Be the Light of Christ

HSC ECONOMICS TASK 4 NOTIFICATION

TASK	CASE STUDY REPORT 1500 + 10% words
DISTRIBUTED: Date DUE:	13TH JULY 2021 19TH AUGUST 2021
OUTCOMES	HI demonstrates understanding of economic terms, concepts and relationships H2 analyses the economic role of individuals, firms, institutions and governments H4 analyses the impact of global markets on the Australian and global economies H5 discusses policy options for dealing with problems and issues in contemporary and hypothetical contexts H6 analyses the impact of economic policies in theoretical and contemporary Australian contexts H7 evaluates the consequences of contemporary economic problems and issues on individuals, firms and governments H8 applies appropriate terminology, concepts and theories in contemporary and hypothetical economic contexts H9 selects and organises information from a variety of sources for relevance and reliability H10 communicates economic information, ideas and issues in appropriate forms
TOPIC FOCUS	Topic 4: Economic Policies and Management
WEIGHTING	30%

TASK DESCRIPTION

Attempt **either** Question 1 **or** Question 2.

Write a 1500 + 10% extended response (this means your word count should be between 1350 and 1650 words, without including direct quotes). See exemplars for each question to help you scaffold your response.

Assessment Task 4: Case Study Report

20 marks
Attempt either Question 1or Question 2

In your answer you will be assessed on how well you:
- demonstrate knowledge and understanding relevant to the question
- use the information provided
- apply relevant economic terms, concepts, relationships and theory
- present a sustained, logical and cohesive response

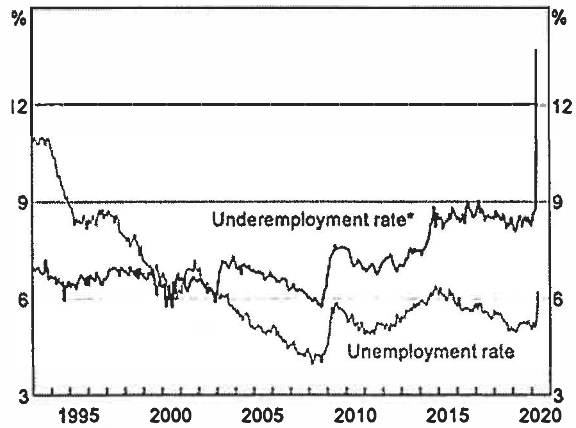
Question 1 (20 marks)

Discuss the effectiveness of expansionary monetary policy in achieving Australia's economic objectives of economic growth and full employment. In your response, refer to economic information provided.

> There has been a substantial, co-ordinated and unprecedented fiscal and monetary response in Australia to the coronavirus ... supporting people's incomes, maintaining the important connections between businesses and their employees, underpinning the supply of credit to businesses and households, and keeping borrowing costs low.
>
> *Statement by Philip Lowe, Governor,* Reserve Bank of Australia*: Monetary Policy Decision*
> *Date: 5th May 2020*

> The Reserve Bank has eased monetary policy by lowering the cash rate and introducing a target for the 3-year Australian Government bond yield, which has lowered borrowing costs in the economy. The Bank has also introduced the Term Funding Facility (TFF), which provides an incentive to banks to lend to small and medium-sized firms.
>
> The Board will not increase the cash rate target until progress is being made towards full employment and it is confident that inflation will be sustainably within the 2–3 per cent target band.
>
> Reserve Bank of Australia, *Statement on Monetary Policy – May 2020*

Labour underutilisation rates



Source: Australian Bureau of Statistics

OR

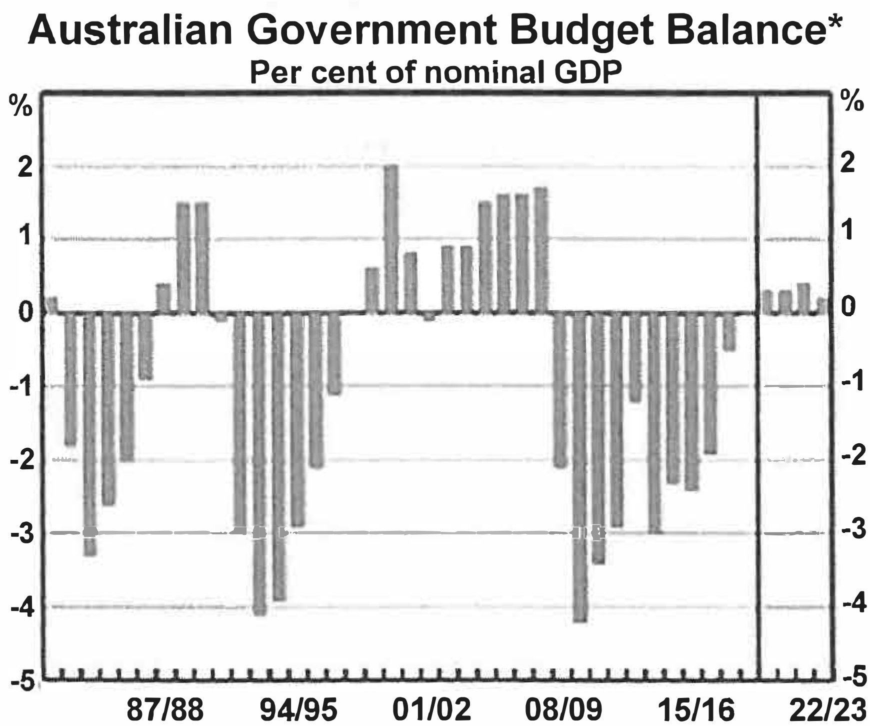
In your answer you will be assessed on how well you:

