ECONOMICS

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Contents

1 Nature and Operation of Budgetary Policy

1.1 Definition

Budgetary policy (Also known as Fiscal Policy) refers to the manipulation of the level and composition of Federal Government receipts and outlays in order to assist in the achievement of its economic and social goals for Australia. It is released annually each May and contains estimates or projections of all income and expenditure of the Government into the future. Though introduced in May, new measures or 'mini budgets' can be taken by the Government.

1.2 Objectives

The goal of all policies is to improve the welfare or living standards of all Australians and to achieve the most efficient allocation of the nation's resources.

This is achieved by:

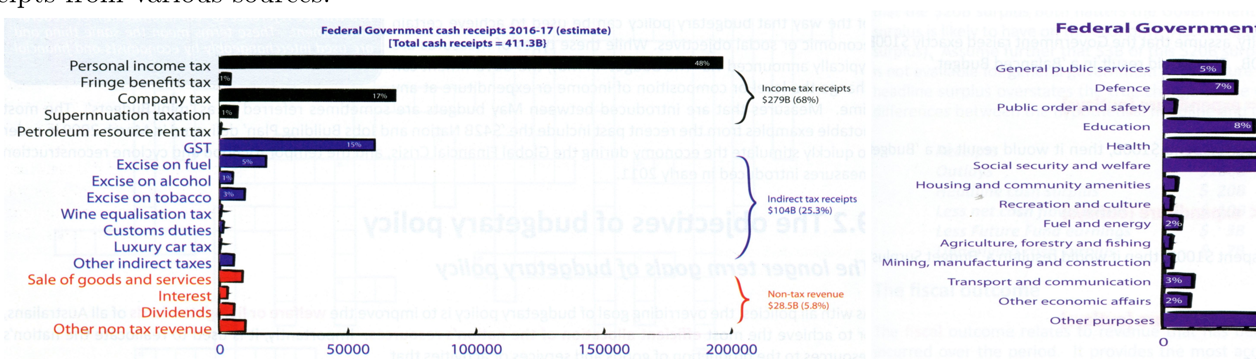
- Strong and sustainable economic growth
- Low inflation
- Full Employment

This is clearly articulated in Government lesgilation (Charter of Budget Honesty Act 1998)

> The Government's fiscal policy is to be directed at maintaining the on-going economic prosperity and welfare of the people of Australia and is therefore to be set in a sustainable medium-term framework.

1.3 Composition of Revenue and Expenses

The Federal Government collects approximately $411 billion per annum in receipts from various sources.



1.4 Budget Outcomes

The Budget can have three possible outcomes:

$$\text{Budget Balance} = \text{Income(receipts)} = \text{Expenditure(outlays)}$$
$$\text{Budget Deficit} = \text{Income} < \text{Expenditure}$$
$$\text{Budget Surplus} = \text{Income} > \text{Expenditure}$$

There are also several ways the Commonwealth Government will report these outcomes.

1.4.1 Headline Cash Outcome

This is the total cash received by the Federal Government subtracted by the total cash paid. This can be misleading as it includes cash flows that do not directly impact on the economy.

1.4.2 Underlying Cash Outcome

This is the total cash received by the Federal Government subtracted by the total cash paid. This can be misleading as it includes cash flows that do not directly impact on the economy.

Future Fund Earnings - interest and dividends earned by government owned 'Future fund'. Excluded as earnings are mandated to be reinvested.

IFAAP - Investments in financial assets for policy purposes; including sale of government business enterprise (GBE), purchases of shares by the government or granting or repaying State Government debt. Excluded as does not directly add to economic activity

To illustrate (using hypothetical figures):

Total Cash Receipts	110
Total Cash Payments	100
less Future Fund earnings	3
Underlying Cash Balance	7
Net Cash flows from investments in financial assets for policy purposes	10
plus Future Fund earnings	3
Headline Cash Balance	20

1.5 TODO Automatic and Discretionary Stabilisers

Stabilisers - help to dampen the severity of booms and recessions in the business cycles.

2 types:

- discretionary
- autmoatic

Discretionary fiscal / budgetary policy determined by the government as per the annual budget

- Automatic

  in a boom rising AD → higher employment, incomes and profits

  - Government tax revenues increases and welfare spending decreases
  - Fiscal system is automatically becoming contractionary

  in a recession falling AD → higher unemployment, lower incomes and profits.

  - Government tax revenues decreases and welfare payments increases
  - Fiscal situation is automatically becoming expansionary

Discretionary stabilisers are used when the automatic stabiliser are not enough to correct a server boom or recession.

1.6 Fiscal Drag / Bracket Creep

This occurs during times of inflation for countries with a progressive tax system. When inflation occurs there is a decrease in the real wage and workers will demand an increase in nominal wage to keep up with inflatiion.

When the nominal wage increases, some workers are pushed into a higher marginal tax bracket which increases the 'average' rate of tax paid.

These have two effects:

- Increases the total personal income tax revenue received by the Federeal Government.
- Some taxpayers will experience a decline in their real disposable income because they will be paying a higher average rate of tax.

