Question 23 (10 marks)

(a) Distinguish between the current account deficit and foreign debt. **2**

The current account deficit is a deficit in the current acount of the Balance of Payments caused by the amount of money spent on goods and services outweighing the amount recieved on goods, services and net income. Foreign debt is the money owed overseas from borrowing.

(b) Explain how the level of national savings can influence the size of the current account. **3**

An increase in national savings will lead to a reduction on spending on goods and services, reducing the outflow on the current acount, which reduces the size of the current account deficit. This national savings would also reduce the multiplier effect leading to a reduction in national income, resulting in less money for consumers to spend on goods and services. Similarly, if the level of national savings decrease, leading to increased expenditure on goods and services the outflows on the current acount will increase leading to larger current account deficit.

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Question 23 (continued)

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(c) What are the positive and negative implications of a current account deficit for the Australian economy? **5**

The positive implications of a current account deficit are that ~~the~~ expenditure in the economy is high, most likely resulting in a strong level of economic growth and a high level of global influence. The negative implications of a current account deficit are the problems associated with servicing the cost of the deficit through borrowing from overseas leading to an increase in foreign debt. Australia has undergone a CAD for many years with many economists arguing that it is not possible to maintain in the long term.

End of Question 23

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