MACROECONOMICS AT WORK EXERCISE

TAX REFORM AND MACROECONOMIC POLICY

REFERENCES: 'President's tax pack falls flat' (by Peter Hartcher) and **'Bush's tax cuts will take time to work'** (by Corinne Lim), *Australian Financial Review*, 17 January 2003, p.25, and 20 January 2003 , p. 17.

CHAPTERS RELEVANT TO THIS EXERCISE: Chapters 12, 15.

OVERVIEW

Early in 2003 the US President announced changes to the tax system. These were aimed at giving a stimulus to aggregate demand and thus GDP which was considered to be growing below the potential rate. While there was a 'package' of reforms, the single most important element was the elimination of tax payable by individuals on income earned in the form of dividends from shares. The package has been evaluated largely in terms of this change. As *macro*economic policy, the reform has been assessed primarily in terms of the *aggregate size* of the increased demand to which it is expected to lead (mainly in the form of consumption expenditure). This will indeed be large, but whether it will be sufficient to boost consumption, and aggregate demand, has been debated. The debate centres on *which individuals* will benefit from the reform, an issue which has led to the policy also being criticised in *micro*economic terms. The issue here has been the *distributional* effects of the tax reform, and in particular the *fairness* of the tax reform. And, as is inevitably the case with any matter to do with taxation, the political implications of the reform are also profound.

QUESTIONS

1. Explain the nature and extent of the major tax reform in question.

2. How is this change seen to encourage a higher rate of growth in GDP?

3. What will determine how large this effect will be?

4. What are the 'equity issues' involved? What is meant by this term?

5. What are the political implications of this piece of economic policy-making?