- demonstrate knowledge and understanding relevant to the question
- use the information provided
- apply relevant economic terms, concepts, relationships and theory
- present a sustained, logical and cohesive response

Question 2 (20 marks)

Discuss the effects of expansionary fiscal policy on Australian economic activity, the budget outcome and net debt. In your response, refer to the economic information provided.

> Economic Response to the Coronavirus – Last updated: 25th May 2020
>
> The Government is providing $259 billion in fiscal and balance sheet support, which is equivalent to around 13.3 per cent of annual GDP. Direct fiscal measures are equivalent to around 6.9 per cent of GDP. The measures provide timely support to workers, households and businesses through a difficult time and position the Australian economy to recover strongly once the health challenge has been overcome.
>
> The Government's economic response supports households and businesses. It is designed to support businesses in managing short-term cash flow challenges, provide support to individuals, severely affected communities and regions, and to ensure the continued flow of credit in the Australian economy.
>
> *Source*: Australian Government, www.treasury.gov.au



- Underlying cash balance; 2019/20 Mid-year economic and fiscal outlook

Source: Australian Treasury

Marking Criteria and Sample Responses

Question 1 *Outcomes assessed: H1, H2, H4, H5, H6, H7, H8, H9, H10*

Criteria	Marks
• Synthesises own knowledge and understanding with the information provided, to develop a sustained, logical and cohesive response • Integrates relevant economic terms, concepts, relationships and theory • Demonstrates a clear and comprehensive understanding of the effectiveness of expansionary monetary policy in achieving Australia's economic objectives of economic growth and full employment	**17–20**
• Synthesises own knowledge and understanding with the information provided, to develop a logical and cohesive response • Applies relevant economic terms, concepts, relationships and theory • Demonstrates a sound understanding of the effectiveness of expansionary monetary policy in achieving Australia's economic objectives of economic growth and full employment	**13–16**
• Uses own knowledge and understanding with the information provided, to develop a coherent response • Uses relevant economic terms, concepts, relationships and theory • Sketches in general terms the effectiveness of expansionary monetary policy in achieving Australia's economic objectives of economic growth and full employment OR • Demonstrates a sound understanding of the effectiveness of expansionary monetary policy in achieving Australia's economic objectives of economic growth OR full employment	**9–12**
• Presents a generalised response • Uses some economic terms and concepts • Identifies some aspects of the effectiveness of expansionary monetary policy in achieving Australia's economic objectives of economic growth and full employment	**5–8**
• Presents a limited response • Uses some economic terms and concepts • Lists some aspects of EITHER monetary policy OR economic growth OR full employment	**1–4**

Essay plan: Monetary policy is the arm of macroeconomic policy that is concerned with influencing the cost and availability of money and credit in the Australian economy. The Reserve Bank of Australia (RBA) is charged with the responsibility for the conduct of monetary policy. Monetary policy and fiscal policy are the two macroeconomic policy instruments used to address the demand side of the economy.

The adoption of expansionary monetary policy by the RBA over the past 29 years of economic growth in Australia has corresponded with periods in the business cycle when the Australian economy was faltering and not achieving the desired economic objectives of economic growth and full employment. Expansionary monetary policy played an important but not exclusive role in Australia in the recovery that followed the 1990–91 recession and the recovery after the Global Financial Crisis in 2008–09. As well, the Reserve Bank's response to the Covid-19 pandemic has been a wide-ranging package to lower funding costs and to support the supply of credit to the economy.

Two of the main economic objectives of the Australian government are economic growth and full employment. The other economic objectives include price stability, external balance, environmental sustainability and a more equitable distribution of income.

