Chapter 3: Government management of the economy

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Chapter 3: Government management of the economy

Overview

We have already seen in chapters 1 and 2 that the government sets goals for the performance of the economy and measures how well the economy has worked in achieving those goals. We have examined the impact on the economy and its citizens if these goals are not met and how the government is keen for these goals to be achieved.

The role of managing the economy rests with the government. Sometimes its attempt at managing the economy conflicts with community ideals.

In this chapter we will discuss what society or the government can do if economic performance is not acceptable or the economy is not achieving any of the goals that have been set.

Why manage the economy?

It is the role of the government to implement policies in an effort to change the behaviour of individuals and businesses, and even overseas consumers, to achieve the goals of the economy. Policies can be directed at the economy as a whole — referred to as macroeconomic policies — or they can be directed at small sectors of the economy — referred to as microeconomic policies.
In addition to this, the policies introduced by the government can be directed at the demand side of the economy; that is, they are designed to influence the level of demand in the economy. These are policies that reduce or increase the level of spending on goods and services in the economy.

Alternatively, policies can be directed at influencing the supply side of the economy; that is, they aim to increase or decrease the supply of goods and services into the economy and/or the types of goods and services supplied.

It is possible that some of the policy measures put in place may conflict with each other. It is also possible that some policy measures will be unpopular or that some of them will not have the desired effect. What is important to remember is that management of the economy is a key factor during elections, and often during election campaigns each political party will make claims about the economy. These claims refer to how the economy has been managed to date and how it could be managed better or couldn’t be managed better.

Understanding how these policies operate and what they aim to achieve is important in understanding how our economy is performing and enables people to make informed decisions economically and politically.

**STARTER QUESTIONS**

1. What is meant by a ‘policy’?

2. Why do governments have to implement economic policies?

3. Identify the two types of policies that a government could implement.

4. A policy can be a demand-side policy or a supply-side policy. What do these terms mean?

5. In your opinion, how well do you think the government is currently managing the economy?

**3.1 Macroeconomic policy options**

Macroeconomics refers to the branch of economics that involves the level of expenditure or aggregate demand. It involves looking at the general influences on national spending, national output, national income, employment and overall material living standards. It emphasises the need for some degree of government involvement and manipulation of aggregate demand and economic activity demand-side policies.
Macroeconomic policies involve two key areas of influence by the government: budgetary/fiscal policy and monetary policy. Each of these policy areas attempts to manipulate the level of demand and spending in the economy to achieve the economic goals of the government. Let’s examine each of these policies.

**Budgetary/fiscal policy**

*Budgetary policy* (also called *fiscal policy*) is a government economic policy that involves altering the level of government spending and government receipts. Each year the government prepares its *budget*, which outlines its priorities for the coming year and, in some cases, for the years ahead. The budget is a document outlining where the government plans on receiving money from (receipts) and where it intends to spend that money (expenditure).

The difference between the receipts of the government and the expenditure by the government is known as the budget outcome. There are three possible budget outcomes:

- *deficit budget*, where the level of government receipts is less than the level of government expenditure
- *budget surplus*, where the level of government receipts is greater than the level of government expenditure
- **balanced budget**, where the level of government receipts equals the level of government expenditure. This is a rare event and the government usually aims for a fiscal balance, where the value of budget deficits equals the value of budget surpluses over the business-cycle period (seven years).

To better understand how the government uses the budget to achieve its economic goals, it is important to understand the two components of the budget: budget receipts and budget spending.

**Government budget receipts**

Budget receipts are the government’s incoming receipts of money that pay for budget spending. The most common form of government receipt is taxation. There are generally considered to be two types of taxes:

- **direct taxes** are those that refer to levies imposed directly onto the incomes of individuals and companies.
- **indirect taxes** are those placed on the sale of goods and services and added onto the price of items.

A third type of government receipt is non-tax revenue; that is, receipts from a source other than taxation, such as asset sales, interest, the repayment of HECS debts by university students and profits from government business enterprises such as Australia Post.

**Direct taxes**

Examples of direct taxes include:

- **personal income tax**. This is a direct tax paid by individuals who earn incomes in the form of wages, salaries, rent, interest and dividends. For most people, income tax is deducted by their employer from their pay packet before they are paid (pay-as-you-go or PAYG). However, for self-employed individuals, a different system exists for estimating income and tax that must be paid.

- **capital gains tax** (CGT). This tax is levied on the real profits made from the sale of capital assets such as land and shares purchased after 1985.

