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The Role of Government in Australia

Multiple Choice Answers

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|---|---|----|---|----|---|
| 1 | A | 6 | A | 11 | C |
| 2 | D | 7 | A | 12 | B |
| 3 | B | 8 | C | 13 | A |
| 4 | C | 9 | C | 14 | B |
| 5 | C | 10 | A | 15 | D |

Short Answer Questions

Question 1

- (a) A direct tax must be paid by the person on whom it is imposed, whereas an indirect tax is imposed on a good or service and can be passed onto another person.
- (b) Personal income tax is a progressive tax which taxes higher income levels at a higher marginal rate of tax than lower income earners. The goods and services tax is a regressive tax which is levied at a flat 10 per cent of the price of a good or service. This will be a higher proportion of a lower income earner's income than a higher income earner's income.
- (c) A tax on luxury goods would raise the price of luxury goods in the economy. The higher price would cause a contraction in demand, lowering the total consumption of luxury goods. As overall consumption falls, the proportion of each additional dollar which is spent on consumption will fall slightly, lowering the marginal propensity to consume.
- (d) The Commonwealth government has responsibility for the national economy in general. It collects the most tax revenue, mainly from income tax, company tax and taxes on goods and services. It is responsible for national government expenditure such as defence, education and welfare. In addition it usually jointly funds areas of state expenditure. State governments have a more limited role, and collect fewer taxes. States have a major role in infrastructure expenditure and regional projects.

Question 2

- (a) Macroeconomic policy aims to smooth the fluctuations in the business cycle and raise the long term rate of sustainable economic growth.

- (b)** If there was an upswing in the business cycle, monetary policy would try to lower economic activity to counteract the boom. The Reserve Bank of Australia would tighten monetary policy by raising interest rates. This would reduce consumption and investment in the economy, lowering the level of economic activity. As a result, the increase in economic growth will be lower than it would have been without the change in monetary policy.
- (c)** The government might first try to use its tax and spending powers to change consumer and business behaviour. If the government wanted to discourage the production of a certain product it might tax the good, raising the price and contracting demand, lowering consumption and giving firms less of an incentive to produce the product. The government could also try to subsidise alternative products to lower their price and encourage consumers to switch their consumption. If the government wanted to encourage the production of a product the government might intervene and directly provide the good or service. Examples include the provision of health care and public schools.

Question 3

- (a)** The government uses competition policy to maximise the amount of workable competition in the economy. It achieves this by ensuring that markets are contestable and by banning uncompetitive business practises.
- (b)** Consumer protection is achieved by banning business practises which harm consumers. The Trade Practises Act 1974 (Cth) prohibits uncompetitive business practises which harm consumers, and the Australian Competition and Consumer Commission (ACCC) acts as the government regulator to enforce the legislation.
- (c)** Higher levels of competition will generally encourage firms to increase their efficiency of production. As competition levels increase, firms must compete against each other for a limited market share. To increase their market share and output firms can either lower their prices or increase the quality of their product. In order to maintain a competitive price, firms are forced to lower business costs by increasing their efficiency of production.
- (d)** The use of a proportional tax regime encourages businesses to make profits. If the government were to use a progressive company tax, it would discourage businesses from making large profits since the entrepreneurs would receive lower profit levels. Whereas if company tax were regressive, it would penalise businesses when profits were low. The use of proportional tax means that whatever the profit level, the tax paid is at the same rate, and so the tax system does not distort the profitability of the business.