*Questions*

1. What evidence suggests that the Australian economy was in recession?
2. Describe three characteristics of a recession.
3. Other than a fall in real GDP, describe three other economic indicators that would have fallen as a result of the pandemic.
4. Describe and explain the change in both household and government saving.
5. Use the AD/AS model to illustrate and explain the impact of the pandemic on the Australian economy.

## Extended responses

*Each of the following questions should be answered in 2-3 pages of writing. Include diagrams and examples where appropriate. Pay attention to the allocation of marks when writing your answer.*

1. a. Distinguish between the causes of a movement along the aggregate demand curve and a shift of the curve. [10 marks]
   b. Explain how an increase in aggregate demand would impact on the economy, assuming the economy was initially in a trough or recession. [10 marks]

2. Show how the impact of the following events can be modeled using an AD/AS framework:
   (i) Australia's recent mining construction boom.
   (ii) disruptions to supply chains associated with the pandemic.
   (iii) a rise in productivity. [5 marks each]

3. a. In 2020-2022, supply chains around the world were disrupted by production and transport closures associated with the COVID-19 pandemic . Use the AD/AS model to explain how the disruptions affected economic growth. [10 marks]
   b. Use the AD/AS model to model an expansionary gap. Discuss five characteristics of such a period. [10 marks]

4. Use the AD/AS model to depict and explain each of the following statements.
   a. "the economy has experienced a large expansionary shock from the high terms of trade and has relatively modest amounts of spare capacity. Looking ahead, the risk of inflation rising again over the medium term remains". [10 marks]
   b. "House prices in Queensland are likely to sink as the financial effects of the state's devastating floods strain household budgets and dent banks' willingness to lend". [10 marks]

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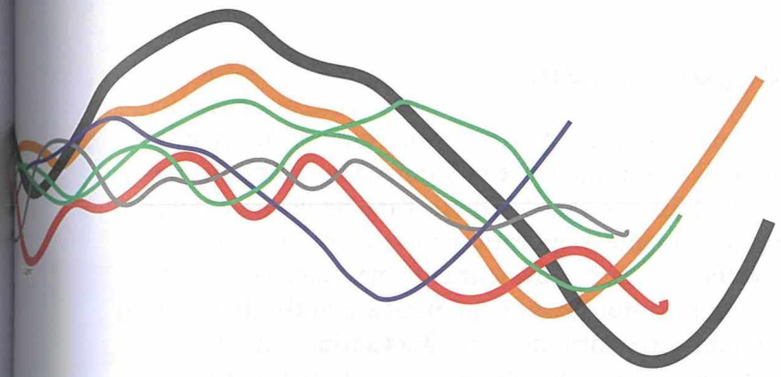
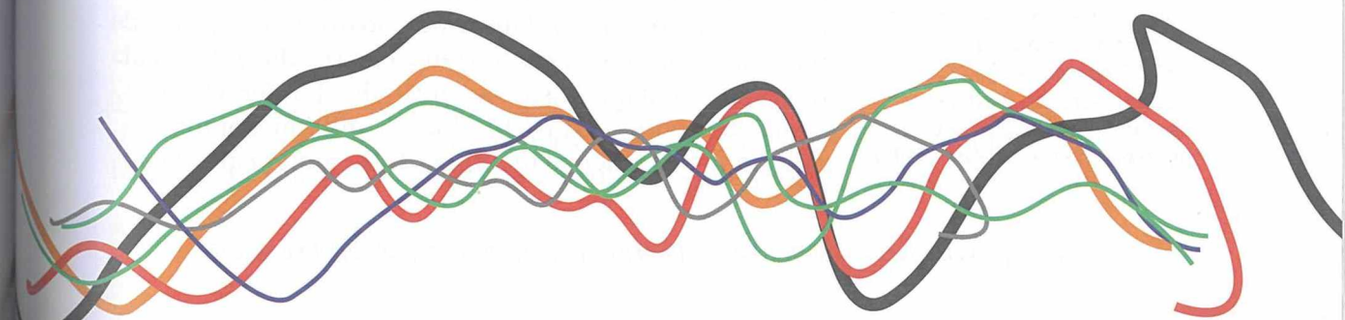