- **the Medicare levy**. This direct tax is designed to provide medical insurance to help cover the basic costs of family healthcare. It is normally levied at a rate of 1.5 per cent of personal taxable incomes.

- **withholding tax**. This is applied to individuals who fail to register their tax file number when receiving income such as dividends and interest. It is currently levied at the top tax rate of 46.5 per cent (including the Medicare levy).

- **company tax**. This is a fixed or proportional tax levied directly on business profits. In 2010–11, the tax rate was 30 per cent of company profits.

- **fringe benefits tax** (FBT). This represents a direct tax paid by firms on the value of ‘perks’ provided to employees, such as a company-provided car or house. It is currently levied at 46.5 per cent of the taxable benefit.
• superannuation fund tax. This tax is levied at 15 per cent of most premiums as well as on the interest from fund investments. People aged over 60 can currently withdraw their super tax-free

• petroleum resource rent tax (PRRT). This is levied at 40 per cent of the profits made from offshore petroleum operations.

Indirect taxes

Examples of indirect taxes include:

• excise duty. This is an indirect tax imposed on selected, locally produced goods such as petrol, LPG, beer, spirits, wine and tobacco. It is a flat percentage added to the cost of the product. For example, the excise on unleaded petrol is about thirty per cent of the price of each litre sold. The precise rates applied are adjusted twice a year and are generally linked to changes in the Consumer Price Index.

![Image of a car refueling](image)

**FIGURE 3** The tax on petrol provides the government with a significant source of revenue.

• customs duties. These are taxes levied on certain imported goods to raise revenue and protect local producers from foreign competition. Since the 1970s governments have had a policy of reducing tariffs to increase competition in Australia and to reduce prices for consumers.

• Goods and Services Tax (GST). This tax was introduced in July 2000. It is a broad-based, indirect tax levied at the rate of 10 per cent on many goods and services in the economy.

Figure 4 summarises the sources of government revenue in 2012. Income tax on individuals is easily the main source of receipts, followed by revenues from sales tax.
Government budget spending

Budget spending is how the government uses the receipts it collects to provide certain goods and services for the community. Government spending is designed to affect the incomes of consumers, the level of demand and economic activity in the economy, inflation, trade and living standards. Government budget spending is allocated mainly to:

- social security and welfare. These payments go to the neediest groups in society including the unemployed, aged pensioners and disabled people. The main aim is to redistribute income, thereby helping to reduce poverty and improve general living standards.
A part of government spending goes to the provision of welfare.

- **health.** This involves providing medical attention to consumers, paying wages and salaries of hospital staff, and outlays on building and furnishing hospitals.

- **defence.** This money is used for the payment of staff and day-to-day running expenses for the armed services, which includes payments for peacekeeping activities.

- **education.** Public education is provided by paying staff at universities, supporting state and non-government schools; vocational education and training; and building programs.

- **transport and communications.** This involves spending on government infrastructure such as road, shipping, aviation and rail services.

- **housing and community amenities.** This includes spending on public housing and the First Home Owner Grant.

- **public-debt interest.** This is the cost to the government of paying interest on its debts or borrowings. Much of the debt incurred by the government comes from having to finance a budget deficit.

- **net payments to other governments.** These are federal payments to state and local governments to enable them to provide community services including public education, health, housing and transport.

Other areas to which government budget spending is allocated include mining, manufacturing and construction, other economic affairs, agriculture, forestry and fishing, recreation and culture, public order and safety, and fuel and energy.

Figure 6 shows the relative importance of each area of spending in 2012 and 2013.
Impact of the budget outcome

When the government delivers its budget it has an outcome in mind.

Budget deficits are designed to be expansionary; they encourage spending through tax reductions and increased government spending. It is expected that the increase in spending by the government and by consumers (due to lower taxation payments) will lead to increased economic growth and consequently increased living standards.

Budget surpluses are designed to be contractionary; they discourage spending through tax increases and decreased government spending. It is expected that the decrease in spending by the government and by consumers (due to higher taxation payments) will lead to a slowing of the economy.

Monetary policy

In addition to altering the level of spending in the economy through taxation and direct government spending, the government can also manage the economy through monetary policy.

Monetary policy is a policy operated by the Reserve Bank of Australia (RBA) that seeks to manage the level of spending in the economy. It involves controlling the money in the economy and the rate at which money flows around the economy. The primary instrument of monetary policy is the manipulation of interest rates to alter the cost, availability and demand for borrowing money.
Because interest rates have the capacity to alter the level of spending in the economy, they can help to achieve the government’s goals of low inflation, strong and sustainable economic growth and full employment, ultimately improving Australia’s living standards. Monetary policy operates without the approval of parliament and can be altered quickly through changes to the cash rate by the Reserve Bank of Australia at its monthly meetings.

