BRETTONOMICS · AUSTRALIAN CONTEXT · UNIT 4 TOPIC 3

Economic Management in Australia

The tax system, RBA policy in practice, and Australian supply-side programs

How to use this guide

This companion holds the Australian evidence for the topic. Information is colour-coded and labelled; each coloured box carries a word label as well as a colour, so you can use it whether or not you distinguish the colours easily.

KEY DEFINITION	What a measure means and how it is defined.
AUSTRALIAN CONTEXT	Australian evidence, data or events you can quote as examples.
WORKED EXAMPLE	A calculation worked through step by step.
COMMON MISTAKE	A misreading of the data that commonly costs marks.
EXAM TIP	How to use this evidence in an exam response.
BRETTONOMICS INTERACTIVE	A matching interactive tool on brettonomics.com.

EXAM TIP

Using these figures

Always date your data. Every figure here belongs to a point in time. In an exam, state the period and the source — "unemployment was 4.0% in December 2024 (ABS)" earns the mark that a bare number does not.

Check before you quote. Economic data is revised. Confirm the latest figure against the ABS or RBA before relying on it in assessment.

SECTION 1 Australia's tax system & government revenue

1.1 Sources of Australian Government Revenue (2023–24 Budget)

Total Revenue: ~$590 billion (~21% of GDP)

Revenue Source	2023–24	% of Total	Type	Classification
Income tax (individuals)	$230 billion	39%	Direct	Progressive
Company tax	$75 billion	13%	Direct	Proportional (30% flat)
GST (10% goods/services tax)	$80 billion	13%	Indirect	Regressive

Revenue Source	2023-24	% of Total	Type	Classification
Excise duties (fuel, alcohol, tobacco)	$35 billion	6%	Indirect	Regressive
Payroll tax (states)	$30 billion	5%	Direct	Proportional
Other taxes (capital gains, super)	$50 billion	8%	Direct	Mixed
Non-tax revenue (fees, asset sales)	$90 billion	15%	Mixed	N/A

1.2 Australia's Progressive Income Tax System

2024–25 Tax Brackets (Federal):

Income Range	Marginal Tax Rate	Effective Rate (avg.)
$0–$18,200	Tax-free	0%
$18,200–$45,000	16%	~9.5%
$45,000–$135,000	30%	~23%
$135,000–$190,000	37%	~27%
$190,000+	45%	27%+

Plus the Medicare levy: 2% of taxable income. Higher-income earners without private hospital cover may also pay the Medicare levy surcharge of 1% to 1.5%.

Reality check — what was actually legislated: the original 2019 design of Stage 3 would have collapsed the 32.5% and 37% brackets into a single 30% rate to $200,000. It was redesigned in February 2024 before taking effect. The version that began on 1 July 2024 instead cut the 19% rate to 16% and the 32.5% rate to 30%, and lifted the 37% threshold to $135,000 and the 45% threshold to $190,000. The redesign shifted a larger share of the benefit toward low and middle income earners than the original would have.

1.3 Why Income Tax is Progressive

Rationale: - Ability to pay: Wealthy can afford higher rates with less hardship - Marginal utility of income: Extra $1k matters more to poor than rich - Reduces inequality: Redistributes from top to bottom - Political: Most democratic societies choose progressive taxes

Trade-off: - Efficiency cost: High marginal rates (45–47%) may reduce work incentive - Claimed effect: 1pp higher tax rate → 0.3–0.5% fewer hours worked (debated) - Capital flight: High earners may emigrate or shift income offshore

1.4 Why GST is Regressive

Mechanism: - Same 10% rate for all consumers - Lower-income households spend ~80–90% of income (no savings) - Higher-income households spend ~50–60% of income (save more) - Result: GST = larger % of income for poor than rich

Example: - Poor household: $40k income → spends $36k → $3,600 GST (~9% effective rate) - Rich household: $200k income → spends $120k → $12,000 GST (~6% effective rate)

Why still implemented (2000)? - Broadens tax base (simpler than income tax) - Encourages saving (only on spending) - Less distorting than income tax (no work disincentive) - Hidden (embedded in prices; less visible than income tax)

1.5 Excise Taxes (Sin Taxes)

Examples: - Fuel excise: $0.45 per litre (affects everyone, regressive) - Alcohol excise: Higher on spirits than beer (consumption-based) - Tobacco excise: ~60% of cigarette price (discourage use)

Rationale: - Negative externality: Smoking/drinking harm society (healthcare costs) - Tax internalizes cost: Makes price reflect true social cost - Dual benefit: Raises revenue + discourages harmful consumption

