

# 17

# Government in Action

## Multiple Choice Answers

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

## Short Answer Questions

### Question 1

- (a) The budget is a statement of a government's planned revenue and expenditure for the upcoming fiscal year. It is the main instrument of fiscal policy.
- (b) A correct answer may include any one of the following:
- The government can adopt a contractionary budget stance to lower economic activity if economic growth is too high, or the government might adopt an expansionary budget stance to boost economic activity if economic growth is too low.
  - The government can influence the allocation of resources by taxing goods which it wishes to discourage. Higher prices would lower demand and lower production. The government could also subsidise goods it wishes to encourage, lowering the price and increasing production. The government could also provide the good or service itself.
  - The government could influence the distribution of income by adopting a progressive income tax system, and social welfare policies. The more progressive the tax system, and the more expansive the welfare system, the more equal the distribution of income. The more regressive the tax system, and the more restrictive the welfare system, the less equal the distribution of income.
  - The government might seek to increase the productive capacity of the economy by spending on infrastructure projects in the economy, increasing the level of social overhead capital.
- (c) Welfare agencies lobby for the interests of the socially disadvantaged in society. A welfare agency might lobby for an increase in welfare benefits to those who are unable to work and participate in the production process. A welfare agency might also lobby the government for an income tax system which is highly progressive, charging lowering income earners very little tax, and higher income earners the highest rates. The income received from higher income earners can then be used to fund higher welfare spending. A welfare agency might also lobby the government the implement retraining programs and subsidised education to help the long-term unemployed increase their skills and find employment.

- (d) Automatic stabilisers counteract changes in the business cycle to achieve a more sustainable rate of economic growth. As economic activity rises, individuals begin to earn higher incomes and move to higher marginal rates of tax. The progressive income tax system begins to tax individuals at a higher proportion, dampening the growth in disposable incomes. Government revenue rises. As unemployment levels, unemployment benefits fall, lowering government expenditure. The budget changes to a contractionary stance, dampening economic activity. Conversely, when economy activity falls, individuals begin to earn lower incomes, however they move to lower marginal rates of tax, which boosts disposable income and lowers government revenue. As unemployment rises, unemployment benefits rise, increasing government expenditure, and unemployed still gain an income. Overall the budget moves to an expansionary stance, increasing economic activity and offsetting the fall in the business cycle.

### Question 2

- (a) Non-tax sources of revenue include income from government businesses and fees for service charged by government agencies and departments.
- (b) The government could increase taxation levels, for example by raising personal income tax rates, company tax rates, or taxes on goods and services. The government could also lower government expenditure, lowering spending on welfare, education, health, defence or infrastructure.
- (c) Business groups might oppose an increase in customs duty. Australian imports a high volume of capital goods, and higher customs duty would increase the price of inputs into the production process, increasing costs for business.
- (d) Expansionary fiscal policy would first increase economic growth. Lower taxation levels would increase disposable incomes in the economy, which would increase consumption and investment, raising economic activity and production levels in the economy. Higher government spending would increase the productive capacity of the economy and directly increase production levels in the economy. Secondly, as economic growth rises, there will be higher demand for goods and services, raising labour demand in the economy (since labour demand is derived from the demand for goods and services). This would lower cyclical unemployment. Also if the government spent on education and employment skills programmes, structural unemployment may fall as workers gain the skills demanded by firms in the economy.

### Question 3

- (a) Pressure from environmental groups throughout the economy in response to the challenge of climate change has prompted the government to increase spending on environmental programmes such as subsidies for alternative energy resources.
- (b) In the short run, persistent budget deficits might have an expansionary impact upon the economy, increasing economic activity. However the government will be forced to borrow money to finance the deficit, which might lower investor confidence and discourage foreign investors from saving in Australia.
- (c) The Commonwealth government is limited by the federal constitution. The constitution sets out a limited number of heads of power under which the government can pass laws, which limits the range of possible economic policies. Also the constitution places limitations upon states when imposing taxes, and so states are often without a secure source of government revenue. The government might also lack the necessary political support to pass the laws necessary to implement its economic policy. It might lack a majority in both houses of parliament (the house of representatives and the senate), or its economic policies might have short term economic consequences (such as higher structural unemployment) which might make it politically unpopular.