![Reserve Bank of Australia](image)

**Figure 7** The Reserve Bank of Australia is responsible for managing the amount of money in the economy.

The RBA has three means of influencing the flow of money, which affects how money is spent in the economy. These are:

- **changing interest rates**: it does this through market operations
- **influencing the exchange rate**: it achieves this by buying and selling Australian dollars
- **persuasion**: it uses its influence to achieve the desired direction of lending activities

**Changing interest rates**

Interest rates represent the cost of borrowing money. Whenever you borrow money you are required to repay that money, generally with interest. As money is a good like any other, there is a price for borrowing money and that price can change. An increase in the price of borrowing money will generally see a decrease in the demand for money. The opposite is also true.
The official price of borrowing money is called the *cash rate*. The cash rate is the interest rate that applies to a specialised market called the short-term money market. This cash rate depends on the overall deposits of cash in the short-term money market, which, in turn, is controlled by the RBA through its market operations. Market operations involve the Reserve Bank of Australia either buying back or selling second-hand government bonds through the short-term money market. Whether the cash rate rises or falls depends on the Reserve Bank of Australia’s decision to either buy back or sell these bonds.

**Increasing interest rates — a contractionary stance**

If the Reserve Bank of Australia (RBA) wanted to slow inflation, it would encourage interest rates to rise. This would discourage borrowing and spending. How would this happen? First, the RBA would announce a rise in the cash rate target at its monthly meeting (held on the first Tuesday of each month) and provide the reasons for its decision. This sends a signal to the economy of the direction in which the RBA believes the economy is heading. It would then set out to achieve this target by selling government bonds in the short-term money market. Financial institutions such as banks — which are keen to make a profit — would enter the short-term money market and buy these bonds because they are selling at a lower price with an attractive rate of interest. This creates a situation where financial institutions earn a better return, increasing their profits. The RBA achieves its aim as money is withdrawn from the market leaving less money available for borrowing and interest rates — the cost of borrowing — rise as there is a reduced supply. Financial institutions buying these bonds would then transfer deposits to the RBA to pay for the bonds. This directly reduces deposits or the supply of cash held by financial institutions.

The opposite is true if the Reserve Bank wishes to lower interest rates to stimulate demand. Buying back bonds from the banks and other financial institutions provides additional funds for the banks to lend, which would lower interest rates and encourage borrowing from consumers.

Higher interest rates make borrowing more expensive because the amount of interest to be repaid increases. Borrowing would mean a greater percentage of a person’s income is required to repay debt — and that’s money that could otherwise be used to buy goods and services. This is particularly true for home loans. Due to the high amounts borrowed, interest-rate rises can mean more income is needed to maintain repayments on home loans, increasing the financial stress on families. At the extreme end, it can lead to mortgage defaults and families losing their homes.
Higher interest rates can lead to mortgage defaults, causing families to lose their homes.

At a time when interest rates on borrowings are higher, interest rates on deposits will also be higher. This is good for people with excess cash, who may choose to deposit their money in a bank account and earn interest on it rather than spending this excess cash.

Overall, spending falls, aggregate demand falls and economic growth slows down. The negative impact can be a decline in material living standards as consumers have less access to goods and services. Unemployment can also result from decreased spending, leading to negative effects on non-material living standards through financial stress, marriage breakdowns and increased bankruptcies.

Influencing the exchange rate

The exchange rate is the price at which the Australian dollar is traded against other currencies. When the Australian dollar appreciates in value, our currency is able to buy more of another currency. In effect, this means imported goods and services become cheaper as fewer Australian dollars are needed to buy the same quantity of imports.

The RBA can influence the value of the exchange rate by entering the foreign exchange market and buying or selling Australian dollars. If the RBA wanted to increase the level of economic activity and employment it would sell Australian dollars, increasing the supply and lowering the price. Imports would become more expensive and consumers would switch to locally-produced goods and services. The opposite is also true.

While influencing the exchange rate is an instrument of monetary policy, it is seldom used now and is generally reserved for times when the Australian dollar is changing erratically.

Persuasion

Persuasion is a strategy used by the RBA to talk up or down the level of borrowing, spending and economic activity. As a result of this, consumers and investors react and change their level of spending and borrowing. Statements by the RBA that suggest the economy is performing well will see an increase in consumer and business confidence and therefore an increase in the level of economic activity.
ACTIVITIES

REMEMBER

1. Explain what is meant by the term ‘budget’.
2. What are the two main possible budget outcomes?
3. What is a ‘cash rate’?
4. What is meant by ‘interest rates’?