The main sources of economic growth in Australia are based on the components of aggregate demand which are consumption expenditure (C), investment spending (I), net government spending (G) and net exports (X–M). As well, on the supply side, improvements in labour and capital productivity and changes in technology assist with increasing economic growth. Consumption is a major contributor to economic growth.

Question 1 continues on the next page

Full employment occurs when the quantity of labour demanded equals the quantity of labour supplied. Even at full employment some unemployment exists such as people between jobs, people lacking the required skills for jobs and so on. This is referred to as the Non-Accelerating Inflation Rate of Unemployment (NAIRU) and is consistent with a stable inflation rate and full employment in the labour market. The RBA's estimates suggest that the NAIRU has declined since the mid-1990s and is currently around 4.5% of the labour force.

The responsibility for conducting monetary policy lies with the Reserve Bank of Australia (RBA) which is a statutory body operating independently from the Australian government. The RBA has statutory objectives including price stability, full employment and the economic prosperity and welfare of Australians. In attempting to achieve these objectives the RBA has an inflation target of between 2% and 3%, on average, over the economic cycle. The target is set in terms of the underlying inflation rate which excludes particular anomalies from the headline inflation rate.

[Note: some students may discuss at this point the syllabus dot point: "implementation of monetary policy by the RBA". Some students may write a classical textbook response about Open Market Operations (OMO) while others students may supplement their response with information published by the RBA in December 2018: [https://www.rba.gov.au/education/resources/teacher-updates/bridging-the-textbook-gaps-on-how-the-rba-implements-monetary-policy/index.html]

The RBA implements monetary policy in the short-term money market through the use of open market operations (OMO). An easing of monetary policy (expansionary stance) involves the RBA purchasing existing Commonwealth Government Securities and Repurchase Agreements. The increase in funds in the cash market puts downward pressure on the official cash rate. A tightening of monetary policy (i.e. a contractionary stance) involves the RBA selling Commonwealth Government Securities and Repurchase Agreements. This decreases funds in the cash market and puts upward pressure on the official cash rate.

"*In practice, the RBA uses OMOs to manage the supply of cash to keep the cash rate at its target.*

Essentially, in Australia, OMOs are used to manage the supply of cash (or liquidity) so that it can meet demand and ensure that the cash rate remains at its target. This is done on a daily basis – regardless of whether there is a change to the cash rate target – and is often referred to as 'liquidity management'. However, when the RBA does change the target for the cash rate, this is achieved by shifting something known as the 'policy interest rate corridor'.

The corridor is key to how the RBA implements monetary policy, particularly a change in the stance of monetary policy, as it encourages banks to trade ES balances (Exchange Settlement Balances) at the target cash rate.

In summary, the market automatically trades at the new cash rate target following a change to monetary policy. This is achieved by the policy interest rate corridor, which resets around the new cash rate target, and banks have no incentive to trade outside of this corridor. Given the automatic adjustment to the cash rate target, there is no need for additional OMOs. OMOs are instead used by the RBA to manage the supply of cash (liquidity) in the market on a daily basis as part of its liquidity management practices."

Source: Kellie Bellrose, "Bridging the Textbook Gaps on How the RBA Implements Monetary Policy", RBA Bulletin, December 2018.

By changing the stance of monetary policy, the RBA attempts to influence domestic interest rates and the level of economic activity through the transmission mechanism. The transmission mechanism operates through changes in household saving, consumer spending patterns, investment by firms, as well as the supply of credit, the exchange rate and asset prices. Ultimately these changes impact on economic growth, full employment and price stability in the Australian economy.

Question 1 continues on the next page

The stance of monetary policy may be altered by the RBA in response to a range of economic conditions. Prior to the recession of the early 1990s, contractionary monetary policy was used in the late 1980s to address high inflation (7.5% in 1989) in Australia as well as external stability issues. The official cash rate was increased to 18% in order to reduce aggregate demand in the economy. High interest rates, combined with other factors, pushed the Australian economy into recession. However, as the recession wore on the role of expansionary monetary policy was important in stimulating economic growth which fell by 1.7%, and to lower the level of unemployment which had risen to 10.7% by February 1993. As well, underemployment, which measures those people who are not working to their full capacity and desire more hours of work, rose from 4.1% to 7% during the recession.

The response by the RBA to the recession was to adopt an expansionary stance by reducing the official cash rate. Between January 1990 and July 1993, the cash rate was changed 15 times from 17.50% to 4.75%. Midway through the expansionary stance of monetary policy, the Governor of the Reserve Bank, Bernie Fraser, stated that the reduction in the overnight interest rate would contribute to … "a sustained recovery in activity and employment." However, monetary policy did not operate alone. In 1992 the federal budget outcome was a deficit, for the first time in five years. The deficit was part of the policy mix in order to reduce the impact of the downturn in Australia. At that time macroeconomic policies were being used to stimulate the demand side of the economy. The government also continued with its microeconomic reform agenda which was designed to improve economic efficiency and lift productivity growth.