Regressive? Yes: - Lower-income smokers pay larger % of income in tobacco tax - But can be justified: Tax corrects market failure (externality)

SECTION 2 Government spending breakdown

2.1 Types of Government Spending

Current Spending: ~$380 billion (66% of spending) - Salaries: Public servants, teachers, doctors, police - Goods/services: Fuel, office supplies, maintenance - Examples: Defence salaries, Medicare (doctor payments), welfare administration

Capital Spending: ~$60 billion (10% of spending) - Infrastructure: Roads, railways, schools, hospitals - Benefits: Flow over 20–50 years - Examples: NBN ($50bn), Melbourne metro extension

Transfer Payments: ~$160 billion (27% of spending) - Welfare: Unemployment benefits, disability support - Pensions: Age pensions (~$150bn/year, largest single item) - Family payments: Child benefits, first-home saver help - No new production created; purely redistribution

Subtotal government spending: ~$600 billion (~21% of GDP)

2.2 Major Spending Programs

Program	Annual Cost	% of Budget	Purpose
Age Pensions	$150 billion	25%	Retirees 65+
Disability Support Pension (DSP)	$30 billion	5%	Permanently disabled
Unemployment Benefits (JobSeeker)	$18 billion	3%	Jobless, actively seeking
Family Assistance	$25 billion	4%	Families with children
Medicare	$35 billion	6%	Healthcare subsidies
Education	$35 billion	6%	Schools, universities
Defence	$35 billion	6%	Military
Interest on Debt	$25 billion	4%	Cost of borrowing

Total welfare: ~$240 billion (40% of federal budget)

2.3 Merit Goods in Australian Budget

Health (Medicare): - Government subsidizes doctor visits, prescriptions - Rationale: Positive externality (healthy society benefits all) - Equity: Ensures poor can access healthcare - Funding: the 2% Medicare levy plus general revenue

Education: - Government funding: Universities (~$10bn), schools (~$20bn) - Rationale: Positive externality (educated workforce, lower crime) - Market failure: Poor couldn't afford private education - Equity: Ensures equal opportunity - Recent change: University fees increased (more student contribution)

Childcare Subsidies: - Government pays up to 30 hours/week free childcare - Rationale: Encourages workforce participation (especially women); positive externality - Cost: ~$8 billion/year (2024) - Effect: Has increased participation rates

SECTION 3 Reserve bank of Australia monetary policy

3.1 RBA Statutory Objectives (RBA Charter)

- Price Stability: Inflation 2–3% over the medium term
- Full Employment: Maximum sustainable employment
- Economic Prosperity & Wellbeing: Of Australian people
- Financial System Stability: Not explicit but implicit

3.2 RBA Inflation Targeting Framework

Target: 2–3% inflation (CPI) over the medium term (3–5 year horizon)

Why 2–3%, not 0% or 1%? - Avoid deflation: Negative inflation risks wage-price spirals, discourages spending - Measurement error: CPI measured with 0.1–0.2pp error; need buffer below 2% - Positive inflation: Allows real wage adjustments without nominal cuts - Flexibility: "Medium term" means not hitting target every quarter

Operational Target: - RBA sets official cash rate (OCR); currently 4.35% as of late 2024 - All other interest rates flow from OCR (mortgage rates, savings rates)

3.3 RBA Rate Decisions (2020–2024): Case Study

Timeline:

Period	RBA Rate	Action	Rationale
2020 (COVID)	0.1%	Cut from 0.75% to 0.1%	Emergency: prevent depression
2021	0.1%	Hold	Recovery strong, but inflation still low
2022 (May–Nov)	0.1% → 4.35%	Raise 425bp (11 hikes)	Inflation spiked to 7.8%; emergency tightening
2023	4.35%	Hold (pause)	Assess effects; inflation moderating
2024 (Expected)	4.35% → ~3.85%	Cut 50bp	Growth weak; inflation under control

3.4 Transmission Mechanism Example: The 2022–23 Tightening Cycle

Action: RBA raised rates from 0.1% to 4.35% (425bp)

Step 1: Bank Rates Change - Mortgage rates: 2.8% (early 2022) → 7.5% (Sept 2023) - Savings rates: 0.1% → 3–4% - Business lending: 2.5% → 6–7%

Step 2: Consumption Falls - Mortgage payment on $500k: $15k/year → $37.5k/year (extra $22.5k/year) - Discretionary spending: Households cut back - Effect: Consumption grows slower than normal

