Question 22 (10 marks)

2013 HSC - Economics
Band 5/6
Sample 1 Question 22

(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**

$\Delta AD = 100 \times 2.5$
$= \$250$ million increase

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

Economic growth ~~which~~ signifies the increase in national income. The partner economy will have a greater income and possible currency appreciation, ~~&~~ and ultimately a higher overall MPC. Therefore, there will result a stronger demand for Australian exports to fuel their growth and/or development. This will nourish Australia's ability to experience greater levels of growth, or reduced negative growth.

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

The recent proposal to increase compulsory superannuation and volatile global economic outlooks has resulted in a higher MPS. A reduced level of consumption in the economy will subdue the multiplier effect, leading to lower possible increases in national income. However, this will reduce Australia's savings-investment gap, allowing for businesses to draw on ~~national~~ (private) domestic savings to fuel their investment. Increased domestic investment will outweigh the subdued consumption and contribute to a higher level of economic growth, through the multiplier effect. This will in turn, increase consumer confidence and spur greater levels of private consumption and investment.

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

A lesser rate of growth will cause the government to reconsider its budgetary stance. Firstly, a reduction in the rate of EG will cause businesses to outlay some employees as labour is a derived demand. This will eventually lead to a rise in unemployment levels, namely cyclical, and a subsequent rise in cost push inflation as labour becomes a more scarce resource. The automatic stabilisers will readjust their focus and provide more transport payments for the unemployed. The progressive taxation system will generate less revenue as fewer people pay the higher income tax. This ~~will~~ may stimulate the need for greater discretionary spending, such as a stimulus package. The government will have less revenue, and the budget will need to take an expansionary stance (G > T) to counter the economic downturn, whilst curbing inflation levels through greater aggregate demand, ~~to~~ by producing the need for derived labour, thereby balancing objectives of inflation and unemployment.

End of Question 22

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