Following the 1991 recession in Australia until the start of the Global Financial Crisis (GFC) in 2008 were two periods of expansionary monetary policy undertaken by the RBA. This occurred during 1996–97 and again throughout 2001. The Reserve Bank saw a need to provide, … "increased impetus to spending and confidence" ... to the Australian economy in 1996–97 and to reduce the level of unemployment during the same period which had increased to 8.3%. In 2001 there was a downturn in the global economy which impacted on the domestic economy. At the same time the domestic economy was impacted by the introduction of the goods and services tax (GST) in Australia and some weakness in the employment market heralded in another phase of expansionary monetary policy.

From mid 2002 to midway through 2008 the Australian economy performed strongly during the global resources boom. During this time the setting of monetary policy by the Reserve Bank was contractionary with the overall objective of maintaining sustainable economic growth in a low inflationary environment. The use of monetary policy by the Reserve Bank to achieve economic growth and full employment had been the preferred macroeconomic tool up until the Global Financial Crisis (GFC) began to impact on Australia in 2008. This was because of the overall effectiveness of monetary policy in achieving the short to medium term economic objectives of the Australian government.

During the second half of 2008, however, there was an unravelling of, and a deterioration in global financial markets. This impacted on Australia during 2008–09. Australia's unemployment rate increased to 5.8% and economic growth began contracting. During the GFC the underemployment rate rose by 2%, while the unemployment rate increased by 1.6% to 5.8%.

The Reserve Bank used monetary policy counter cyclically by adopting an expansionary policy stance, reducing the cash rate from 7.25% in September 2008 to 3.0% by April 2009. However, due to the extent of the downturn and the concern that monetary policy would not be effective on its own to lift aggregate demand and support employment, the federal government implemented a range of expansionary fiscal measures to boost domestic growth and employment. This included tax cuts and increased expenditure on stimulus payments to households and new infrastructure projects. In addition, the Australian government introduced a Deposit Guarantee Scheme to protect bank deposits and new measures to guarantee wholesale funding and the supply of credit to commercial banks.

Question 1 continues on the next page

Due to the effectiveness of the policy mix adopted by the Australian government during the GFC, as well as other contributing factors including the strength of the Chinese economy and the strong demand for Australian resources, the domestic economy, whilst experiencing a downturn, escaped a recession. As a consequence, economic conditions in 2009 were stronger than expected. These conditions continued through to the early part of 2010.

The post GFC period from November 2011 to October 2019 saw the cash rate lowered on 15 occasions. The cash rate changed from 4.75% in November 2011 to 0.75% in October 2019. Throughout this extended period the RBA's focus was on supporting economic growth, to achieve full employment and lift inflation into the target band of 2–3%.

From 2017 to December 2019 the Australian economy's performance was relatively weak with annual real GDP growth averaging 2.3%, low levels of productivity, real wages growth at 0.4% per annum and low levels of business activity. These economic indicators showed that the domestic economy wasn't performing well. Globally, there was uncertainty about the trade and technology disputes between China and the USA and the flow-on effect to the Australian economy. A continuing drought also caused economic hardship and in addition, over the Summer period of 2019–20 in Australia, the economy was further impacted as a result of severe bushfires across widespread areas of Australia. The underlying weaknesses in the Australian economy made it vulnerable to the severe economic impacts which were forecast after the confirmation of the rapid global spread of the coronavirus (Covid-19). Covid-19 was first detected in Wuhan, China in late 2019. Australia took its first actions to restrict in-bound travel to Australia in early February 2020 and the World Health Organisation declared Covid-19 a pandemic in March 2020. The coronavirus outbreak had near immediate impacts on the education and travel sectors of the Australian economy.

The decision by the RBA Board on 3 March 2020 to lower the cash rate by 25 basis points to 0.50% was made in light of the global Covid-19 outbreak. This expansionary stance of monetary policy was important in supporting the Australian government's economic objectives of sustainable economic growth and full employment. Achieving these two objectives would assist in lifting inflation within the targeted range of 2% to 3%.

Following the Board's decision in early March, the coronavirus now classified as a pandemic, was impacting at a rate which was extremely damaging to the global economy and the domestic economy. The Australian government introduced a large package of fiscal and financial support. The support packages were critical to the economy, businesses and individuals. The main support packages were announced from 12th March to 30th March 2020, with ongoing smaller stimulus packages continuing to be announced by the government. Central to the packages was the Job Keeper package which provided the following:

- A payment of $1,500 per fortnight for eligible employees until 27th September 2020,
- A temporary increase of $550 per fortnight to current and eligible recipients of Jobseeker Payments, and
- Early access for individuals to their superannuation up to $10,000.

