THE OBJECTIVES OF ECONOMIC POLICY 13

MULTIPLE CHOICE

1.	B	6.	B	11.	A	16.	B
2.	D	7.	D	12.	B	17.	A
3.	A	8.	D	13.	B	18.	A
4.	D	9.	C	14.	C	19.	D
5.	D	10.	A	15.	D	20.	A

SHORT ANSWER QUESTIONS

Question 1

(a) Economic growth occurs when there is a sustained increase in a country's productive capacity over time. It is commonly measured by the percentage increase in real Gross Domestic Product.

(b) An answer to this question may include any two of the following:

- Maintaining a sustainable rate of economic growth of 3-4% in order to improve living standards and minimise unemployment without triggering inflation.
- Achieving full employment, so that cyclical unemployment is eliminated and the economy is operating at its productive potential.
- Keeping inflation within its 2-3% target band, in order to maintain the real value of income and wealth and preserve Australia's international competitiveness.
- Ensuring Australia's external stability, through keeping the CAD at around 3% of GDP, keeping foreign liabilities at a serviceable level and maintaining a stable currency.
- Achieving a socially acceptable level of equality in the distribution of income, with all members of the society able to attain a basic standard of living.
- Achieving a level of economic growth consistent with the preservation of the natural environment.

(c) Economic growth leads to an increase in incomes. When people's incomes rise, they demand more goods and services, leading to an increase in production to meet this demand. Producers will demand more labour in order to produce these goods and services, so that a decrease in unemployment accompanies economic growth. The reverse occurs during an economic downturn.

(d) Australia has difficulty achieving external balance. Australia's persistent CADs have created a reliance on financial inflows, which have beyond 60% of GDP. Their servicing requirements are a key component of the net incomes deficit of the CAD. Australia's economic growth has increased demand for imports, while the appreciating Australian dollar has hurt Australia's exports through reducing its international competitiveness. The record CAD threatens international investor confidence in the Australian dollar and the Australian economy.

Question 2

(a) The curve is known as the Phillips Curve.

(b) A decrease in unemployment often occurs from economic growth, as the increase in aggregate demand leads producers to require more employees in order to expand production. If production cannot keep pace with demand, consumers will use their increased incomes to bid up prices for limited goods, leading to demand-pull inflation.

(c) Inflation impacts investment decisions by firms because it creates uncertainty about future prices and revenues. Exporting firms suffer a decline in international competitiveness. Inflation harms individuals because it erodes the value of their savings and income, reducing their purchasing power. Inflation may compel the government to slow the economy, which will increase unemployment and slow economic growth.

(d) Economic growth leads to an increase in incomes which creates increased demand for imports, worsening the balance of goods and services component of the CAD. Growth may also create inflationary pressures which undermine the international competitiveness of Australia's exports. To prevent these costs to external stability, the government may seek to slow the domestic economy through implementing contractionary policies. However, this means the Australian economy must grow below its productive potential, resulting in a conflict between growth and external stability.

Question 3

(a) Macroeconomic policies are counter-cyclical policies intended to influence aggregate demand. They impact on the entire economy. In contrast, microeconomic policies aim to increase aggregate supply. They target particular firms, sectors or industries.

(b) Fiscal policy and monetary policy are macroeconomic policies used in Australia. Fiscal policy involves the use of the government's budget, and monetary policy uses the level of interest rates in Australia.

(c) Microeconomic policy tends to involve short-term costs in exchange for long-term benefits. Attempts restructure an industry to increase efficiency, such as the removal of tariffs to increase the efficiency of domestic producers, often result in structural unemployment. This occurs in the short-term as inefficient firms close and as other firms may seek to minimise costs through reducing the size of their workforce.

(d) Macroeconomic policy plays an integral role in the government's policy mix. Both fiscal and monetary policy are macroeconomic policies as each can have an economy-wide affect on aggregate demand. In recent years, monetary policy has played the driving role in the government's macroeconomic policy mix, with the RBA changing interest rates pre-emptively to ensure stable growth in aggregate demand. The Government has seen fiscal policy play a supportive macroeconomic role through the operation of automatic stabilisers. It increasingly targets its discretionary changes in fiscal policy to achieving structural objectives.