ECONOMICS

Australia's Fiscal Policy

The Australian government implements macroeconomic policies such as monetary and fiscal policy as stabilisation or counter-cyclical policies that smooth out fluctuations in the business cycle. These policies influence aggregate demand (total expenditure) and determine economic activity (output) and thus economic growth (increases in real GDP over time). The most important weapon of fiscal policy is the federal budget which outlines the expenditure and revenue initiatives for that financial year which in turn influence economic activity, income distribution and resource use. The effectiveness of fiscal policy can best be seen in the past 2 federal budgets of 2008-09 and 2009-10 which have acted as fiscal stimulus packages in an attempt to reduce the impact of the Global Financial Crisis (GFC) on the Australian economy. The success of these actions is best reflected in the 2010-11 budget which forecasts a surplus in 2011-12, three years ahead of schedule, and the current Australian economy which experienced ***strong economic growth of 3.3% in 2009-10 and a forecasted 4% in 2011-12.***

The use of fiscal policy often assists the government in attaining their economic objectives of prolonged periods of sustained economic growth (minimal inflation and CAD), internal balance (full employment and low inflation), external balance (import expenditure financed by export income, stable exchange rate and NFLs), sustainable management of the environment and distribution of income and wealth. The use of expansionary fiscal policy in 2008-09 and 2009-10 to counter economic downturn was seen to be successful with Australian economy avoiding a technical recession. This was done by a significant increase in govt. expenditure with cash handouts of up to $900, rebates and rapid infrastructure spending in order to support aggregate demand and reduce the rise in unemployment. Thus a structural (govt. expenditure) and cyclical (automatic stabilisers) deficit was taken. A structural deficit indicates a government's deliberate decision for a deficit (govt. expenditure > govt. revenue). Because the economy was in a downturn, weak growth and falling terms of trade caused a decrease in national income and thus a cyclical deficit occurred. Automatic stabilisers such as unemployment benefits rose and progressive tax income receipts fell, reducing government revenue. With Australia recovering from the GFC with moderate levels of economic growth, stimulus measures were withdrawn to form a fiscal stance that is mildly expansionary with a deficit of ***$40.8b in 2010-11 from $58bn deficit in 2009-10***. Spending priorities in the 2010-11 budget focussed on boosting the economy's productive capacity (GDP), with high expenditure on infrastructure, skills and training with an objective of achieving higher economic growth, lower unemployment and less capacity constraints.

According to John Maynard Keynes, an expansionary fiscal policy as seen in the 2008-2009 and 2009-10 federal budgets, allows aggregate demand to increase due to the increase in government expenditure which encourages consumption<u>. This can be explained by the simple multiplier which states any change in autonomous expenditure is multiplied to give a larger equilibrium level of national income.</u> With a larger supply of funds, higher consumption occurs with an increase in production to meet the aggregate demand and thus an increase in economic output (GDP) and economic growth. In the 2009-10 budget, the government implemented several nation-building investments and stimulus packages including a ***$22b Nation Building and Infrastructure plan, $42b Nation Building and Jobs Scheme, $10b Economic Security Strategy*** which all aided in boosting AD by investing in infrastructure, transport, communication and employment. The government also ***aided household consumption through the ESS and $20b cash handouts and a first home owner boost.***

These measures allowed economic growth to rise by 1.4% to 2.7% in 2009 while other advanced economies contracted by 3%.

Economic growth must be fairly distributed among the economy to ensure equitable income distribution. With the current mining boom, from China's great demand for Australian commodities, the Federal Government is planning to introduce the ***Resource Super Profits Tax (RSPT)***. This will attract investment to the business sector and lead to more infrastructure, thus providing more job opportunities, lowering unemployment and thus increasing income and standards of living. The increase in income will lead to greater consumption, savings, tax and imports and through the multiplier effect, will contribute to a rise in national income, and therefore economic growth. Further, the revenue raised by the ***RSPT will allow company tax rate cuts, to 29% from 2013-14*** which will improve Australia's competitiveness in global markets and lead to a greater demand for Australia's domestic goods and services, leading to an increase of income which will similarly lead through the multiplier effect to economic growth. However the passing of this legislation and its subsequent benefits remains unknown to the Australian public due to its controversial nature in parliament, emphasising the limitations of political constraints with the Senate delaying major policy initiatives possibly because it may be electorally unpopular. Also the influence of lobby groups such as the mining companies who have engaged in a successful campaign to increase negative public perceptions of the policy, have pressured the government to abandon it.