1.7 TODO Actual and Estimated Budget Outcomes

The Department of Treasury releases the 'actual' budget figures for the previous financial year in September or October (16 months after the release of the budget).

Estimated budget outcome released in May

Actual budget outcome released in September or October

The estimated budget outcome heavily relies on forecasts for economic growth and other statistic which are never 100% accurate.

1.8 TODO Expansionary v. Contractionary Budgets

1.8.1 Budget Deficit $R < E$

Expansionary $\rightarrow$ Rise in AD which impacts on production, employment and inflation

The gap is financed by government borrowing:

1. Borrow from public and financial sector by sale of bonds
2. Borrow from the RBA
3. Overseas borrowings

1.8.2 Budget Surplus $R > E$

Contractionary $\rightarrow$ Fall in AD

Use of surplus:

1. Save with RBA
2. Place in special investment or savings fund
3. Repay local and foreign debt

1.9 TODO Financing a Deficit / Investing a Surplus

1.9.1 Problems with a expansionary budget deficit

1.9.2 Dealing witha budget surplus

1.9.3 Fiscal consolidation and the rationale for delivering a budget surplus

- Help buffer Austraia against future economic decline as surplus funds can be saved and then spent.
- Helps to generate greater international investor confidence in Australian government finances preserving Australia's AAA credit rating.
- Allows the cyclical component of the budget to do its job of automatically reducing the deficit as the economy recovers.
- Allows monetary policy to better manage the economy.

1.10 TODO Budget and Economic Goals

1.10.1 Stablising the business cycle

1.10.2 Changing role of Budgetary Policy

1.10.3 Budgetary policy and low inflation

1.10.4 Budgetary policy and strong and sustainable growth

1.10.5 Budgetary policy and ull employment

1.11 TODO Budgetary Policy and Living Standards

1.12 Strengths and weaknesses of Budgetary Policy

1.12.1 Strengths

- Target particular sectors
- Greater range of economic goals
- Impact lag
- Effictively stimulating AD
- Effect through automatic stabilisers
- Checks and balances

1.12.2 Weakness

- Political hurdles
- Political bias
- Imlementation lag
- Inflexible
- Less effective at restricting AD during a boom

2 Budgetary policy in Action

2.1 Recent use of the budget

2.2 Evaluating the effectiveness of budgetary policy

2.3 Specific budgetary policy initiatives

2.4 Budget Examples

2.4.1 Growth

2.4.2 Unemployement

1. Youth Employment Packages
2. Skilling Australians Fund

2.4.3 Inflation

3 TODO Monetary Policy

Relies on changing the level of interest rates to alter the cost, demand and availability of credit. It has fast impact and does not require the involvement of parliament.

3.1 Role of RBA:

- banker to the government, banks, and NBFIs (Non-bank Financial Institute)
- Issues notes and coins
- custodian of overseas currency reserves

Priority is low inflation; as it is a precondition to achieving consumer and business confidence.

RBA board meets monthly on Tuesday (except January), and considers the following economic data:

- Quarterly trends in headline CPI
- Spending levels (C), (I)
  - Building approvals
  - Household debt
- Unemployment rate
  - Job vaccancies
  - Participation
- Overseas markets
- Government budgetary stance.

Monetary Policy works in a counter cylical pattern.

3.2 Definition

This medium term objective is 'stability of the currency', which the RBA currently defines as price stability, where consumer price inflation is kept between 2 and 3 per cent, on average, over time.

The RBA will only be concerned if inflation is outside the range for a 'sustained' period. Once low inflation is achieved, the RBA can then focus on policy decisions that assist in the attainment.

3.3 Objectives

3.4 Implementation

3.5 Cash rate and Open Market Operations

3.6 Monetary Policy Tightening / Loosening

3.7 Monetary Policy Settings

3.8 Tranmission Mechanism

3.9 Exchange rate intervention

3.10 Strengths and weeknesses of Monetary Policy

3.10.1 Strengths

- Free from political bias
- Short Implementation lag
- Powerful influence on consumers, investors, borrowers or lenders
- Good at restraining AD as policy reduces discretionary income of indebted households.

3.10.2 Weaknesses

- Is one dimensional and unable to concentrate its affect on a speicific area
- Full impact can take up to two years (Impact lag)
- RBA does not have direct control over interest rates. This could mean financial insitutions won't pass on 'in full' the reductions in the cash rate.
- A reduction in interest rates may not immediately increase AD because consumers are not forced to spend any increase in discretionary income.
- Policy becomes less effectve as levels of private sector indebtedness increase to high levels.
- Policy cannot directly reduce inflationary pressures that are generated from the supply side of the economy (cost inflation). This will instead only ignite demand inflationary pressures, worsening inflation overall.

4 TODO Monetary Policy in Action

4.1 Price Stability

4.2 Stronger Economic Growth and Employment

4.3 Stabilisation of the Business Cycle

4.4 Living Standards

4.5 Specific Policy Changes Over the Cycle