Tax 101 Activity 4: The budget -Taxes and spending

Years 11-12

TASK 2 BUDGETARY POLICY

Worksheet

Focus: Economics
Opportunities: Mathematics

YOU WILL:

- represent and interpret data and diagrams relating to budgetary policy and macroeconomic objectives
- apply economic theory to explain how a government can address an economic problem
- explain the impact of fiscal policy on the economy
- analyse the federal budget to identify discretionary policies to increase AD
- analyse recent trends in Australia's macroeconomic conditions
- predict the impact of different scenarios or policies on aggregate demand

YOU WILL NEED:

- *Fact sheet: The budget – Taxes and spending*
- A calculator or spreadsheet
- Graph paper or graphing software (Excel, Geogebra, Desmos, etc)
- The most recent Federal budget

INTERPRET DATA

Read Fact Sheet: The budget – taxes and spending

1. What are the three main sources of federal government budget revenue?
2. What are the three most important areas of federal government budget outlays?

Some facts

The two main instruments of budgetary policy (or fiscal policy) are government spending and government taxation. There are three possible outcomes from a budget:

- Balanced – Government spending = Taxation revenue
- Deficit – Government spending > Taxation revenue
- Surplus – Government spending < Taxation revenue.

Governments use fiscal policy to influence the level of aggregate demand in the economy to boost or slow economic growth.

Aggregate demand (AD) is the total level of expenditure in an economy over a certain period of time. These are injections in the economy and include consumption, investment, government spending and net exports (exports – imports).

$AD = C + I + G = (X – M)$

Where:

AD = aggregate demand
C = consumption
I = investment
G = government spending
X = export revenue
M = spending on imports

The intended macroeconomic impact of the budget outcome on the direction of AD ($C + I + G + X – M$) is known as the budget stance. Budgetary policy can be used to reduce the severity of booms and recessions that are typical of the normal business cycle. In a slowdown of economic activity, characterised by weaker growth and higher unemployment, the budget can be used to boost AD. During an upswing in economic activity, the budget can be used to slow the growth in AD to a sustainable rate.

There are three budget stances:

1. Neutral stance: Usually undertaken when an economy is in equilibrium. In this instance, government spending is fully funded by tax revenue, which has a neutral effect on the level of economic activity.
2. Expansionary stance: Usually undertaken to increase the level of economic activity in an economy. This is achieved by decreasing tax revenue and/or increasing government expenditure. Expansionary fiscal policy creates either a smaller surplus or a larger deficit than the previous year.
3. Contractionary stance: Undertaken to decrease the level of economic activity in an economy. This is achieved by increasing tax revenue and/or decreasing government expenditure. Contractionary fiscal policy creates either a smaller deficit or a bigger surplus than the previous year.

Data

Figure 1: Aggregate demand-supply diagram showing cyclical instability in economic activity