Step 3: Investment Slows - Business capex hurdle rate rises (higher cost of capital) - Projects yielding <6% now unattractive - Effect: Investment falls 5–10%

Step 4: Asset Prices Fall - Share prices: ASX 200 index down 10–15% - Housing prices: Down 10–15% nationally - Wealth effect: Households feel poorer, spend less

Step 5: Exchange Rate Appreciates - Higher Australian rates attract foreign capital - AUD appreciates from 0.70 to 0.75 USD - Effect: Exports less competitive, imports cheaper - X−M deteriorates (current account widens)

Step 6: Aggregate Demand Falls - AD = C + I + G + (X−M) - C ↓ (mortgage costs up), I ↓ (capex rates high), X−M ↓ (AUD high) - Only G stable; net effect: AD falls

Step 7: Inflation Falls (with 12–18 month lag) - December 2022 quarter: Inflation 7.8% (the peak), unemployment 3.5% - December 2023 quarter: Inflation 4.1%, unemployment 3.9% - June 2024 quarter: Inflation 3.8%, unemployment 4.1% - RBA's tight policy worked—inflation came back to target

Cost: Temporary unemployment rise (3.4% → 4.1%) and GDP growth stalled (below 2% trend)

3.5 Limitations of Monetary Policy Experienced in 2020–24

Zero Lower Bound (ZLB): - 2020: RBA cut to 0.1%, couldn't go lower - Spent 18 months at ZLB with ongoing COVID recovery - Alternative: Quantitative easing (asset purchases) had limited effect

Time Lags: - March 2022: RBA warned of inflation; started tightening May 2022 - But the inflation peak in the December 2022 quarter (immediately) - Policy effects didn't bite until late 2022 onwards - Full impact: 12–18 months (unemployment peaked Q4 2023)

Global Influences: - Energy prices: Oil spike (Russia-Ukraine war) beyond RBA control - China's growth: Commodity demand collapse affects Australia - Global interest rates: US Fed tightening, capital flows overseas - RBA cannot fully control Australian inflation without global cooperation

Asset Bubble Risk: - Low rates 2020–2021 inflated housing prices 20%+ - Creates financial stability risk - RBA managing monetary policy without macroprudential tools (banking regulation is APRA's job)

SECTION 4 Supply-side policies in Australia

4.1 National Broadband Network (NBN): Infrastructure Supply-Side Policy

Project Overview: - Cost: ~$50 billion over 20 years (2009–2029) - Coverage: Fiber to ~90% of premises; wireless/satellite to remote areas - Speed target: 1 Gbps possible to 90%, 12 Mbps minimum to all

Supply-Side Mechanism: - Lower broadband costs → businesses adopt digital tools → productivity rises - Enable remote work → labour market efficiency, regional development - Faster internet → startups viable in regions, not just cities - Effect: LRAS shifts right over 10+ years

Assessment: - Cost overruns: Originally $43bn → ~$55–60bn (scope/inflation) - Speed: Original 100 Mbps target reduced (cost too high) - Effectiveness: Hard to measure yet (benefits accrue over decades) - Political impact: Very contentious; Labor upgraded fiber vs. Coalition's mixed approach

4.2 Education & Skills Training

Australian Initiatives:

University System: - Mostly government-funded (~$10bn/year) - Student contribution scheme: Fees linked to field (STEM cheaper, law/commerce dearer) - Effect: Increased education attainment, but rising student debt

Vocational Education (VET): - TAFE (Technical and Further Education): Funded by government, states - Apprenticeships: Subsidized 50% wages in first year - Recent focus: Trades skills shortage (plumbers, electricians) - Effect: Matching supply/demand in labor market

Upskilling/Retraining: - Coal transition: Queensland/NSW government funding for retrained workers - Older workers: JobTrainer program (free/subsidized training) - Effect: Structural unemployment mitigation

Effectiveness: - Participation rates rising (tertiary education ~50% of 18–24 cohort) - But: Graduate unemployment among humanities rising - Mismatch: Oversupply of graduates, shortage of trades

4.3 Research & Development (R&D)

Government R&D Spending: ~$15 billion/year (~2.5% of GDP)

Institution	Function	Funding	Focus
CSIRO	Applied research	Government	Agriculture, minerals, energy
Universities	Basic research	Government	All fields
Tax Credit	R&D incentive	Tax deduction	Companies can claim up to 40% of R&D spending