Question 1 continues on the next page

With forecasts of a looming recession for many countries, including Australia, the RBA Board held an emergency meeting on 19th March 2020. The decisions made by the Board at the meeting were to complement the fiscal response of the Australian government. As noted in the stimulus material ..."There has been a substantial, co-ordinated and unprecedented fiscal and monetary response in Australia to the coronavirus". The main features of the package included:

- A reduction in the cash rate target to 0.25%
- A target for the yield on 3-year Australian Government bonds of around 0.25%
- A new $90b plus, three-year funding facility to support small to medium sized businesses
- An increase in the interest rate paid on balances held by Authorised Deposit Taking Institutions in their Exchange Settlement Accounts (ESAs) held with the RBA

The Governor of the Reserve Bank, Philip Lowe stated.... "The various elements of this package reinforce one another and will help to lower funding costs across the economy and support the provision of credit, especially to small and medium sized businesses."

The package is also designed to assist banks with elevated costs during the downturn due to extra costs associated with the increase in bond purchases and the use of the RBA's funding facilities. The substantial easing of monetary policy in Australia by the Reserve Bank is in line with the actions of other central banks including the US Federal Reserve and the Bank of England. The use of both conventional monetary policy and unconventional monetary by the RBA and the extensive fiscal response by the Australian government gives a clear indication of the depth of unease about the impact of the global pandemic on the Australian economy.

The economy contracted by -0.3% in the March quarter 2020 which meant that the annual growth rate had declined to 1.4%. There was a fall in consumer spending of 1.1%, and investment spending on new homes and alterations fell by 1.7%. These two components of economic growth were the major contributors to the decline in GDP in the March quarter 2020. The March quarter contraction figure for Australia in comparison to other economies was viewed favourably.

Confirming the downturn in the Australian economy was the release of the April unemployment figures by the ABS. These showed that the unemployment rate had increased in April to 6.2%. Of significant concern was the increase in the underemployment rate by 4.9% to 13.7%. This is the highest underemployment rate on record and reflects the significant reduction in working hours for workers. The graph in the stimulus material shows the severe 'spikes' in the unemployment and underemployment rates in April 2020. In May 2020 the unemployment rate rose to 7.1% and the underemployment rate to 13.1%, while the participation rate fell to 62.9%. It is expected that the June quarter 2020 GDP figure in Australia will show a severe contraction in GDP growth. The prediction for the June quarter by some sources is for a contraction in the order of negative 8.0%.

The Reserve Bank's forecast of the impact of the coronavirus on the Australian economy over the first half of 2020, included a fall in economic growth of around 10%, a decline in work hours by around 10% and a rise in the unemployment rate close to 10%. Further evidence of the impact of the coronavirus was announced by the Treasurer, Josh Frydenberg, on the release of the national accounts on the 3rd June 2020 when he declared that Australia was moving towards a recession (i.e. two quarters of negative growth). The 29-year economic growth period for the Australian economy will come to an end after the announcement of the June quarter GDP figure.

Question 1 continues on the next page

The role played by monetary policy for macroeconomic stabilisation over the past 29 years in Australia has tended to be more effective in reducing the growth of aggregate demand during periods of high economic growth and higher inflation, than during periods of promoting aggregate demand during downturns in the economy. Monetary policy combined with fiscal policy stimulus has played a critical role in the short to medium term during these downturns to support the economy in achieving the objectives of economic growth and full employment. Macroeconomic policies have been complemented by the use of microeconomic policies which aim to address the economy's efficiency, productivity and international competitiveness in the long run.

The path to recovery for the Australian economy is difficult to forecast. The impact of the coronavirus on the Australian economy has not been witnessed since the Great Depression of the 1930s. The impact of a recession in the global economy on the domestic economy will play an important role. In particular, the China trade war with the US has impacted on international trade flows and investment. Further, the more recent imposition by China of an 80% tariff on Australia's barley, the banning of beef exports from four Australian processing plants, and the warning by China advising tourists and students to avoid travelling to Australia due to racism may have an economic impact on a number of sectors of the economy. In the coming months the expansionary stances of monetary and fiscal policy will be critical in supporting the Australian economy. As the federal government implements the three stages of re-opening the economy there will be less focus on the health crisis and more focus on the economic recovery. Macroeconomic policies will play a critical role in the recovery. The RBA stated in May 2020 that … "The Board will not increase the cash rate target until progress is being made towards full employment and it is confident that inflation will be sustainably within the 2–3 per cent target band."

