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CRSET

HSC Economics

Topic 4: Economics Policies and Management

Lesson 1

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HSC Economics Topic 4: Economic Policies and Management
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Syllabus Dot-points covered:

Macroeconomic Policies

- Rationale for macroeconomic policies - stabilisation and shifts in aggregate demand

Fiscal policy

- Federal Government budgets and budget outcomes
- Effects of budgetary changes on resource use, income distribution and economic activity

Macroeconomic policies

- Macro policies include the use of the government budget (fiscal policy) and changes in the level of interest rates (monetary policy) to impact the overall level of economic activity. These policies tend to influence the level of aggregate demand in the economy
- The main role of macro-policies is to manage the **business cycle** - they are designed to minimise the fluctuations of the business cycles so that economies experience low rates of inflation and unemployment and relatively stable economic growth
- As such, they are often known as **counter-cyclical policies**
- For example, methods to reduce the level of economic activity may include:
    - Higher tax rates - reduce consumers' disposable income and reduce the level of spending and aggregate demand, also reducing pressures on inflation and the CAD
    - Reduced government (budget) spending - lower the level of AD by lowering the level of aggregate expenditure in the economy
    - High interest rates- make borrowing less attracting and will discourage borrowing and spending by both consumers and businesses. Also encourages saving rather than spending

- **Methods to increase the level of economic activity:**
    - Tax cuts, increased government spending and reductions in the level of interest rates
    - Cash payments to families - increase consumer disposable income and overall consumption in the economy

- **HOWEVER:** The main limitation of macroeconomic policies is that it does not address longer-term problems such as a lack of international competitiveness, lower productivity growth, a low level of national savings or the need to reduce carbon emissions

Fiscal policy

Fiscal policy involves the use of the Commonwealth Government's Budget in order to achieve the government's economic objectives. By varying the amount of government spending and revenue, the government can alter the level of economic activity, which in turn will influence economic growth, inflation, unemployment and the external indicators in the economy.

- **Reallocation of resources** i.e. structural change in what the economy produces
- **Redistributing income** e.g. from high income earners to low income earners
- **Reduce fluctuations of the business cycle**

Features of government revenue (2019 Federal Budget):

- Direct tax (personal and company) - personal income tax provides 46% of total revenue while company tax provides 19%
- Indirect tax (such as customs and excise duties and the Goods and Services Tax) provides 24% of total revenue
- Other revenues (such as dividends from public trading enterprises) make up 11% of total revenue

Features of government expenditure (2019 Federal Budget):

- Social welfare - 36%
- Health - 16%
- Education - 7%
- Defence - 6%
- Public administration - 5%

<u>Federal government budgets and budget outcomes</u>

The fiscal or budget outcome gives an indication of the overall impact of fiscal policy on the state of the economy

The Budget outcome:

- **Fiscal surplus** (or budget surplus)- Revenue > Expenditure
- **Fiscal deficit** (or budget deficit) - Expenditure > Revenue
- **Fiscal balance** (or balanced budget) - Revenue = Expenditure

The 2019/20 Federal Budget marked the **first return to a surplus** position in almost a decade with a surplus of **$7.1 billion.** Total receipts were expected to be $505.5 billion and total payments were $493.3 billion.