EXPLAIN

5. Explain how a smaller budget deficit may affect economic growth and spending in the economy.
6. Explain the difference between a direct tax and an indirect tax.
7. Explain how monetary policy works.

DISCOVER

8. Use the Historical budget and net financial worth data and Detailed economic forecasts weblinks in your Resources section to help you answer the following questions.
   a. Identify the projected budget outcome for the next year.
   b. Graph the budget outcome for the past ten years and the predicted outcome for the next four years.
   c. Summarise the trend in the budget outcome over the period shown.
   d. Identify the predicted performance of the Australian economy in terms of unemployment and the CPI.

3.2 Microeconomic policy options

As mentioned earlier, microeconomics involves examining the operation of the smaller fragments or units making up the whole economy, such as a particular business, an industry or a specific market or small sector of the economy.
Microeconomic policies involve government actions to assist industries or markets with improving their productivity to make them more competitive and to improve outcomes for consumers through lower prices, greater choice and increased employment opportunities. All of these outcomes should lead to an improvement in the living standards of Australians. This is generally known as microeconomic reform. In recent years the microeconomic reform policy has centred around four main areas:

- trade liberalisation
- labour market reforms
- market deregulation
- the National Competition Policy (NCP).

In addition to these areas, microeconomic policies have also been specifically directed at small areas of the economy such as:

- immigration
- the environment.

Let's look at these areas in more detail.

**Trade liberalisation**

Trade between nations has often been subject to protection from governments. The imposition of tariffs and quotas and the provision of subsidies have all worked to protect local industries from overseas competitors.

Tariffs are a tax on imports that raises the price of those imported goods, making the locally produced goods more price competitive. Quotas are a limit on the number of goods allowed into Australia. This meant at some point locally produced goods had to be purchased as there were no imports available to purchase. Subsidies were an amount given to local producers to help them lower their price and compete with imports.
Trade liberalisation works to reduce these protection mechanisms, making it necessary for local businesses to improve their productivity so they can lower their costs and improve their ability to compete with overseas products on a level playing field. The result should be reduced prices for locally made goods and services so consumers benefit from choice options and lower prices. This enables more goods and services to be purchased and so material living standards are raised.

Figure 2: Trade liberalisation has had some negative effects on Australian manufacturers, particularly in the motor-vehicle industry.

Trade liberalisation operates through:

- cutting tariffs
- reducing subsidies
- abolishing import quotas
- increasing the number of bilateral free-trade agreements.

Figure 3 summarises changes made to Australia’s level of protectionism since 1970.
Reducing the level of protection has had some negative impacts. Industries where local manufacturers were unable to significantly change have ceased to operate, causing unemployment (the motor-vehicle industry is an example). The rise in unemployment has negative impacts on non-material living standards because stress, financial pressures, mortgage defaults and marriage breakdowns often result.

**Labour market reforms**

The labour market is the market where wage levels and working conditions such as hours of work, leave and terms of dismissal are determined. Over the past 20 years various governments have introduced major microeconomic reforms by reducing their control over wages and wage determination. In tandem with trade liberalisation, these policies were aimed at lifting labour efficiency (a higher level of GDP per hour worked), keeping labour costs down and increasing our productive capacity.

This was done by way of a shift from the centralised wage system to a system involving greater deregulation of wages based on collective bargaining or individual workplace agreements. In most cases this created a situation where wages were linked to efficiency and determined at the
workplace level, rather than by the government. Since 2010 more than 85 per cent of workers have been covered by enterprise bargaining or other arrangements.

**FIGURE 4** Labour market reforms have resulted in many employees signing individual contracts with their employers.

The deregulation of the labour market enabled workers to access wage increases as a result of their increased productivity. This benefited both employer and employee as increased productivity meant lower costs and improved competitiveness. Wage increases could then be sourced from improved profits.

Improved competitiveness can also lead to increased employment levels and improved material living standards. On the other hand, non-material living standards may fall because increasing productivity usually means working more hours.

**Market deregulation**

**Deregulation** is the removal of unnecessary government controls, restrictions and supervision in various areas of the economy. In Australia this has seen progressive changes to key markets such as telecommunications, airlines, ports, shipping, primary produce and retail. Because economists believe that markets allocate resources most efficiently, a deregulated market should lead to lower prices due to stronger competition.
Market deregulation has led to increased competition in markets previously dominated by one company.