# 11

# Economic Policy Objectives

## Chapter concepts

- ***the economic objectives of the Australian government***
- ***the economic objectives of the Reserve Bank of Australia***
- ***the extent to which the economic objectives of the Australian government may conflict and complement each other***
- ***time lags and how they affect the use of economic policies.***



## The economic roles of government

As discussed in chapter 8, government spending in developed economies typically accounts for about 23 per cent of all spending in the economy. Governments have a wide range of responsibilities and functions, not all of which have an economic focus – they also regulate aspects of business operation; provide public goods and services; and provide a social welfare system. Governments in western economies have played an active role in macroeconomic management since the 1950s. The development and use of policy measures to reduce the fluctuations in economic activity associated with the business cycle came about as a result of the influence of 'Keynesian' economics.

The next four chapters are concerned with the role the government plays in managing the macroeconomy. This chapter discusses the objectives of economic policy, and chapters 12–14 discuss the policies that can be implemented in pursuit of those outcomes.

## Government economic objectives

Australia has had two official statements outlining government economic objectives:

- a 1945 White Paper (a policy discussion document) entitled "Full Employment in Australia" concluded that the basic economic objective of the Commonwealth Government was to 'stimulate spending on goods and services to the extent necessary to maintain full employment'. The title of the paper reflected concern that the high levels of unemployment (up to 32 per cent) seen in the Great Depression of the 1930s should not occur again after World War II.
- the Vernon Report (1965) concluded that the broad objective of economic policy should be a "high rate of economic and population growth with full employment, increasing productivity, rising standards of living, external viability and stability of costs and prices".

A lot of time has elapsed since these statements were released. For a number of reasons, they seem less relevant in the 2020s. Rapid economic growth is now regarded as being unsustainable from an economic, environmental and social point of view. The high rates of population growth that supported infrastructure and resource projects and the development of a manufacturing economy after World War II were founded on both natural increase and migration. Natural population growth rates started to fall in the 1970s, but migration remained strong until the border closures associated with COVID-19. The 25 million population milestone was reached in August 2018, some years ahead

*In the 2010s, annual population growth averaged around 1.5 million people – about 60% of which was migration. The onset of the pandemic slowed population growth. Australia's population increased by just 135,000 people in 2021. Natural increase (births - deaths) was 138,500 and net overseas migration was -3,600.*





of the forecast. The 'external viability' objective referred to a sustainable trade balance; no excessive fluctuations in the exchange rate; and the maintenance a 'sustainable' foreign debt to GDP ratio. But external viability no longer has any real meaning, because the government has had no policy control over the exchange rate since the currency was floated in 1983 (although exchange rates are a part of the monetary policy transmission mechanism, as explained in chapter 13). The importance of economic efficiency and productivity as an objective has increased since the 1980s, when governments of both political persuasions started a process of deregulation and pro-competition reforms, as described in chapter 14.

If a list of economic objectives and policy goals was drawn up today, it would be somewhat different from the priorities listed in the Vernon Report. A sustainable rate of economic growth would probably be the top priority, given that we now recognise the need for immediate action on climate change and the environment. Price stability is crucial to maintain the spending power of our income and the competitiveness of our economy. High employment is a very important objective, although the concept of 'full employment' has a different meaning today than it did in the 1960s. Productivity, efficiency and competitiveness would feature prominently in any current discussion of economic objectives. Equality of opportunity is considered important in achieving an equitable distribution of income and wealth in the long term.

## Policy objectives of the Reserve Bank

The Reserve Bank's Charter states:

> *"It is the duty of the Reserve Bank Board, within the limits of its powers, to ensure that the monetary and banking policy of the Bank is directed to the greatest advantage of the people of Australia and that the powers of the Bank ... are exercised in such a manner as, in the opinion of the Reserve Bank Board, will best contribute to:*
> - *the stability of the currency of Australia;*
> - *the maintenance of full employment in Australia; and*
> - *the economic prosperity and welfare of the people of Australia".* *(RBA, 2018)*

The Charter effectively sets out the economic objectives of the Bank. The phrase 'currency stability' refers to price stability, not exchange rate stability. Since 1992, the RBA has followed the objective of keeping consumer price inflation between 2 and 3 per cent, on average, over the course of the business cycle. 'Economic prosperity and welfare' can be taken to mean the achievement of rising living standards in the long term (economic growth), along with the management of the business cycle through monetary policy. 'Full employment' can be taken to mean achieving the 'natural' rate of unemployment, which is currently thought to be about 4 per cent of the workforce. At this level, cyclical unemployment would be close to zero, but there would be some frictional and structural unemployment.

