

# ECONOMICS

## Fiscal Policy in Australia (2010)

---

Governments of each country have a set of number of targets and goals established in order to improve the living standards and economic growth of their nation.

In Australia the government has five broad goals:

1. Internal balance – This refers to the achievement of full employment and price/external stability (low inflation)
2. Economic Growth – This means sustainable economic growth at a level that provides full employment and minimal inflation
3. External Balance – Refers to the stabilization of exchange rates and NFLs
4. Equitable Distribution of Income
5. Environmental Management

In order to achieve these goals, the government implements a range of policies such as Macro and Micro Economic Policies. A Macroeconomic policy is a government policy that aims to manipulate the aggregate demand of an economy in order to achieve economic stabilization. One example of a Macroeconomic Policy is Fiscal Policy which involves the government use of a Budget (annual statement of expected government expenditure and revenue for the forthcoming financial year, usually 'handed down' in Parliament in May each year) to affect the levels of economic activity, resource allocation and income distribution within the given nation. This is achieved through changes to government spending (G) and taxation (T).

Fiscal policy can be either structural or cyclical (discretionary or non-discretionary). Structural (discretionary) fiscal policy refers to deliberate changes that the government spending or taxation policies have on the budget outcome

CYCLICAL (non discretionary) fiscal policy is the application of built in stabilizers which reduce cyclical fluctuations automatically. Examples are progressive taxation and welfare payments.

There are three possible outcomes of the budget and each outcome leads to different effects on the economy for economic activity, resource allocation and income distribution.

The following table depicts the three possible outcomes and their effects on the economy:

Budget Outcome	This means the Government has undertaken...	Spending vs. Tax	This means...	Effects on Economy
<b>Balanced Budget</b>	No Stance.	$G=T$	Government revenue finances all of government spending and the budget balance is zero	None. The Government does not want Fiscal Policy to impact on the level of economic activity
<b>Budget Deficit</b>	Expansionary Stance	$G>T$	Government spending exceeds revenue and therefore the budget balance is negative	This means that the government is trying to stimulate the economy. Unemployment may be an issue hindering economic growth
<b>Budget Surplus</b>	Contractionary Stance	$G<T$	Government spending is less than revenue which means the budget balance is positive	The government may be trying to dampen the economy as inflation may be starting the rise and the economy is experiencing growth at an unsustainable rate

Effects of budgetary change on resource use  
Income distribution  
Economic Activity

If the budget is a deficit, the government will need to find ways in order to fund its debt. There are many ways to do this such as monetary financing (printing money), or borrowing from OS however, both these ways have adverse effects ( $\uparrow$ inflation,  $\uparrow$ CAD). Therefore, the Australian government uses debt financing through selling new Commonwealth Government Securities (CGS) as investments to the private sector. However, this too has a disadvantage that it creates public debt. (Deficit budgets over the last few years have raised the Public debt to \$90 billion – this is a stark contrast compared to the Howard Government’s Net Public Debt of zero in 2006)

On the other hand if the budget is in surplus, the government may choose to retire debt, accumulate surplus (to finance future expenditure) or repay foreign debt (to  $\downarrow$ CAD and servicing costs).

It is important to remember that the budget is merely an estimate therefore the actual outcomes for expenditure and revenue may differ from that originally budgeted. There are also numerous limitations to the budget outcome such as time lags, political constraints and \_\_\_\_.

In May 2010, Treasurer Wayne Swan delivered his third budget to the nation – a budget deficit of \$40.8bn. He labelled three key areas of concern as ‘the return to full capacity in a two speed economy, climate change and fiscal pressures of an aging population.’

1. **Objective:** Return to full capacity economy (Economic Growth + Internal Stability)  
Economic Growth –

The government forecasts a rebound of 3.25% economic growth rate in 2010-2011 and 4% in 2011-2012. This is based on current trends which indicate a strong recovery of the economy after the GFC. In the 2009-2010 Budget, the economy was expected to contract by 0.5% but in reality it grew by 1.4%. If this trend continues the projections by the treasury could prove to be accurate.

Treasurer Wayne Swan claims that the reason behind Australia's defiance of 'global economic gravity' was 'not by luck, but by choice'. It is largely due to apt government responses through Fiscal Stimulus Packages in 2009-2010 and a well supervised banking system. However, 'the surging ToT'(highest in 60 years) as well as growth underpinned by the Asian commodities boom are also key contributors to Australia's quick recovery from the GFC.

Unemployment – In the 2009-2010 budget, just after the shock of the GFC, unemployment was forecast to peak at 8.5%. Instead the unemployment rate in Australia peaked at 5.8% before it began to fall and it is currently continuing it's decent. The current unemployment rate is at 5.3% and is predicted to fall to 4% by mid 2012.