Market deregulation is seen as an important area of government microeconomic reform because it is a way of promoting many government economic goals including:

- **lower cost inflation** through lower prices due to competition between firms
- **strong and sustainable economic growth** through increased spending on goods and services due to lower prices (meaning higher demand)
- **higher employment in the long term** because new businesses will open in markets previously blocked, creating new jobs
- **external stability** through increased exports and less reliance on imports as locally-produced goods become price competitive.

The end result is that both material and non-material living standards will improve over time as the new competitors establish a share of the market.

**National Competition Policy (NCP)**

The National Competition Policy (NCP) is a broad collection of microeconomic reform measures designed to strengthen the level of competition and efficiency in markets. Strong competition results in greater efficiency, lower costs of production, cheaper prices and better quality of service and product. In 1995, the Australian Competition and Consumer Commission (ACCC) was established to help prevent powerful companies from artificially raising prices to exploit
consumers. The ACCC now enforces the *Competition and Consumer Act 2010*, under which a number of anti-competitive practices are illegal, including the following:

- **price fixing.** This is when firms collaborate to set common or similar prices that are higher than normal.

- **exclusive dealing.** This occurs when companies refuse to supply their products or services to one or more firms.

- **collusive bidding.** This is when supposedly competing firms that are submitting a tender or quote for the completion of works or to supply goods or services meet secretly beforehand to agree whose tender should be most attractive, cheapest and likely to win the contract.

- **price leadership.** This involves a dominant or leading firm taking a lead in setting prices that others follow.

- **predatory pricing.** This is when dominant firms conduct a price war involving big cuts in selling prices with the intention of driving rival firms bankrupt, then later enjoying the market without competition.

- **market zoning.** This happens when competing firms in a region divide the market into zones, areas or regions within which they agree not to compete with each other over prices.

![Figure 6](image)

**Figure 6** Firms should be able to compete on a level playing field without one firm getting an unfair advantage because of its size or power.

**Immigration policy**

Australia's immigration policy has been used as an approach to managing the number and composition of migrants coming to Australia from overseas. In other words, apart from important
humanitarian and family considerations, the federal government’s current immigration program tries to attract young and suitably skilled people who are likely to make a very valuable and ongoing economic contribution to the labour force and the Australian economy.

**Figure 7** Skilled migrants can improve the productivity of local businesses.

By prioritising skilled persons as the majority of our yearly immigration intake, Australia is able to fill vacancies in industries where local skills are lacking. This can result in improved productivity, leading to expansion in those industries as they increase their profits.

These migrants also assist in improving non-material living standards as they further develop our multicultural society, bringing elements of their culture to Australia.

It can be argued, however, that if money was spent on training within Australia, we could fill these skill vacancies with people who are currently unemployed, raising their incomes and living standards.

**Environmental policy**

Environmental policy refers to specific policies created by the government to improve the quality of our environment and move away from traditional power generation methods by promoting industries that offer an alternative. Some measures introduced include:

- a government scheme that provides rebates for households that install domestic water tanks to preserve rainwater and cut down on water usage from dams
- a government scheme that provides rebates for households that install insulation in their homes to reduce power bills
- a government scheme that provides rebates to households who install solar panels to provide their household with solar power and possibly return unused energy into the power grid, reducing reliance on fossil-fuel generated power
- the creation of the Renewable Energy Target (RET) scheme whereby 20 per cent of Australia’s electricity will come from renewable energy sources by 2020
- the signing of the Kyoto agreement in 2008 to commit Australia to reduce emissions
- the imposition of a carbon tax (repealed in 2014).
Our environmental policy has led to the creation of a number of new industries.

These policies, among others, aimed to create new industries and provide a cleaner environment for future generations — a means of improving our non-material living standards. They also create jobs in new industries and make it important for traditional energy providers to become more efficient to remain competitive.

**ACTIVITIES**

**REMEMBER**
1. Define the term ‘microeconomic reform’.
2. Outline two key areas of government microeconomic policy.
3. Explain how one microeconomic reform can assist the government in achieving one economic objective.

**EXPLAIN**
4. Using your parents as a resource, complete the following table identifying the sole provider of a service during the 1980s and compare it with the range of providers available today. The first one has been completed for you:

<table>
<thead>
<tr>
<th>Service</th>
<th>Previous provider</th>
<th>Providers today</th>
</tr>
</thead>
<tbody>
<tr>
<td>Telecommunications</td>
<td>Telecom</td>
<td>Telstra, Optus, Vodafone</td>
</tr>
<tr>
<td>Electricity</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
5. Define what is meant by ‘environmental policies’, listing two important examples of such measures.