The Reserve Bank Board makes decisions independently of the political process – the government of the day has no role in the conduct of monetary policy (the policy interest rate that is in Australia called the 'cash rate'). Central bank independence

in determining monetary policy is the international norm. Independence prevents manipulation of interest rates for political ends and keeps monetary policy focused on RBA goals.

The following sections provide further detail about government economic objectives.

## Economic growth

Economic growth is defined as the increasing capacity of the economy to satisfy the material wants of its members. Growth is usually measured by calculating the rate of change in real Gross Domestic Product (GDP) over a period of time. In Australia, the target rate of growth is perhaps 3 per cent per annum.

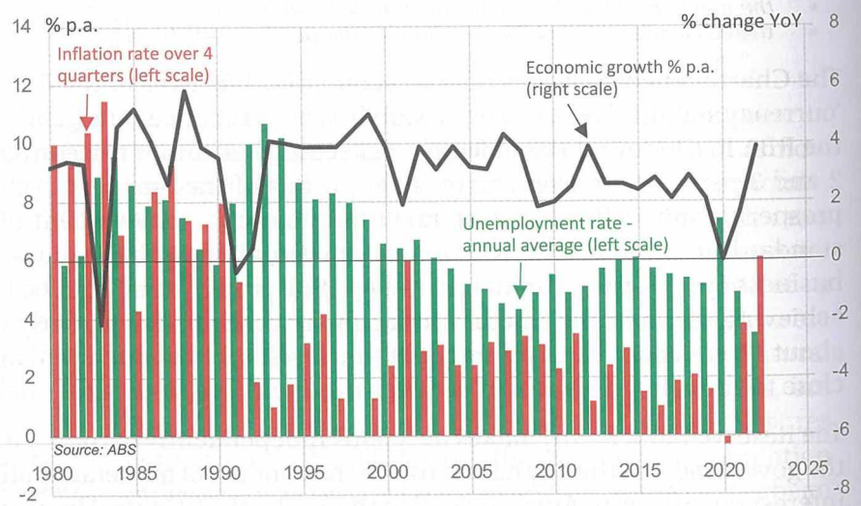
Potential growth is determined by growth in the labour force, and growth of productivity. If, for example, the labour force grew by 1.75 percent, and productivity by 1.5 per cent, then potential GDP growth would be 3.25 per cent. The actual rate of growth in any year, however, depends upon the level of aggregate demand at any point in time.

Growth is the key economic objective because it delivers higher real income and enables people to satisfy more wants. Growth creates more demand for productive resources, including labour. The extent to which growth helps achieve higher employment depends, however, on whether the growth rate exceeds the rate of growth of the population and workforce.

Figure 11.1 illustrates Australia's economic growth since 1980 (read the black line against the right hand scale). Growth has ranged between –2.1 and 5.9 per cent over the period, averaging 3.0 per cent per annum if we include the COVID-19 recession of 2020-2021 (or 3.1 per cent otherwise).

### Figure 11.1 Australia's macroeconomic record: 1980–2022

*Since the early nineties, the three main economic objectives have essentially been achieved, with economic growth averaging 3.1 per cent per annum; inflation within the 2–3 per cent target band (although quite sluggish after the GFC); and unemployment within 0.5 – 1.0 per cent of the 'natural rate'.*








Economic growth in Australia exceeded 5 per cent on three occasions since 1980. Rates that high are unsustainable in a mature economy as they put pressure on factor markets (i.e. markets for raw materials and labour) and risk driving up prices (demand inflation). On the other hand, when growth is slow (as in the three years when it was below 2 per cent) there is insufficient demand to fully employ resources. In developed countries, a rule of thumb is that economic growth rates have to exceed 3 per cent per annum before unemployment can be reduced.