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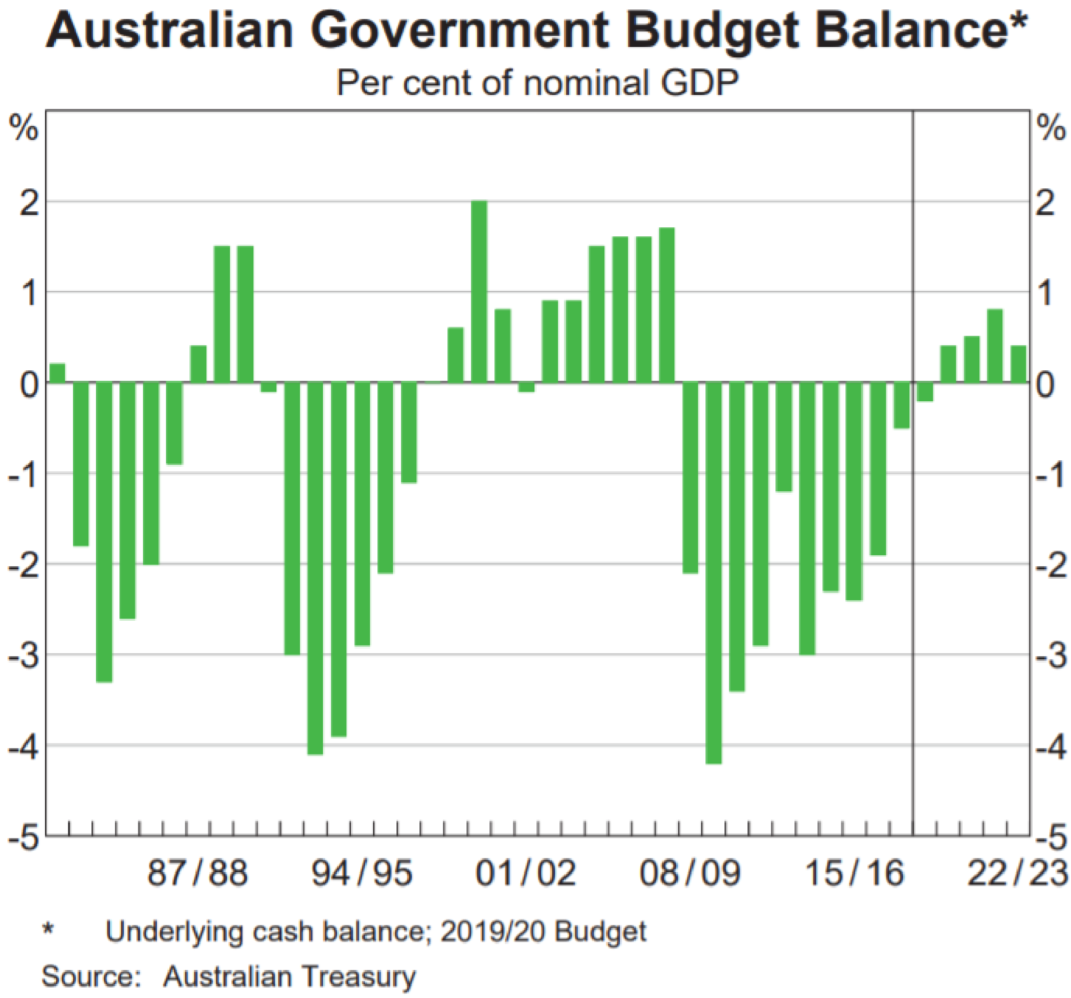
Historical Budget Outcomes



Measuring the budget outcome

The Fiscal outcome

Calculated as total revenue less total expenses let net capital investment (excludes one-off items such as privatisation of previous government-owned businesses - e.g. Telstra, which are recorded in the State of Other Economic Flows)

- Calculated using the accrual account method - e.g. includes superannuation owed by the government to public servants even it is not paid out until retirement
- Regarded as most accurate long-term indicator of fiscal policy

The underlying cash outcome

- Calculated similarly to the fiscal outcome except using the cash accounting method
- In this method, receipts are recorded during the period they are received, and expenses are recorded in the period in which they are actually paid
- Also removes the effect of one-off transactions that can distort the Budget outcome (e.g. sale of government assets/loans to state government)
- Gives the best indicator of the impact of fiscal policy on the level of economic activity this year

The headline budget outcome

- Like fiscal outcome, except it includes one-off transactions
- Not regarded as a useful indicator of fiscal policy as economists agree such revenue should be removed when assessing the effect of the Budget on the economy
- Selling of government assets to the private sector is merely a transfer of assets and will not necessarily generate extra economic activity, at least in the short run

A main goal of fiscal policy aim is to achieve fiscal balance, on average, over the course of the economic cycle.

Budget outcome drivers

- Changes in the budget outcome reflects the impact of two key drivers: changing economic conditions (cyclical or non-discretionary changes) and changes in fiscal policy (known as structural or discretionary factors)
- **Discretionary changes** in fiscal policy
    - Deliberate changes to fiscal policy, such as reduced spending or changing taxation rates
    - Influences the structural component of the budget outcome

- **Non-discretionary changes** in fiscal policy
    - Caused by changes in the level of economic activity and not the introduction of new policy
    - The budget deficit tends to increase during recessionary periods and vice versa during periods of economic booms
    - Influences the cyclical component of the budget outcome
    - Includes automatic stabilisers (see below)

- **Automatic stabilisers**
    - Changes in the level of government revenue and expenditure that "automatically" occur as a result of changes in the level of economic activity
    - These automatically counterbalance economic activity - in boom they decrease economic activity and, in a recession,, they increase economic activity
    - **Unemployment benefits** - in a recession, economic activity falls causing a rise in unemployment. A rise in unemployment leads to greater government expenditure on unemployment benefits. Thus a decrease in the level of economic activity leads to an increase in government expenditure. Vice versa.
    - **The progressive income tax system** - During boom, employment opportunities rise and incomes rise. Rising incomes move workers into higher tax brackets and previously unemployed persons start paying income tax. This leads to an increase in taxation revenue. Vice Versa
    - These play a **counter-cyclical role** (designed to smooth fluctuations in the business cycle)
    - However, automatic stabilisers are not powerful enough, as they merely reduce the severity of the problem. The government still relies on discretionary policy measures to curb the economic cycle.