As expressed by many economic commentators, businesses, trade unions and employer associations, there remains great uncertainty beyond late September 2020 when the current Covid-19 stimulus package is to end. Some economists are referring to this period as the "the economic cliff."

Question 2 *Outcomes assessed: H1, H2, H4, H5, H6, H7, H8, H9, H10*

Criteria	Marks
• Synthesises own knowledge and understanding with the information provided, to develop a logical and cohesive response • Integrates relevant economic terms, concepts, relationships and theory • Demonstrates a clear and comprehensive understanding of the effects of expansionary fiscal policy on Australian economic activity, the budget outcome and net debt	**17–20**
• Synthesises own knowledge and understanding with the information provided, to develop a logical and coherent response • Applies relevant economic terms, concepts, relationships and theory • Demonstrates a sound understanding of the effects of expansionary fiscal policy on Australian economic activity, the budget outcome and net debt	**13–16**
• Uses own knowledge and understanding with the information provided, to develop a coherent response • Uses relevant economic terms, concepts, relationships and theory • Sketches in general terms some of the effects of expansionary fiscal policy on Australian economic activity, the budget outcome and net debt	**9–12**
• Presents a generalised response • Uses some economic terms and concepts • Identifies some aspects of the effects of expansionary fiscal policy on Australian economic activity, the budget outcome and net debt	**5–8**
• Presents a limited response • Uses some economic terms and concepts • Lists some aspects of expansionary fiscal policy on Australian economic activity OR the budget outcome OR net debt	**1–4**

Essay plan: The Australian government implements fiscal policy when it delivers its annual budget of expected revenue and expenditure for the forthcoming financial year. Fiscal policy refers to the use of the budget to influence economic activity, resource allocation and income distribution. The budget contains estimates of taxation and other revenue and expenditure on items such as social security and welfare, health, education and defence.

In early 2020 it became apparent that the spread of the Covid–19 pandemic to Australia required the Australian government, and state and territory governments to act quickly by implementing measures to slow and eventually stop the spread of the coronavirus from leading to increasing infections and deaths in the Australian community. These measures included closing borders to domestic and international travel, the lockdown of most businesses and industries and the introduction of social distancing rules, quarantines, widespread testing and contact tracing. These measures had the effect of 'flattening the curve' to reduce the incidence of infections and deaths from the coronavirus in Australia.

The lockdown of the Australian economy led to a contraction in economic activity with real GDP contracting by –0.3% in the March quarter 2020. The Australian government postponed the delivery of the 2020–21 budget until October 6th, 2020 and implemented a series of fiscal stimulus measures in March 2020 to support economic activity, including business cash flow and employment. This is referred to as the use of expansionary fiscal policy to raise aggregate demand through increased government spending and cuts in taxes to support expenditure and employment. The use of activist or discretionary fiscal policy during a recession is based on the Keynesian theory of 'pump priming' the economy when the equilibrium level of national income falls below the full employment level of income.

Students should illustrate this situation by including a diagram of aggregate demand to show how equilibrium income can be below the full employment level of income, resulting in a deflationary gap and rising unemployment. Students can also show on the diagram how increased government spending and/or reductions in taxation can increase aggregate demand in order to reduce unemployment and eliminate the deflationary gap in the economy.

Question 2 continues on the next page

The unemployment rate in Australia was predicted by the Reserve Bank and Treasury to peak at around 8%–10% by the end of the June quarter 2020. This was due to the lockdown of the economy resulting in falling expenditure by consumers and businesses, a fall in output and rising job losses.

In response to the significant economic consequences of the coronavirus and the government lockdown of the economy the Australian government implemented three important fiscal stimulus packages in March 2020. These and other measures are estimated at $259b in Australian government fiscal and balance sheet support, equivalent to 13.3% of GDP as outlined in the stimulus material. The three main fiscal stimulus packages were the following:

1. The first Economic Stimulus Package on 12th March 2020 was valued at $17.63b.

   This involved a number of measures designed to support business investment such as increasing the instant asset tax write–off threshold from $30,000 to $150,000, accelerated depreciation allowances and $6.7b to Boost Cash Flow for Employers by up to $25,000.

   There was also $1.3b allocated to support small businesses to support the jobs of around 120,000 apprentices. This was in the form of wage subsidies of up to 50% between January 1st, 2020 and 30th September 2020. Other measures included $4.8b to provide a one–off $750 stimulus payment to eligible welfare beneficiaries such as pensioners, and $1b to support those sectors, regions and communities most adversely affected by the economic impact of the coronavirus.

   In summary these measures were designed to support business investment, apprentices' jobs and cash spending by households receiving social security payments.

