journal articles and book chapters.