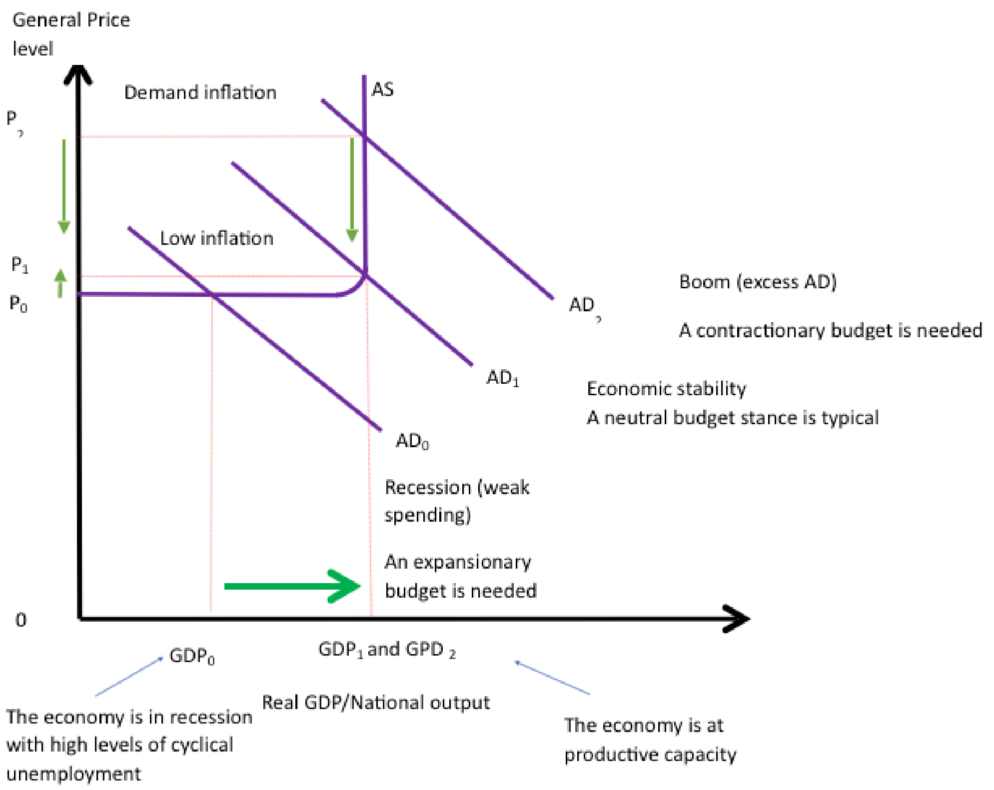


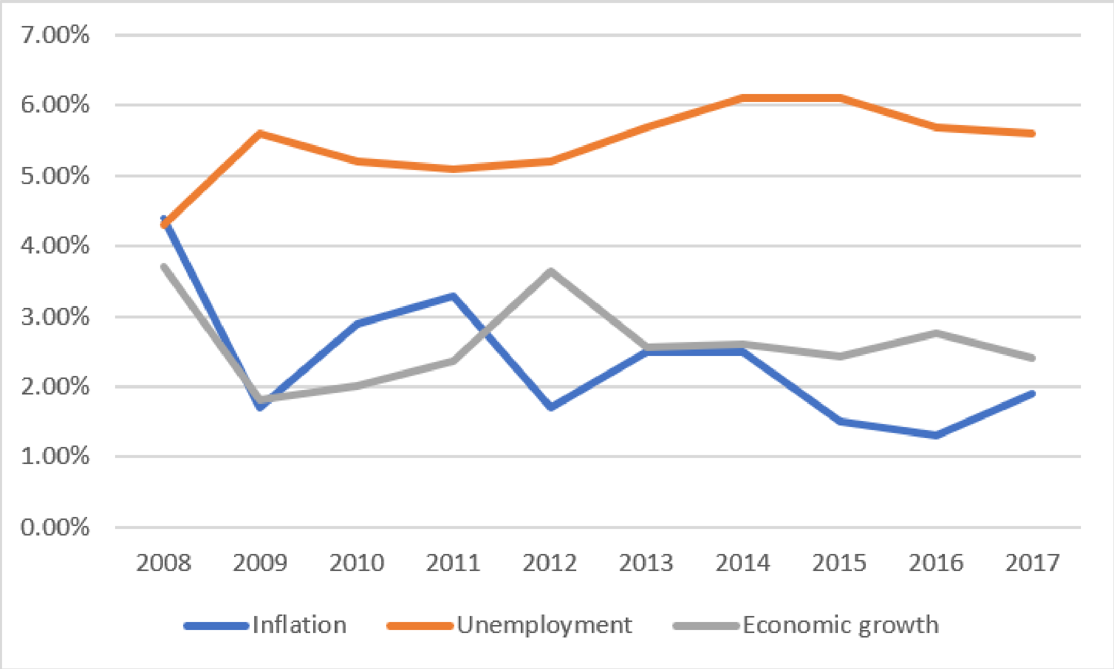
Table 1: Australian Government accrual revenue, expenses and fiscal balance

Fiscal Year	Fiscal revenue	Fiscal expenses	Fiscal balance
2007-08	303,402	279,862	20,948
2008-09	298,508	324,188	-29,743
2009-10	292,387	339,829	-53,875
2010-11	309,204	355,667	-51,760
2011-12	337,324	377,220	-44,746
2012-13	359,496	381,980	-23,472
2013-14	374,151	414,047	-43,746
2014-15	380,746	417,898	-39,857
2015-16 (e)	396,396	431,470	-39,429
2016-17 (e)	416,862	450,553	-37,129
2017-18 (e)	449,524	464,812	-18,675
2018-19 (p)	484,370	489,324	-9,839
2019-20 (p)	515,062	511,604	-2,059

(e) Estimates
(p) Projections.