In 2010-11 federal budget, less stimulus was pumped in the economy in order to meet objectives by returning to surplus and repay govt. debt. With the Australian economy looking to recovery, concerns that capacity constraints and the absence of skilled labour will restrict economic growth are being targeted. With the Skills ***for Sustainable Growth package*** being implemented, skills shortages are thought to be relieved in the labour force in providing training places to boost workplace skills, address skills shortages through ongoing support for fundamental skills (literacy and numeracy) and increase productivity levels. Infrastructure spending such as the new ***$5.6b infrastructure fund with advancements in key road, rail and port networks***, will reduce infrastructure bottlenecks that prevent Australia from reaching its full export potential. Improved transport infrastructure enables businesses (particularly in the mining sector) to increase output to the consumers by increasing export volumes while the improved efficiency allows this to be done at a relatively lower price, improving productivity (increase in output for every input unit). The new transport infrastructure will increase the ability to distribute Australian exports overseas and thus improve the flow of international and domestic trade. This will lead higher incomes for exporters, and thus greater consumption, saving, tax and imports, contributing to an increase in national income and ultimately economic growth.

In targeting internal balance, in particular full employment, the government implemented aggressive labour market programmes in their policies in order to reduce the ***predicted unemployment rate of 8.5% in 2009*** and thousands of redundancies. The 2009-10 budget implemented the "***Jobs and training compact"*** aimed specifically at young workers and job losses during the GFC to allow them to re-enter the labour market and prevent frictional unemployment turning into structural unemployment. A large component of Australia's unemployment is structural due to lack of skills in workers due to a deficiency in modernisation. Thus in the 2010-11 budget, the government announced a ***"Skills for Sustainable growth***" strategy that involved creating a ***Critical Skills Investment fund to provide up to 39000 training places and a "Foundation Skills package".*** These skill packages are specifically aimed at building skills in infrastructure, renewable energy and transport sectors which are particularly booming in the Australian economy. Therefore an improvement of quality and quantity of resources will occur, allowing an outward movement of the production possibility curve leading to economic growth. Due to this expansionary macroeconomic policy, ***unemployment peaked at 5.8% in 2009 and is currently 5.1%,*** considerably lower than the predictions.

Australia's focus on sustainable environmental management was evident in the 2009-10 budget with plans to invest ***$4.5b over time into a Clean Energy Initiative*** to help transition to a low pollution, low emission economy. This initiative was designed to encourage innovation and investment in clean energy generation and low emission technology with a boost in employment in the clean energy industry. In the 2010-11 budget, the govt. announce the ***Clean Energy Initiative***

would receive an additional $650m worth of funding over the next four years. This would introduce ***Renewable Australia***, a four year program that will establish renewable technologies through research and infrastructure and ***Carbon Capture Storage Flagship programs (CSS) which is a nine year $2b program*** to support carbon capture for coal fired power stations using "clean coal" technology. The government's largest proposed initiative ***Carbon Pollution Reduction Scheme consisting of a carbon credits emission trading scheme*** however is being postponed with the future of Australia's environmental policy unclear.

Such postponements however can be sourced by the conflicting nature of environmental quality and economic growth as increases in economic activity leads to depletion of renewable and non-renewable resources with increasing externalities of pollution, land degradation and loss of biodiversity. Other limitations that hinder the effectiveness of fiscal policy are political constraints.

This can be particularly seen with the ETS that has been rejected by the senate twice thus making it difficult for the Australian government to implement ecologically sustainable fiscal policy. The slow nature of political processes can also lead to delaying the implementation of policies until awareness for this need has passed, as seen with the ETS which is supposedly to be re-introduced before 2013. Also due to the existence of close election cycles, governments may not implement policies which are electoral unpopular with less political incentive to pursue them due to their long term benefits and often immediate structural adjustment costs.