2. The second Economic Support Package on 22nd March 2020 was valued at $66.1b.

   The measures included in the Package were designed to support employment, household spending and business survival. The coronavirus supplement of $550 was to be paid to both new and existing recipients of the JobSeeker Payment (which replaced the NewStart Allowance) and other benefits such as Youth Allowance JobSeeker and Parenting Payments. A further $750 payment to 5m welfare recipients was to be paid from 13th July 2020.

   Another measure was the early release of superannuation funds of up to $10,000 in 2019–20 and a further $10,000 in 2020–21 for individuals in financial stress. The government also committed to providing up to $100,000 to eligible small and medium sized businesses (that employ people) to boost their cash flow. A Coronavirus Guarantee Scheme was established to give SMEs access to working capital, and temporary relief for businesses to pay their creditors. A final measure was $715m in support for Australian airlines and airports because of the disruption to international and domestic air travel caused by the coronavirus pandemic. This package was intended to complement the $105b finance support package that the government and the Reserve Bank of Australia announced a week earlier with the Reserve Bank providing a three-year funding facility (valued at $90b) for the banking system to support SMEs with a line of credit. This followed the Reserve Bank Board's decision to lower the cash rate by 0.25% to 0.25% on March 19th, 2020 to support business borrowing.

Question 2 continues on the next page

Question 2 continued

3. The third stimulus package involved the JobKeeper Payment: Supporting Businesses to Retain Jobs, which was announced on 30th March 2020. Called the JobKeeper scheme, the subsidy is for full and part time workers, sole traders and casuals with a year's service including workers already stood down. The subsidy will cost $130b over six months for up to six million workers. To be eligible for the subsidy, a firm's turnover must fall by at least 30% to qualify, and if a firm's turnover is above $1b it must experience a fall in turnover of at least 50%.

   This package was initially costed at $130b in the form of a massive wage subsidy scheme. This programme centres around a $1,500 per fortnight per employee payment which is equivalent to 70% of the median wage, or around 100% of the median wage in the hospitality, tourism and retail sectors. However Treasury made an error of $60b in calculating the cost of the scheme and it is now estimated to cost $70b not $130b. This leaves a further $60b which could be used after September 30th, 2020 to extend or modify the JobKeeper scheme.

In April 2020 the Australian government announced a temporary $3b rescue package which offered free government subsidised childcare to working parents. This was designed to keep childcare centres open, assist parents in keeping their jobs and reducing the cost of childcare services.

In late May 2020 the Australian government announced a new JobMaker programme to target reform in skills and training in the Vocational Education and Training (VET) sector. This was seen as important in protecting apprentices' jobs and preparing for major industrial relations reform in the future after the end of the Covid–19 pandemic and lockdown of the economy.

In early June the Australian government announced a new HomeBuilder scheme targeted at the building and construction industry to protect jobs. It offers $25,000 grants to those who wish to build a new house up to $750,000 or to undertake a major renovation that costs a minimum of $150,000. However, eligibility for the scheme is limited to properties valued at less than $1.5m, single applicants must not earn more than $125,000 and couples must not earn more than $200,000.

In addition to the Australian government, state and territory governments also implemented economic stimulus packages in March 2020: NSW ($2.3b), Victoria ($1.7b), Queensland ($4b), South Australia ($350m), Western Australia ($607m), the ACT ($137m) and the NT ($60m). These packages mainly targeted support for employment and industries most affected by the Covid–19 pandemic and subsequent lockdown.

These fiscal stimulus measures were designed to support demand and business activity while social distancing and lockdown provisions are in place. They were targeted at consumers, businesses and employees who were encouraged to spend on consumption and investment to support aggregate demand (C + I + G + X – M) and economic growth. By far the most costly and potentially valuable programme of the JobKeeper Payment will help to support employment and prevent the expected rise in the unemployment rate of between 8% and 10% from being greater and imposing greater economic and social costs and hardship on the Australian community.

The current fiscal stimulus measures are similar to those implemented by the Rudd government in response to the Global Financial Crisis (GFC) in 2008–09. These measures included the following:

- The Economic Security Strategy package of $10b in spending on short term cash transfers to low- and middle-income households in November 2008 and February 2009 to support spending
- The Council of Australian Governments (COAG) reform package of $15.2b in new spending on state infrastructure
- The Nation Building package on education, health and infrastructure in the 2008–09 budget, and
- The $42b Nation Building and Jobs Plan in the 2009–10 budget to support infrastructure investment and employment

Question 26 continues on the next page

Whilst the use of expansionary fiscal policy during contractions or recessions in economic activity can offset to some degree the economic and social costs associated with downturns, it has major implications for the budget outcome and the level of net public debt. Prior to the onset of the global Covid–19 pandemic and subsequent government lockdown of the economy the Australian government was expecting to achieve a $7.1b budget surplus as shown in the stimulus graph. This was based on the Australian Government's Medium Term Fiscal Strategy of achieving budget surpluses on average over the economic cycle.