6. How can our immigration policy work to improve both material and non-material living standards?

DISCOVER

7. Use the Anti-competitive behaviour weblink in your Resources section to help you answer the following question.

Describe two anti-competitive behaviours businesses may not engage in.

3.3 Direct government intervention in the market

In chapters 1 and 2 we identified the economic goals of the government, how it measures its performance in relation to those goals and the impact of achieving or not achieving those goals has on the living standards of Australians.

Setting economic goals and implementing policies is one key way the government is actively involved in the economy. However, the government also intervenes in other areas.

The reasons why governments directly intervene in the market are:

- to stabilise the economy
- to reallocate resources
- to distribute income.
Stabilisation of the economy

The level of economic activity involves the overall pace or speed at which the economy is performing and production is growing. The speed at which this occurs can affect:

- *inflation*. If the economy is moving too quickly, inflation will result as demand will pull prices upwards.

- *unemployment*. If the economy is moving too slowly, demand will fall and businesses may be forced to lay off workers or close down, leading to rising unemployment.

If the economy is unregulated, it can be very unstable and it can sometimes experience large and sudden changes to production and activity. It is the government’s job to directly intervene in the market to stabilise the level of economic activity. As we have seen, the government does this through the implementation of budgetary, monetary and microeconomic reform policies.
Reallocating resources

If left to itself, a market can be a very efficient allocator of resources. This is because the owners of those resources are always seeking to maximise their profits and incomes. They do this by producing only those goods and services that are likely to deliver the most profit because they are the most in demand. However, this is not always the case and it is possible to identify a number of circumstances where the market does not use resources efficiently; for example:

- **The market may produce socially undesirable items.** Some products are deemed to be undesirable but can be profitable for those who produce them. However, the government does not want these goods to be produced at all, or to be produced in the quantities they currently are. The production or provision of illegal drugs, gambling, guns and pollution often has negative effects on families’ and communities’ living standards so the government tries to reallocate resources away from the production and provision of such goods and services.
the market may not produce enough socially desirable goods and services. The government intervenes to ensure an adequate supply of these products. The private sector may under-produce these goods because they are expensive to produce and it is difficult to make a profit from them. Such items include products related to health care, education, public housing and public transport.

the government may intervene to provide goods that the private sector won’t supply. These are services such as defence, public toilets and street lighting, which are not profitable because it is not possible to make users pay for such services.

the government may, in some instances, intervene to allocate resources. These resources may be used for producing goods and services that compete with the private sector to ensure the product is available to everyone, not just to those who can afford it. One example is the ABC (Australian Broadcasting Corporation). This company initially provided television and radio services to all Australians because commercial television channels (7, 9 and 10) did not provide a service to remote areas. The same applied to telephone services through Telecom (now Telstra) and banking services (the Commonwealth Bank was originally established to compete with private banks before it was privatised).

Distribution of income

In a market economy, people earn an income according to the demand and supply of the labour they offer. Some people earn high incomes and some earn low incomes. We also know that because of changes in the level of economic activity some people lose their jobs and spend some time earning no income.

The private sector does not provide for people who don’t, can’t or are limited in their ability to earn an income. In these circumstances the government intervenes to provide these people with a minimum level of income through welfare payments.

Modern Australia (and society in general) recognises that it has an obligation to look after the more vulnerable in our society and that those who can most afford to should carry the majority of the burden for providing for these vulnerable people. As a result, the following government measures are used to redistribute income and provide support to some groups in society.

![Figure 4: The government uses taxation and its budget to ensure a minimum level of income for all Australians.](image)
• **Welfare benefits.** The government provides direct payments through its welfare system to vulnerable Australians. Unemployment benefits are the most visible payment made, but the government also makes welfare payments to aged pensioners, disabled people, veterans and indigenous Australians. The government also makes payments to certain groups for various reasons from time to time. Examples include:
  
  i. *the First Home Owner Grant.* This helps young people move into their first home and out of renting or public housing.

  ii. *the baby bonus.* This is a payment made to women having children. Initially this was a cash payment but more recently it has changed to a voucher system.

• **Progressive taxes.** Income tax is applied progressively. Higher income earners pay a larger percentage of their income in tax than low-income earners. The money collected from this taxation can be used to pay for welfare benefits to those in need and to provide necessary government services such as health care, education and housing. Taxation rates change periodically according to government policy and aims for the economy.

• **Payments to parents of school-aged children.** Eligible families receive two instalments of $211 per year for each child in primary school and two instalments of $421 per year for each child in secondary school. This scheme has changed over the years and will be stopped at the end of 2016.