**Australia's growth record by decade**

| Decade | Annual average % p.a. |
|---|---|
| 1960s | 5.5 |
| 1970s | 3.8 |
| 1980s | 3.6 |
| 1990s | 3.3 |
| 2000s | 3.1 |
| 2010s | 2.4 |

*Source: ABS, National Accounts*

Prior to the COVID-19 pandemic, the Australian economy had recorded 28 consecutive years of economic growth – the longest period of recession-free growth for a developed country. The pandemic brought on an economic recession because of its dual impact on aggregate demand and aggregate supply, and it will also impact on Australia's long-term growth potential because migration stopped for two years.

It should be noted that GDP is not necessarily considered the best, or most accurate, measure of economic welfare and progress. Many economists prefer broader measures of national well-being that include a number of welfare indicators such as environmental sustainability; objective indicators of social welfare such as education, health and economic security; and subjective measures of well-being such as life satisfaction and happiness.

## Price stability

Price stability occurs when there is little change in the general price level – that is, there are low rates of inflation. The Reserve Bank and the Treasury agree that the appropriate target for inflation rate is 2-3 per cent, on average, over the course of the business cycle. Price increases have been within the target range since the early 1990s (see the red columns in figure 11.1, using the left hand scale). 2000 was an exception because the introduction of the Goods and Services Tax (GST) in July flowed through to prices. Inflation has increased markedly in the last two years due to the combined effect of:

- supply side pressures associated with the pandemic (interruptions to supply chains; periodic lockdowns; high rates of absenteeism from work), the war in Ukraine and floods in eastern Australia; and
- demand pressures – pent-up demand, pandemic stimulus payments and record-low interest rates.

Controlling inflation is a very important objective. Sustained inflation rates above the target range bring a number of economic costs. Firstly, inflation erodes the purchasing power of household incomes (real income). Price increases mean consumers are able to buy smaller quantities of goods and services than they previously could, unless their income increased at the same rate as general prices.

*Inflation can be described as the 'headline' rate or the 'underlying' rate. The headline rate is the rate of change in the Consumer Price Index (CPI) which reflects the prices consumers pay for goods and services. The underlying rate takes volatile and seasonal price changes into account, and is also adjusted for the influence of government policies such as changes in tax rates or interest rates.*

Inflation also feeds into higher interest rates, which are an important influence on business decisions concerning investment and household discretionary spending. When prices rise, interest rates must follow otherwise lenders are paid in inflated dollars and they do not receive a positive rate of return. That said, the real interest rate is more important than the nominal rate – the real rate is the nominal interest rate minus the inflation rate. If the inflation rate is 3 per cent, and the nominal interest rate is 7 per cent, the real rate of interest is 4 per cent.

Persistent inflation erodes the confidence people have in money as a store of value, so many households seek 'hedges' against expected price rises by purchasing assets which are likely to appreciate in value, such as property, antiques or precious metals. Such 'speculative activity' reduces the potential output of the economy if it diverts resources away from productive activities.

Business investment decisions are more risky in an inflationary environment because rising prices make it more difficult to contain costs and operate profitably.

Other things being equal, international competitiveness is eroded if domestic inflation rates exceed those overseas. To illustrate, assume a buyer in the United States could purchase a product from either New Zealand or Australia – if the quality of the competing products are similar, the decision would presumably be made on the basis of price. If inflation levels in New Zealand were running at 4 per cent, whilst prices in Australia were increasing at 7 per cent, then over a period of time the US importer will tend to favour the New Zealand product as it becomes cheaper relative to the Australian product. Similarly, imports become more competitive in the domestic market as their prices fall relative to domestic prices.

The relationship between inflation and the exchange rate is a 'double-edged sword'. Other things being equal, if our inflation rate was higher than that experienced overseas, we would predict currency depreciation because demand for our exports would fall. But depreciation means exports become more competitive (overseas buyers can buy more goods for the same cost), and imports become more expensive. It also means the prices of imports rise, which is inflationary! The net effect of depreciation on inflation depends upon the relative

Economic skills

**Numeracy - interpreting statistical information**

Use the International Monetary Fund's World Economic Outlook (WEO) database (search for IMF WEO) to collect economic performance data for any six countries. The data should refer to:

- price stability
- level of unemployment
- annual rate of economic growth

Compare your findings with the Australian data in figure 11.1.





price elasticities of imports and exports – that is, the responsiveness of domestic and overseas buyers to price changes.