Source: Budget.gov.au. (2017). Budget Paper No. 1: Budget Strategy & Outlook

Figure 2: Indicators of Australia's macroeconomic conditions 2008-2017



Source: ABS 6202.0 - Labour Force, Australia, Aug 2017; 5206.0 - Australian National Accounts: National Income, Expenditure and Product; Reserve Bank of Australia Inflation calculator (Calendar year)

REPRESENT AND ANALYSE DATA

3. Using Figure 1, explain how the budget stance can be used to reduce cyclical instability in economic activity (vis a vis spending (AD), economic activity (GDP) and inflation (P)).
4. Predict the impact of each stance on the budget outcome.
5. Using the statistics in Table 1, construct a bar graph showing the budget outcomes for the ten-year period between 2007-08 and 2016-17.
6. Identify the years in which:
   a. The budget was in surplus
   b. The budget was in deficit
7. Label your graph to show the years in which a contractionary stance and expansionary stance were undertaken.
8. Draw a five-sector circular flow model and predict the intended macroeconomic impact of the budget surplus and deficit on the direction of AD (C+ I + G + X – M).
9. Use Figure 2 to describe the trends in economic growth, unemployment and inflation over the past 10 years.
10. Drawing on data from Table 1, Figure 2 and your own graph, describe the trends in economic conditions and changes in the budget policy stance adopted between each of the following periods:
    a. ï 2008-2010
    b. ï 2012-2014.
11. Explain the likely causes of large budget deficits in recent years.
12. Describe the economic conditions in Australia's economy in 2015-16 and 2016-17.
13. Overall, has fiscal policy been expansionary or contractionary during these two years? Why has this been the case?
14. Below is an excerpt from the 2016-17 budget. Identify and explain two reasons why a return to a budget surplus in the medium term could be desirable.

Return to balance in 2020-21

The projected return to balance in 2020-21 and continuing projected surpluses over the medium term will enable a reduction in debt. This will place Australia in a better position to withstand any future economic downturns. It will reduce the need to increase taxes or cut back on essential services if there comes a time when Government action is needed to support economic activity.

By living within its means the Government will not burden future generations with debt from today's everyday spending. From 2018-19, debt will not be required to fund recurrent spending for the first time since the GFC. This will make Australia stronger and more resilient to the shocks that may come its way.

http://budget.gov.au/2017-18/content/glossies/means/download/Budget2017-18-Balancing-the-budget.pdf

MAKE PREDICTIONS

15. Download the most recent federal budget at www.budget.gov.au. Identify 5 key initiatives outlined in the budget. For each of these initiatives, explain and analyse their likely impact on the economic goals of strong and sustainable growth, full employment and low inflation. The first initiative (2017-18) has been provided as an example.

	Predicted impact on economic goals		
Initiatives	Strong and sustainable economic growth	Full employment	Low inflation
Lower rate of company tax for all business to 25%.	Will encourage firms to contribute to increasing national output by inducing businesses to invest in new plant, equipment and technology. An increase in productive capacity will increase aggregate supply and in turn lead to strong, sustainable economic growth	Will encourage firms to contribute to increasing national output by inducing businesses to invest in new plant, equipment and technology. An increase in productive capacity will increase aggregate supply and in turn lead to strong, sustainable economic growth	Lower company tax rates allow firms to gain stronger after-tax profits. They can sell more competitively at a lower price. Furthermore, with better profits, firms are more able to afford new technology, boosting their technical efficiency and suppressing cost inflation pressures.