• **Provision of essential services.** The government does not only pay money directly to underprivileged people. It also redistributes income by providing services to low-income earners, giving them benefits such as health care, public education, concession travel cards for school children and rental assistance.

• **Compulsory superannuation.** To protect the future of Australians and reduce future reliance on government pensions, the government introduced a compulsory national superannuation scheme for all employees through a levy (currently 9 per cent of wages earned) on employers. The objective is for workers to be able to live off this superannuation and have less need for welfare when they retire.

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**ACTIVITIES**

**REMEMBER**

1. What is a market?

2. Why might the market not provide all the necessary goods and services required by Australians?

3. In what areas does the government intervene?

**EXPLAIN**

4. Explain why the government needs to allocate resources.
5. Explain why the government needs to redistribute income.

**DISCOVER**

6. Use the Individual income tax rates weblink in your Resources section to help you answer the following question.

Calculate how much income tax a person would pay if they earned the following amounts per year:

a. $26,000  
b. $76,000  
c. $136,000  
d. $246,000

7. A second tax system is a proportional system where every person pays the same percentage of tax. Using the incomes in question 6, calculate the amount of tax each person would pay if the tax rate were 25 per cent.

8. Explain which tax system (from questions 6 and 7) is fairer.

### 3.4 Supporting growth in the Asia–Pacific region

The Australian government intervenes in our market to benefit and care for our citizens. However, this is not the only area in which it intervenes. As a member of the Asia–Pacific region and a leading economic power in that area, Australia intervenes to assist other countries in the region improve their economic performance.

It is important for Australia to do this as we export to many of these countries, import from them, our citizens use them as holiday destinations and we hope that their citizens will holiday here. As such, their economic development is linked to our economic prosperity, and vice versa.

There are a number of ways that Australia supports economic growth in this region.

**APEC**

One key way that Australia is involved in the region is through membership of the Asia–Pacific Economic Cooperation (APEC). APEC is a forum for facilitating economic growth, cooperation, trade and investment between the countries in the Asia–Pacific region.

APEC has 21 members — referred to as ‘member economies’ — which account for approximately forty per cent of the world’s population, approximately fifty-five per cent of the world’s GDP and about forty-four per cent of world trade. The member economies are Australia; Brunei Darussalam;
Canada; Chile; Hong Kong; Indonesia; Japan; Malaysia; Mexico; New Zealand; Papua New Guinea; People’s Republic of China; Peru; The Republic of Korea; The Republic of the Philippines; The Russian Federation; Singapore; Chinese Taipei; Thailand; The United States of America; and Vietnam.

APEC is not as formal as other world organisations (such as the World Trade Organization (WTO) or the United Nations), but rather it is a group of countries that agrees to cooperate on the basis of consensus and so any commitments made are undertaken on a voluntary basis. It prides itself on open dialogue and equal respect for the views of all participants.

APEC was established in 1989 and has worked to reduce tariffs and other trade barriers across the Asia–Pacific region, creating efficient domestic economies and increasing exports. APEC members recognise that free trade and investment helps economies to grow, creates jobs and provides greater opportunities for international trade and investment. Free trade helps to lower the costs of production and therefore reduces the prices of goods and services — a direct benefit to all.

**Foreign aid**

In addition to being a member of APEC, Australia provides direct aid to many countries in the Asia–Pacific region. Foreign aid represents the transfer of money and other types of assistance by governments to developing, or ‘poor’, economies. The aim of foreign aid is to assist these poor countries with improving their living standards. It aims to break the cycle of poverty, raise per-capita incomes and improve the quality of daily life. Often it does this by raising the funds available for investment in social and economic infrastructure, lifting efficiency and accelerating productive capacity.

![Care Package](image)

**FIGURE 1** Foreign aid is an important component of Australia’s contribution to the Asia–Pacific region.

There are generally three types of foreign aid:

- **loans.** Money is loaned out to poor countries to assist them in building infrastructure and developing industries. Loans should be repaid and the rate of interest varies according to the reason for the loan and any special conditions that may have been attached.
• *grants.* Donations of cash that do not need to be repaid. Often this type of aid is critical for providing immediate help after disasters such as famines, floods, earthquakes, wars or tsunamis.

• *technical and other assistance.* Scientific, economic, educational, technical, industrial or agricultural personnel are provided to advise on matters relating to economic development.

**FIGURE 2** A snapshot of foreign aid donated by the Australian Government, 2007–08

Charities and non-governmental support

Australia as a country provides aid and support to other countries in its region. Australians as individual citizens are also known for contributing to the development of poorer economies by providing aid privately.