**Action:** In order to boost the strategy along and deal with a skills shortage hindering the growth of the economy and increasing wage and price pressures, the government has implemented a 'Skills for Sustainable Growth Strategy'. This strategy involves an injection of \$661 million into our workforce to ensure the flexibility of our training systems and thus creating 70000 new training places for apprentices over the next 4 years.

Investment in Infrastructure will also subsequent the achievement of this goal with government spending \$5.6billion into the industry over the next decade including an intermodal terminal in Moorebank (Sydney) and the possibility of a National infrastructure pipeline.

**Effect:** Here, the government is stimulating the economy (expansionary stance) in order to achieve full employment sooner. Increased government expenditure leads to more jobs and thus if the government's plan goes to completion, it is possible that the forecasted 4% economic growth rate is once again achieved in 2011-2012 (3 years ahead of schedule)

2. **Objective: 'Climate Change' (Environmental Sustainability)**

**Action:** Government has invested \$662 million dollars into a renewable energy fund. However this has been offset by cuts to the funding of ethanol initiatives and the 'Green Car Scheme' due to lower interest than expected. 200million will be cut from this scheme from the originally 1 billion + initiative.

**Effect:** Economic Growth and Environmental sustainability are incompatible goals. Therefore, in order to increase one, the other must be reduced. In the case of this budget, an aim to stimulate the economy and increase revenue to bring the budget back into surplus as soon as possible has caused a depletion in environmental sustainability funding. Whilst it seems that the government is increasing spending on renewable energy funding, this spending has been offset by cuts to the same sector thus keeping the budgetary stance neutral.

3. **Objective:** “Fiscal pressures of an aging population” (Redistribution of income and wealth; Superannuation/Funds)

The government has undertaken a redistributive role by introducing taxes aiming to ‘offset every dollar of spending’.

**Action:** Taxation allows for ...one sector into another. Under the Henry Tax Review, the government has introduced a Resource Tax Super Fund which will be in place from 1<sup>st</sup> July 2012. This tax aims to ‘reduce the tax burden on less profitable resource projects and projects in their early stages, supporting greater resources sector investment and more production.’ The revenue collected from this initiative will be used to fund a variety of projects such as company tax cut to 28% by 2014/2015.

The government has also decided to increase taxation on drugs and tobacco introducing the Pharmaceutical Benefits Scheme which is set to deliver an \$2.5 billion dollar increase in revenue over the next five years from 2010-2011.

This increased revenue will be used to create electrical patient databases as well as after hour doctor services.

**Effect:** The introduction of the Resources Super Profits Tax and Pharmaceutical Benefits Scheme etc. have lead to a reallocation of funds from one sector to another. This aims to see a more balanced and economically equitable Australia.

Goal	Budget Response	Implicated Effect
Internal Balance (↓ unemployment, ↓ inflation rate)	Investing \$661million into workforce thus providing 70000 new apprenticeship training placements - Investing \$5.6 billion dollars over the next decade into Infrastructure	Expansionary. Promotes more for more jobs and thus economic growth. (see below)
Economic Growth	Stimulus package of 2009-2010	2009-2010 budget initiatives of stimulus packages has so far proved successful reducing the deficit from a relatively unchanged 57bn to 40.8bn  Aims to return to surplus by 2013-2014 (3years ahead of schedule) Forecast real GDP of 3.25% in 2010/2011 and 4% in 2012 ;
External Balance	Aims to transform Australia into a financial services power house by adding to the \$1.7trillion in funds under management. Impediments to international investment removed. 2009-2010 budget has reduced NFD from ? to 92 billion.	Attracting more international investors to fund the deficit

Equitable distribution of income and wealth	Henry Tax Revue - Reallocation of funds from mining sector into companies to give businesses a chance to rebound from the recent GFC - Taxation and cuts such as Pharmaceutical Scheme and new tobacco taxes in order to fund developments to Healthcare system (eg. electronic patient records etc)	Income will be more easily spread over various sectors. Advantages to small businesses
Environmental Sustainability	Investing \$652million into a Renewable Energy Fund as part of a \$5.1billion Clean Energy Initiative - On the other hand government is also cutting 200million from 1billion+ Green Car Scheme after receiving less interest than expected. Also tax cuts to ethanol fund.	Keeps budget in neutral stance due to offsetting of spending.

Judging from the budget outlines above, it would be safe to conclude that the fiscal policy in 2010-2011 holds a neutral-slightly expansionary stance. Although the government is implementing a range of strategies in order to bring the economy back into surplus, 'each dollar of spending' has roughly been offset by equivalent increases to taxation or reduction of project funding. The government has also enforced a 2% cap on spending which helps to keep it in the neutral stance.