

Q26

Fiscal policy is one of the two Australian Government's (govt) macroeconomic policy. It is the use of the Commonwealth's govt's budget, in order to achieve ~~see~~ the economic objectives, especially ~~even~~ the promotion of economic growth, redistribution of income & to assist external stability. The Federal govt does this by ~~about~~ making changes in its spending & revenue collection which either directly or indirectly impacts on ~~these~~ these economic objectives.

The promotion of economic growth can be said to be the major aim of the fiscal policy. Economic growth is an increase in ~~re~~ real GDP over time, and is a quantitative concept since it involves increased productive capacity, leading to rising levels of national income, output & living standards. ~~about~~ The ~~govt~~ ~~ties~~ With fiscal policy, the govt has an option

of ~~the~~ fiscal ~~budget~~ deficit, $\&$ surplus or neutral, which are design to either contract or expand the economy. This is because the govt ~~a~~ tries to achieve sustainable economic growth, which is compatible with long term preservation of environment $\&$ resources.

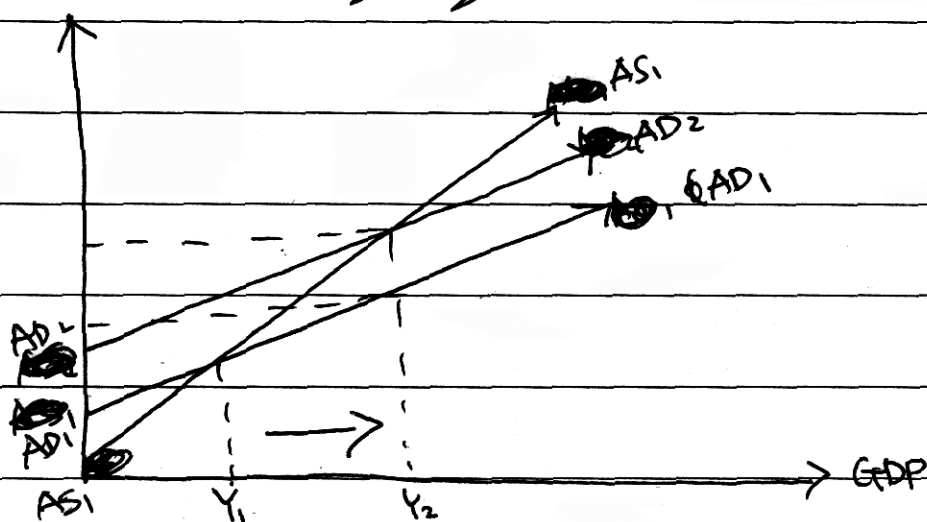
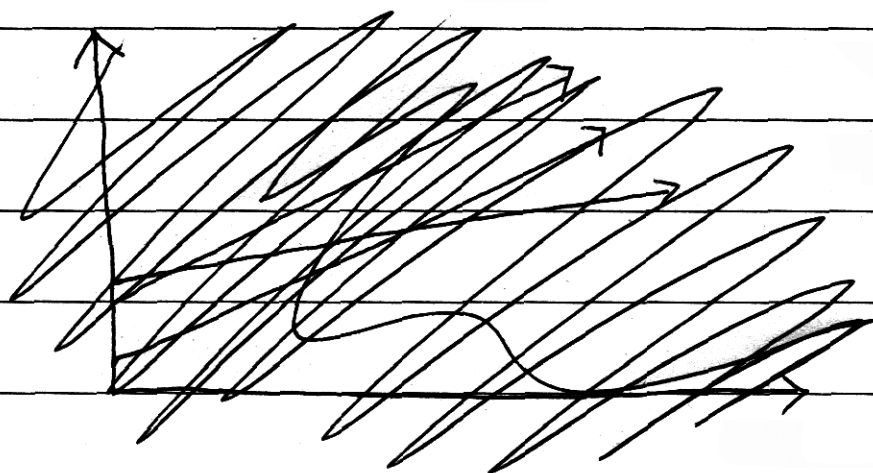
~~The~~ Thus, the govt contracts the economy if the economic growth reaches the level at which is not sustainable, and vice versa.

Fiscal outcomes - fiscal $\&$ deficit, fiscal surplus or $\&$ neutral stance - can be altered by ~~chang~~ making changes in govt spending or revenue collection.

For example, $\&$ the fiscal deficit budget outcome is where ~~the~~ $\&$ govt expenditure is greater than the govt revenue, $\&$ the fiscal surplus is where govt expenditure is less than the govt revenue. With these fiscal outcomes, the govt ~~can~~ can either contract or expand the economy. The expansionary fiscal policy is where govt ~~adds~~

increases its budget deficit, or reduces its budget surplus, or changing from budget surplus to deficit. As it can be seen from the "Reserve Bank Bulletin, January 2002", although the govt is maintaining ~~both~~ surplus from 1998 to 2001, ~~the~~ the level of budget ~~has~~ surplus has gone ~~up~~ down between 1999-2000 to 2000-2001. This reduced surplus has an expansionary effect on the level of economic activity, and thus, promotes economic growth. ~~The way how the govt~~

If the govt wishes to contract the economy then it will do the opposite. The way how the govt's use of budget can impact on the economic growth can be illustrated in the Keynesian diagram.



As seen from above diagram, the ~~govt~~ fiscal policy aims to ~~pro~~ promote economic growth by affecting the demand side of the economy.

If govt increases its spending, the Aggregate demand rises from AD_1 to AD_2 , ~~causing~~ causing the GDP to rise from Y_1 to Y_2 .

Since ~~the~~ ~~the~~ the economic growth is measured by the GDP, there is an increase in the level of economic growth. How much the economy grows by

is dependent on its level of multiplier process.