Much of this aid is funnelled through charity or aid organisations such as Oxfam, World Vision and the Red Cross.

**ACTIVITIES**

**REMEMBER**

1. What does ‘APEC’ stand for?

2. Why is it the government’s responsibility to assist developing countries?
THINK

3. Why do you think associations such as APEC are needed?

4. ‘Assisting other countries makes us a better global citizen and can improve our own living standards.’
   a. Discuss this statement as a group and provide a response on behalf of your group.
   b. Present the response to the class in a multimedia format.

DISCOVER

5. Use the APEC weblink in your Resources section to help you answer the following question.

   Go to the ‘Topics’ tab on the home page and click on one of the topics listed. Write a summary of what APEC is doing in that area and outline how this can improve the conditions in the Asia-Pacific region.

SkillBuilder: Preparing a budget

Tell me

A budget is defined as a plan for the future. The government plans for the future of the economy on an annual basis by preparing and releasing its budget each May. The budget establishes the sources of the government’s expected revenues or receipts; that is, the amount of money it is expecting to receive and from where that money will be sourced. It also establishes where (location) and in which areas of the economy the money will be spent.

![Budget Image](image)

**FIGURE 1** A budget can be used to assist with finances and planning.

The government is not the only group that prepares a budget. Many businesses prepare budgets to provide information about their future and to assist them in deciding on a course of action.
Many families also prepare budgets to enable them to better plan for a holiday or a new car, or in preparation for one member of the family to give up work to start a family.

It is not uncommon for teenagers to prepare a budget when they start working part time and want to save to buy a car.

**Show me**

Prepare a budget for the coming month. Use this template (or design your own) and record your expected receipts and expenditure on a weekly basis for the next month.

Adjust the terms in the rows to suit your personal circumstances.

<table>
<thead>
<tr>
<th>Item</th>
<th>Month:</th>
<th>Month:</th>
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<th>Month:</th>
<th>Total:</th>
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</thead>
<tbody>
<tr>
<td><strong>Receipts</strong></td>
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<td>Work</td>
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<td>Parents</td>
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<td>Presents</td>
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<td><strong>Payments</strong></td>
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<tr>
<td>Mobile phone</td>
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<td>Clothes</td>
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<td><strong>Cash at start of month</strong></td>
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<tr>
<td><strong>Cash at end of month</strong></td>
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</tbody>
</table>
Let me do it

Analyse your budget.

1. Did you receive more than you expected?
2. Did you spend more than you expected?
3. Calculate the percentage contribution to your total receipts for each area of receipts.
4. Calculate the percentage contribution to your total spending for each area of expenditure.
5. If you were to adjust your spending, in which area would you be most able to reduce your spending?
6. If you were to adjust your spending, in which area would you be least able to reduce your spending? Why?
7. What could you do to increase your receipts?

Compare your results with those of your classmates. There is no need to share dollar amounts. Use the percentages and the analysis to explain your financial situation.

Review and reflect

Review

In this chapter we examined how the government is involved in assisting the economy to achieve the economic goals we examined in chapters 1 and 2. By adopting macroeconomic and microeconomic policies it aims to keep inflation under control, minimise unemployment, create a sustainable level of economic growth and keep our trade situation balanced.

Policies are strategies the government implements to achieve these goals. Encouraging spending by lowering taxes and interest rates can lead to employment and economic growth. This can also lead to inflation if microeconomic policies aren’t introduced to raise productive capacity.

Just as the government has economic goals and has those goals measured and assessed, so do you. You have goals for your life and goals for your education. You are also regularly assessed on the achievement of those goals through:

- assessment tasks
- tests
- assignments
- examinations
- reports
- parent-teacher interviews.
You should also be considering strategies you can implement to improve your performance. For example:

- arriving for class on time
- bringing all materials to class
- completing homework on time
- revising your work.

Prioritising what you do to achieve your objectives is not easy — there is only so much time in a day. The same applies to the government budget — there is only so much money available to spend.

Reflect

1. Identify where the government receives its revenue from.

2. Using the categories of expenditure shown, allocate revenue to the various areas of spending.

3. Compare your allocation of money to what the treasurer has allocated. Write a report justifying your allocation of the revenue you received.

4. Compare your “budget” with the budgets prepared by your classmates.
   - What did you notice?
   - Are there any areas of spending that you all agree are more important than others? Why?
   - Which area(s) did the class find less important?

Weblink

Use the Revenue and spending weblink in your Resources section to help you answer these questions.