Fiscal Policy

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Definition

- Fiscal policy refers to the federal government's ability to manipulate the levels of economic activity through changes in the annual budget
- The government attempts to run a countercyclical policy and can employ either a deficit or a surplus to do so

Structural Component

- This is the component of the budget that the government has a discretionary influence on
- This involves the government's ability to run a structural expansionary policy by:
  - Decreasing income tax
  - Decreasing company tax
  - Increasing infrastructure spending
- The government can also run a discretionary contractionary policy by:
  - Increasing income tax
  - Increasing company tax
  - Cutting funding to infrastructure spending

The Cyclical Component

- This is the component of the budget that is affected by the position of the economy in the business cycle and is non-discretionary
- The cyclical component is comprised of government tax receipts and government welfare spending
  - When the economy is in an upswing tax receipts rise and welfare spending falls (Surplus)
  - When the economy is in a downswing tax receipts fall and welfare spending rises (Deficit)

Methods of Financing a Budget Deficit

- Borrow from the central bank (Inflation)
- Borrow from overseas (Foreign Debt)
- Sell government bonds (Crowding out)
  - When the government sells government bonds the pool of private sector funds falls and thus the price of money rises
- Sell state assets (Loss of asset control)

Uses of a Budget Surplus

- A budget surplus can be used to pay down debt and allows Australia to hold a AAA credit rating
- However a budget surplus can also lead to a crowding in effect due to the fact that by paying down debt investors hold more funds to invest in the economy

Strengths	**Weaknesses**
Has virtually no impact lag	Ineffective as a contractionary policy
Can target individual sectors and affect AD/AS	Long decision lag

Is effective in a recessionary period	Subject to political bias