



ECONOMIC GROWTH

Multiple choice

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|------|-------|-------|--|
| 1. A | 6. A | 11. C | 16. D (assuming an increasing MPS as income rises) |
| 2. B | 7. B | 12. A | 17. C |
| 3. B | 8. D | 13. A | 18. C |
| 4. B | 9. C | 14. B | 19. D |
| 5. D | 10. A | 15. B | 20. B |

Short answer questions

Question 1

- (a) An economy is in equilibrium if:

$$\begin{aligned}
 S + T + M &= I + G + X \\
 130 + 40 + 30 &= 200 + 70 + 50 \\
 200 &= 320
 \end{aligned}$$

Thus the economy is not in equilibrium

- (b) In the above example, injections are larger than leakages, meaning that the circular flow of income is not in equilibrium. The initial impact of this is that the excess injections will cause the economy to expand. In the medium term, leakages will increase until the point where the economy is in equilibrium. Whenever an economy is not in equilibrium, the imbalance will cause the economy to tend back towards equilibrium
- (c) The net result of the \$30 million injection can be calculated by using the simple multiplier formula:

$$\begin{aligned}
 \text{Multiplier} &= 1/\text{MPS} \\
 &= 1/0.35 \\
 &= 2.86
 \end{aligned}$$

The \$30 million initial injection will have a multiplied effect on the economy as follows

$$\begin{aligned}
 \text{End effect} &= \text{initial injection} \times \text{multiplier} \\
 &= \$30\text{m} \times 2.86 \\
 &= \$85.8\text{m}
 \end{aligned}$$

Thus an extra \$30 million dollars in export revenue will increase GDP by \$85.8 million.

- (d) **One possible cause is higher levels of economic growth overseas. Higher growth overseas will mean higher incomes, and increased demand for our exports. Another possible cause is lower levels of global protection. Lower protection levels will make Australian exports more competitive in the foreign markets, and increase demand for our exports.**
- (e) **Traditionally, international growth rates particular the US' have had a significant impact on the Australian economy – a general rule of thumb was that the Australian business cycle followed the US business cycle with a 6 month time lag. Since the mid 1990s however, Australia's economy has outperformed the global economy. Although global growth rates have stayed below 2% in recent years, Australia has averaged growth of around 3.5% in the last few years – indicating the resilience of the economy to the international business cycle. This has largely been thanks to the ability of our export industries to find new markets for their products – such as during the Asian crises when exporters found a range of new markets in regions such as Europe and South America.**

Another international factor that has impacted upon the growth rate in Australia is the high levels of protection that are maintained by many countries, particularly agricultural tariffs – such as with the EU's Common Agricultural Policy. These policies limit Australian exporters' access to foreign markets, and thus limit the growth of our export industries.

Question 2

- (a) **Economic growth involves an increase in the volume of goods and services that an economy produces over time. It is measured by the annual rate of change in real gross domestic product (real GDP). These measurements are taken by the Australia Bureau of Statistics, who look at changes to GDP (income), GDP (Production), and GDP (Expenditure) and take an average of all three measurements.**
- (b) **One influence on an economy's level of consumption will be consumer expectations regarding the future rate of inflation and future real incomes – influencing a consumer's decisions to spend rather than save. Higher inflation and higher real income in the future will encourage higher consumption now, and discourage saving for the future. Another factor is interest rates. An increase the level of interest rates will discourage consumption, as higher interest rates make it more costly to borrow, and also more attractive to save.**
- (c) **Australia's economy is not closed from the rest of the world. We rely on other economies for income and to supply us with goods and services. Global economic growth factors will influence Australia's growth rates by influencing the income we receive from our export sector and other flows of capital funds. Higher trade and financial flows between nations as a result of globalisation mean that an economic slowdown in the one or more of Australia's trading partners will then have an impact on economic growth in Australia, because it will mean less export revenue and less foreign investment in Australia.**

Global protection levels will also impact on Australia's particularly in the area of agricultural tariffs – for example the EU's Common Agricultural Policy. Protectionist policies hurt Australian growth because they limit Australian exporters access to foreign markets, and as such limits the growth of our export industries.

Question 3

(a) **Nominal rate of economic growth = $((\text{GDPy2} - \text{GDPy1}) / \text{GDPy1}) \times 100/1$**
= $((600-525) / 525) \times 100/1$
= 14.3%

(b) **Real GDP Year 2 = $600 \times (100/110)$**
= 545.45

Real GDP Year 3 = $750 \times (110/125)$
= 660

Real growth rate = $[(660-545)/545] \times (100/1)$
= 21%

(c) **A positive impact of economic growth on an economy is that as a result of the growth of industries, there will be new jobs created, decreasing the level of unemployment. One negative impact of economic growth is that growth increases gross national income as employment and wage levels increase. Increased national incomes will result in demand-pull inflation, as the newly employed workers (or those now on higher wages) spend their incomes on goods and services, creating inflation.**

(d) **Currently, monetary policy is the major policy instrument used by the government to influence Australia's level of economic growth. Under monetary policy, the Reserve Bank of Australia (RBA) can change the overnight cash rate, which will influence the general level of interest rates in the economy. Changes in the levels of interest rates will influence consumer and business spending and thus influence economic growth.**

Fiscal policy is the use of government revenue and expenditure measures in order to influence an economy. The Government's annual plans for the use of its revenue and expenditure measures to influence economic growth are announced in its annual Budget every May. For example, an increase in government expenditure and a cut to government revenue receipts will increase economic growth by injecting more funds into the circular flow of income.