

MACROECONOMICS AT WORK EXERCISE

THE REVIVAL OF FISCAL POLICY?

REFERENCE: Alan Mitchell, ‘Return of a trusted friend’, *Australian Financial Review*, 21 August 2002, p. 62.

CHAPTER RELEVANT TO THIS EXERCISE: Chapter 15.

OVERVIEW

The context of the article is that (in the author’s words) ‘For a long time discretionary fiscal policy was treated as a dead issue in Australia ...’. (Compare this with the discussion on pp. 352–3 of your textbook.) A recent Treasury statement, however, has raised anew the debate about the effectiveness of fiscal policy and the way it should be used in Australia.

It is argued that, even though automatic stabilisers (see p. 352) may be more effective than discretionary changes, *the experience of the last few years suggests that fiscal policy may nonetheless be a potent weapon in influencing the macro-economy*. This, then, is the proposition under discussion.

The success of Reserve Bank policies in the last decade has led to monetary policy becoming the major macro-economic regulatory weapon, and the priority placed on eliminating budget deficits and reducing public debt has combined with this success in effectively taking the use of discretionary fiscal policy off the agenda. However, it is argued that in the present context, and in the light of some recent experience which has demonstrated the potential potency of fiscal policy, the Treasury and Australian governments may (should?) look afresh at fiscal policy.

The ‘recent experience’ referred to is particularly that of the introduction of the GST (which created first a boom then a slump in housing investment) and the first-home buyers grant, all of which had a major effect on the level of housing investment and on GDP in aggregate. These were highly ‘targeted’ policy measures.

QUESTIONS

1. Explain the reference to fiscal policy as a ‘policy blunderbuss’.
2. Why is it suggested that discretionary fiscal policy became a ‘dead issue’ in the 1990s?
3. What is the argument underlying the suggestion that the introduction of the GST contained ‘a number of useful lessons about fiscal policy’?
4. To what extent and in what way does the analysis, and the recommendations, of the author differ from traditional thinking about fiscal policy?

5. Comment on the author's statement that 'one obvious way to [implement an effective fiscal policy] is to make temporary changes to the rate of GST on durable goods'. What is his own comment on this statement?