Part of this strategy was centred around the Budget Repair Strategy of offsetting new government spending measures by reducing government spending in other areas and using projected budget surpluses to retire and eventually eliminate public debt. Net public debt refers to the accumulated stock of public debt used to finance successive budget deficits, especially since the Global Financial Crisis when the budget deficit increased dramatically to -$54.5b.

However, like during the GFC the Australian government's budgetary position has deteriorated during the Covid–19 pandemic, with a large projected rise in the budget deficit and level of public debt. This is due to a deterioration in both the cyclical (non discretionary) and structural (discretionary) components of the budget framework:

- Taxation revenue will fall as spending, incomes and profits fall during the pandemic. This means that revenue from the PAYG tax system, the Goods and Services Tax (GST) and company tax collections will fall. The fall in taxation revenue is a result of the automatic stabilisers in the budgetary framework, with less tax collected as the economy enters a recession and experiences negative growth in GDP, incomes and employment. This is the cyclical component of the budget deficit.

  In structural terms taxation revenue will also fall because of government policies such as the instant tax write–off to support business investment and tax reductions in business activity statements.

- Government spending will rise as the structural or discretionary component of the budget is forced into deficit because of deliberate government policies to increase spending such as the $70b JobKeeper programme and various measures to support household incomes such as the stimulus payments to households (one off welfare payments and the JobSeeker payments) as well as the JobKeeper scheme designed to keep people in employment. The cyclical component of the budget deficit will also rise due to the increase in the unemployment rate and the number of people applying for unemployment benefits.

Given these cyclical and structural influences on the projected budget outcome, the Australian government's budget is forecast to be a deficit of at least –$125b or –6% of GDP in 2020–21. The 2020–21 budget has been postponed for announcement until October 6th, 2020 by the Treasurer, Josh Frydenberg. With the economic outlook extremely uncertain the forecast for the size of the budget deficit may change.

An interim statement on the budget and the economy will be delivered by the Treasurer on July 23rd, 2020. The size of the budget deficit is expected to fall from 2021–22 onwards as fiscal stimulus measures are withdrawn, and the economy recovers in terms of growth and employment. However, the underlying cash balance is still forecast to be in deficit between $16b and $30b compared to the 2019–20 Mid Year Economic and Fiscal Outlook (MYEFO).

Question 2 continues on the next page

The Parliamentary Budget Office forecast receipts to be between \$10b and \$20b lower in 2029–30 compared to the 2019–20 MYEFO. This was because of lower economic growth and the large impact on personal income tax collections. Payments under each scenario were between \$6b and \$10b higher in 2029–30 compared to the 2019–20 MYEFO.

On June 5th, 2020 the Parliamentary Budget Office which is independent of government released three medium term fiscal scenarios (i.e. Upside, baseline and downside). It projected higher net debt because of lower revenue, higher spending and therefore more borrowing by the Australian government. In the April 2019–20 budget the net debt was forecast to fall to \$361b or 18% of GDP. Net interest payments on the net debt of \$361b were forecast at \$10.9b or 0.5% of GDP. As of April 3rd, 2020, the Australian Office of Financial Management (AOFM) had \$579.2b of bonds on issue to investors.

With increased borrowings needed to finance the increase in the budget deficit in future years, the net debt was estimated at \$580b or 30% of GDP in 2020–21. The Parliamentary Budget Office's analysis shows that the impact of Covid–19 may result in Commonwealth Government net debt in 2029–30 being between 11% and 18% of GDP (up to \$620b), higher than it would have been otherwise. At last December's Mid Year Economic and Fiscal Outlook (MYEFO), net debt was projected to fall to 1.8 per cent of GDP by 2029–30.

The key uncertainties and risks surrounding the fiscal outlook for the Australian government are:

- Whether or not there is an enduring impact of the coronavirus on economic growth
- Whether the government's Covid–19 stimulus measures are temporary or if the economy will require more stimulus in the future to support growth and employment.

These uncertainties are sourced from the length and depth of the expected recession in Australia in 2020. The recession in 1982–83 led to a –3.4% contraction in GDP while the 1991 recession led to a contraction of –1.4% in GDP. The Reserve Bank forecast GDP to contract by –8% in the June quarter 2020 and by –6% in the September quarter 2020, before a recovery of 7% in GDP growth in 2021. These forecasts suggest a much deeper recession and an unprecedented rise in the Australian government's budget deficit and net debt.