Rationale for Government R&D: - Basic research spillovers: University discoveries benefit all firms (no incentive to fund) - Market failure: Firms underinvest because competitors benefit - Government funding fills gap, enabling innovation pipeline

Examples: - CSIRO: Developed Wi-Fi technology (licensed globally, returned $1bn+ in royalties) - University medical research: Led to pharmaceutical developments - Agricultural research: Helped Australia compete globally in food production

Assessment: - Limited output: Australia's R&D intensity low vs. OECD peers (2.5% vs. 3.0% average) - Brain drain: Researchers leave for US, Europe (better funding, prestige) - Corporate contribution: Private R&D only ~65% of total (vs. 75% in developed nations)

4.4 Deregulation Examples

Airline Deregulation (1987): - Before: TWO airlines (protected), domestic fares high (~$500 Sydney–Melbourne) - After: Entry of low-cost carriers (Virgin Blue, later Qantas budget), fares fell to ~$150 - Effect: Productivity surge, tourism boost, efficiency gain - Cost: Some job losses; increased congestion (net positive)

Telecommunications Deregulation (1997–2005): - Before: Telstra monopoly, $80/month landline - After: Competition (Optus, Vodafone), prices fell, mobile adoption surged - Effect: Massive productivity, structural shift to mobile/internet - Cost: Telstra losses, employment decline in landline

Recent Deregulation Efforts (2023–24): - Small business: Reduced compliance cost (cutting red tape) - Childcare regulation: Relaxed requirements (cost pressures) - Labour market: Discussed but limited change (politically sensitive)

Assessment: - Significant gains: Competition improved efficiency, lower prices - Distributional: Inequality increased (technology winners vs. service sector losers)

4.5 Other Supply-Side Policies

Competition Policy: - ACCC (Australian Competition and Consumer Commission): Prevents monopolies - Aims to keep markets competitive → efficiency - Recent focus: Tech giants (Google, Facebook) market power

Productivity Initiatives: - Government-supported skills training - Infrastructure investment (mentioned above) - Tax incentives for business investment - Labor market flexibility reforms (attempted but limited success)

SECTION 5 Policy trade-offs & real examples

5.1 Efficiency vs. Equity

Example: Tax System Trade-off

Policy	Efficiency	Equity	Outcome
Progressive income tax (45% top rate)	Worse (reduces work incentive for high earners)	Better (redistributes to poor)	Accepted in Australia
Flat tax (30% all earners)	Better (no distortion)	Worse (ignores ability to pay)	Rejected in Australia
GST (no income tax)	Worse (creates regressivity)	Better (simpler, less work disincentive)	Partial—Australia uses both

Trade-off: Australia chose progressive + GST = accept some efficiency cost for equity

5.2 Fiscal vs. Monetary Policy Trade-off (2020–2021)

Problem: COVID recession required massive stimulus

Fiscal Route: - $320 billion stimulus (JobKeeper, cash transfers) - Multiplier effect immediate; political popular - Risk: Inflation when supply recovered

Monetary Route: - Cut rates to 0.1%, keep low longer - Gradual effect; not politically popular - Risk: Asset bubbles (housing, stocks)

Australia's Choice: Used both heavily (fiscal + monetary) - Result: Overdone stimulus 2021–2022 → inflation overshoot - Lesson: Coordination matters; both together too much

5.3 Growth vs. Inflation Trade-off (2022–24)

Problem: 7.8% inflation required policy tightening

RBA Tightening: - Raised rates 425bp to 4.35% - Effect: Inflation fell to 2.8% by the September 2024 quarter; unemployment rose 3.4% → 4.1% - Cost: Growth fell below 1%, near-recession

Could Government Have Done More Fiscal Restraint? - If yes: RBA wouldn't need to tighten as much, less unemployment cost - But: Cost-of-living crisis required some support (energy, childcare) - Trade-off: Balance inflation control vs. household support

5.4 Short-term vs. Long-term Policy Mix

Current Australian Challenge (2024): - Growth weak (1.5% vs. 2–3% trend): Need fiscal expansion - Productivity low: Need supply-side reforms - Labor market tight: Need supply-side (skills) + fiscal balance - Optimal mix: Fiscal support (2024–25) + major supply-side reforms (productivity)

Stage 3 tax cuts (July 2024): - Fiscal expansion, supporting demand ✓ - Delivered to every taxpayer after the February 2024 redesign, which shifted a larger share of the benefit to low and middle earners than the original 2019 design ✓ - Still a smaller demand effect per dollar than targeted relief, because higher earners save more of it × - Productivity impact: unclear - Assessment: better targeted than the original design, but broad tax cuts remain a blunt instrument for cost-of-living pressure

