Question 22 (10 marks)

(a) A hypothetical economy has a simple multiplier of 2.5.

Calculate the change in national income that would result from an increase in investment of $100 million. **1**

$\Delta Y = k \times \Delta AD$. ~~$k = \frac{1}{MPS}$~~ $\therefore \Delta Y = 2.5 \times 100\,000\,000$ $\Delta Y = 250\,000\,000$

$= \$250$ million

(b) Outline how economic growth in a major trading partner might influence economic growth in Australia. **2**

~~An incr The influence this change would have includes~~

In the short term, a decline in the TOT would be inevitable as the ~~countries trade~~ trading partners trade and exports increased by its growth. The long term effect would be that Australia ~~has~~ would be opened up to higher levels of trade, evening out the TOT, as the country requires resources and goods for growth.

(c) How will an increase in Australia's marginal propensity to save (MPS) affect Australia's economic growth? **3**

An increase in Australia's MPS means that a greater number of Australians are saving larger amounts. This means that national savings would increase, causing total expenditure or MPC to drop. This can result in a downfall in domestic trade and a decrease in inflation as businesses ~~attempt to~~ lower prices to counteract the change. This could influence exports in the long term as external consumers are lured by lower prices.

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Question 22 (continued)

(d) Explain the effects of a reduced rate of economic growth on the Australian Government budget. **4**

A reduced rate of economic growth can lead to a decline in national income. This means that total taxation revenue (as Australia's is based on a progressive taxation structure) would decrease. ~~This~~ The decline in revenue would mean Australia's total government expenditure ~~within~~ the budget would decrease resulting in a reduction of funding, subsidies, welfare payments etc. To solve this problem, government would have to look externally for income, i.e. borrowing money from overseas to fund an expansionary fiscal policy and a loosened monetary stance.

End of Question 22

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