When the ~~govt~~ govt wishes to contract the economy, it can be illustrated as opposite to above diagram, with decrease in Aggregate demand causing GDP to decrease.

The ~~use~~ altering of govt's budget depends on the two factors: discretionary & non-discretionary. Discretionary decision is

when the govt deliberately changes the ~~ex~~ spending or ~~to~~ revenue to influence the economic growth.

However, non-discretionary fiscal policy occurs when the ~~e~~ level of economic itself changes the govt's budget. These are called automatic ~~st~~ stabilisers.

For example, if the ~~econ~~ economy is experiencing ~~high~~ a severe downturn, there is an automatic increase in govt expenditure because of the "unemployment benefits." This then

automatically has an expansionary ~~policy~~ impact

on the level of economic activity, & thus

promoting economic growth. On the other hand, progressive taxation system has opposite effect.

The govt's fiscal policy can also ensure that the economy is ~~having~~ achieving sustainable economic growth by altering its ~~spend~~ ~~spen~~ budget. For example, if the govt ~~uses~~ raises taxation on ~~the~~ the use of certain resources, then it ~~can~~ can discourage producers to use those resources, and thus can prevent them from ~~de~~ depletion & encourages more efficient allocation of resources.

As evident from "Reserve Bank Bulletin", the govt has implemented ~~the~~ expansionary fiscal policy from 1999-2000 to 2000-2001 & also in 2001-2002, in which it had \$1.8bn deficit budget. This has ~~encouraged~~ boosted the level of Australia's economic

growth, allowing ~~is~~ Aus to achieve 4.2% rate of economic growth, which is very strong, in comparison to weakening world economic conditions, as discussed in "Statement on Monetary Policy". To prevent the economic growth ~~to~~ from going over ~~the~~ its sustainable rate, the govt has adopted budget surplus in 2002-2003, with aim of contracting the economy.

The fiscal policy, ~~is~~ the use of federal govt's budget can also used to ~~to~~ affect the distribution of income. Although achieving more equitable distribution of income is not a very high priority of govt's budget ~~in~~ in 2002/03, ~~the~~ it generally aims to ~~achieve~~ reduce inequality in the ~~res~~ distribution of income. The govt, through fiscal policy, does this by redistributing income away from high income earners to low income ~~earners~~ earners.

The main tool which ~~are~~ achieves this is the

govt's progressive taxation system. This is where ~~the~~ the higher the income, the higher the tax it should pay. Also, if the govt raises ~~the~~ tax on income, which is PAYE a progressive taxation system, it can achieve more - equitable distribution of income, as high income earners must pay even higher taxes. Also, the tax free threshold ensures that low income earners are not disadvantaged. Under tax-free threshold, the first \$6000 is not taxed.

However, while govt's increase in progressive taxation can help in achieving more equitable distribution of income, its increase in regressive taxation may have an adverse effect. For example, if the govt increases the GST, then the ~~low~~ it will increase the income inequality, as low income earners & high income earners pay the same price, but the

proportion of their payment from their total income differ. Thus, ~~as discussed, the~~
~~govt's use of its budget~~ ~~by~~ ~~altering~~
~~its spend~~. Govt's spending also influences
the redistribution of income. If the
govt increases its ~~to~~ spending on welfare
& social security & unemployment benefits,
& if these are provided by the taxes paid
by high-income earners, then a more
equitable distribution may be achieved. Thus,
as discussed, the ~~of~~ fiscal policy, which is
the use of gov'ts budget ~~can~~ can influence
the redistribution of income.

The Govt's fiscal policy also attempts to
assist external stability. However, out of
many issues arising with external stability,
such as foreign debt, fluctuations in
\$A and many more, the fiscal policy
particularly tries to address the issue of

current account deficit, ^{(CAD) & foreign debt} which has been Aus' ~~one~~ one of ~~the~~ the most significant problems. One of the reasons why Aus has ongoing ~~the~~ CAD is because of low national saving levels, which can be directly affected by the govt's fiscal policy.

When govt is implementing deficit budget, it needs ~~to~~ to finance the money deficit from somewhere. In Australia's case, the govt mainly borrows from the private ~~sect~~ domestic sector, as it involves less risk than borrowing from overseas. However, ~~if~~ if the govt borrows large amount of money from the national saving pool, there are ~~a~~ not adequate money available for private sectors to borrow.

This ~~causes~~ causes greater borrowing of private sector from overseas & thus increases Aus' ~~for~~ foreign debt. This is called "crowding out" effect. This increased foreign debt tends to deteriorate the ~~the~~ Aus'

CAD ~~became~~ due to the "debt-trap-scenario".

Therefore, the ^{govt's fiscal policy} ~~govt~~, to ~~to~~ achieve external stability, has an aim of achieving a fiscal balance over the ~~econ~~ economic cycle. This means ~~for~~ for ~~an~~ one economic cycle, the govt tries to even out its spending ~~&~~ with its expenditure, so that there are not ~~any~~ any adverse effects caused by its large deficit budget, after all. When govt is having surplus budget, it uses the surplus money to pay back the foreign debt caused by "crowding out" effect ~~&~~ ~~that~~ also the debts to private domestic sector. By this way, the govt tries to achieve ~~econ~~ fiscal balance over the course of economic cycle.

Additionally, the govt controls the level of economic growth by fiscal policy to assist external stability. Since ~~CAD is~~

~~"speed limit" on the level~~

strong economic growth, associated with rising consumption ~~for~~ for foreign exports, leads to \uparrow CAD, and thus pose a risk to the external stability of the Australian economy, the govt uses ~~at~~ the fiscal policy to control economic growth $\&$ thus external stability.

As discussed above, the ~~govts~~ ~~fixe~~ Federal govt's fiscal policy, which involves the use of govt's budget, can promote economic growth, redistribute income $\&$ assist external stability.