SECTION 6 Assessing government economic management (2020–2024)

6.1 Effectiveness of Policy Responses

Policy Response 1: COVID Emergency (2020) - Fiscal: JobKeeper ($87bn), cash transfers ($130bn) - Monetary: Rates 0.1%, asset purchases - Objective: Prevent depression - Result: ✓ SUCCESSFUL—unemployment peaked 7.2% (vs. feared 10%+) - Assessment: Well-designed, timely emergency response

Policy Response 2: Recovery Phase (2021–22) - Fiscal: Extended JobKeeper, cash transfers through 2021 - Monetary: Rates held 0.1% while inflation rose - Objective: Support recovery - Result: × OVERDONE—stimulus excessive during peak expansion - Effect: Contributed to 7.8% inflation overshoot - Assessment: Poor timing; should have tightened earlier

Policy Response 3: Inflation Control (2022–23) - Fiscal: Mild restraint + cost-of-living relief (energy, childcare) - Monetary: Rapid tightening (425bp) - Objective: Bring inflation back to target - Result: ✓ EFFECTIVE—inflation fell to 3% by late 2024 - Cost: Unemployment rose, growth fell (necessary trade-off) - Assessment: Appropriate but harsh; coordination with fiscal could have been smoother

Policy Response 4: Growth Recovery (2023–24 onwards) - Fiscal: Stage 3 tax cuts, energy support, childcare subsidies - Monetary: markets expecting the cash rate to be cut from its 4.35% peak - Supply-side: Infrastructure, training, deregulation (partial) - Objective: Restore 2–3% growth without overheating - Result: TBD (early 2024); mixed signals - Assessment: Good mix in principle, but tax cut design suboptimal (benefits high earners)

6.2 Achievement of Macro Objectives (2020–2024)

Objective	Target	2020	2024	Assessment
Growth	2–3%	−3.2%	1.5%	Below target; weak recovery
Employment	Full (NAIRU 4–4.5%)	7.2%	4.1%	Achieved; came far
Inflation	2–3%	0.9%	3.0%	Overshot badly; now back
External	Sustainable (~3%)	−2.4%	−3.0%	Acceptable
Living standards	Rising real wages	−2%	−4.5% total	FAILED; wages stagnant
Sustainability	Stable debt	Rising	Rising	Concern; reforms needed

6.3 Policy Constraints Experienced

Time Lags: - RBA warned of inflation May 2022; inflation peaked in the December 2022 quarter - Rate hikes didn't bite until Q4 2023 (18 months) - Fiscal stimulus 2020 took 6–12 months for full effect

Global Influences: - Oil spike (Russia-Ukraine war): Beyond Australian policy control - China slowdown: Commodity prices fell, reducing export demand - US Fed tightening: Capital flowed out, exchange rate pressures

Political Constraints: - Election 2022: Fiscal stimulus delayed (election timing political cycle) - Coal transition: Political sensitivity in Queensland delayed policy - Stage 3 tax cuts: Controversial (high earner focus) but difficult to change

SECTION 7 Study guide summary & key insights

Using Fiscal Policy Effectively:

- Timing is critical: Stimulus in contraction/trough good; in expansion bad
- Design matters: Target low MPC recipients for larger multiplier
- Coordination with monetary policy: Avoid doing both heavily at once
- Acknowledge constraints: Time lags, crowding out, structural deficits limit effectiveness

Using Monetary Policy Effectively:

- Inflation targeting credible but imperfect: 2–3% target good, but medium-term horizon matters
- Transmission slow: 12–18 month lags require forward-looking decisions
- Zero lower bound real: Cannot always stimulate adequately in deep recession
- Global influences matter: Can't fully control inflation/exchange rate without global coordination

Supply-Side Reforms:

- Essential for long-term growth: Demand management cannot achieve >2% growth permanently
- Slow to implement: Effects take 5–10 years; requires political patience
- Design critical: NBN politically contentious, VET system has mismatch problems, R&D underfunded
- Equity trade-offs: Deregulation increases efficiency but can harm workers

Australia's Current Challenge (2024):

- Demand: Weak growth (1.5%); needs fiscal support and rate cuts
- Supply: Low productivity growth; needs structural reforms (skills, infrastructure)
- Trade-off: Real wages falling (−4.5% 2020–24); equity a major concern
- Opportunity: Combined fiscal expansion + supply-side reforms = sustainable growth path