Sustained inflation may bring about structural changes in the economy. For example, capital–for–labour substitution occurs if wages (the price of labour) rise faster than productivity, in which case labour 'prices itself out of a job' and employers replace labour with machines (that don't ask for pay rises). The rising oil prices that led to cost push inflation in the 1970s provided an incentive for companies to focus on energy efficiency and fuel consumption.

The burden of inflation does not fall evenly on all sectors of the community. Households that are able to anticipate inflation may be able to arrange their financial affairs to benefit from expected price increases. As explained above, households in a financial position to purchase real assets which rise in value with inflation (e.g. property) insulate themselves from falls in purchasing power.

The living standards of low income earners and recipients of transfer income (such as pensions) will fall during periods of inflation unless these payments are indexed to compensate for price rises. Sectors of the economy with market power (business owners who can pass on price increases to their customers, or trade unions who can achieve wage increases for their members) seem more capable of maintaining their real incomes.

Sustained inflation also effects taxation and government revenue. 'Pay as you go' (PAYG) taxpayers suffer bracket creep as inflation gradually causes their income levels to rise to levels where they are liable for higher marginal rates of taxation. Government revenue increases as a result.

## Full employment

Full employment occurs when everyone who is willing and able to work can find a job. Given the dynamic nature of developed economies, it is impossible to achieve a zero rate of unemployment. The 'friction' associated with job search (uncertain matching of demand and supply across the labour market) is responsible for perhaps 1.5 to 2.5 per cent of the reported unemployment at any point in time. Structural unemployment occurs if there is a mismatch of available and required skills in a geographical or occupational sector of the economy. Currently, structural unemployment may account for 2–3 per cent of the total unemployment rate.

Together, the frictional and structural rates constitute what economists call the 'natural rate' of unemployment – the lowest rate of unemployment that can be achieved without inflationary pressure developing. In current conditions, the natural rate is thought to be 4 per cent of the workforce. Cyclical or demand–deficient unemployment adds to this during periods of lower economic activity.

The average rate of unemployment during the period covered by figure 11.1 is 6.7 per cent. Unemployment rates at the peak of the boom in 2007–08 were the lowest in thirty years, although they are still high compared to the 1950s and

1960s, when rates were below 2 per cent. Peaks in unemployment followed recessions in 1982-83 and 1990-91, and there was also some increase after the Global Financial Crisis (although much smaller than expected). The COVID-19 pandemic had a negative impact on the labour market due to restrictions on movement, business shutdowns and loss of household income. Unemployment rates have fallen dramatically in 2021 and 2022, reaching just 3.4 per cent in July, 2022. The underemployment rates fell to 6 per cent. At the time of writing, there are apparently more job vacancies than there are unemployed people!

Perhaps figure 11.1 does not tell the full story about whether the unemployment objective was achieved, however! Firstly, ABS data understates the true extent of joblessness in the workforce, perhaps by a significant amount. Many people holding part-time or casual jobs would prefer to work longer hours, and are thus underemployed. In mid–2022, the underutilisation rate (unemployment plus underemployment) was about 9.5 per cent of the workforce (although this was the lowest level for many years). About half of all unemployed people found a job within three months, with the rest fairly evenly divided between medium term (13-52 weeks) and long term unemployment (more than one year). Unemployment among young people is consistently higher than adult unemployment. 7 per cent of 15-24 year-olds were unemployed in June, 2022. Unemployment is usually higher than the headline rate in outer metropolitan and regional areas.

The economic cost of unemployment is modeled by the 'GDP gap', where actual levels of production and income lie inside those that could be achieved on the economy's 'production possibility frontier'. The gap represents two types of costs for the economy. A direct monetary cost arises because unemployment results in lower levels of aggregate consumption, investment and business confidence, and increases the welfare payments paid to the unemployed from employed taxpayers' pockets. Unemployment also has an opportunity cost – the alternative use that could have been made of lost taxation and welfare payments, such as spending on infrastructure, health, or education. Over the long term, persistent unemployment reduces economic growth because the capacity of the economy to satisfy future wants is reduced. Long term unemployment also bears considerable personal and social costs on those who cannot find work.

*With a few assumptions, it is possible to estimate the extent of lost production and income. In June 2022, the AWOTE (average weekly ordinary time earnings) for adults employed full time was approximately $1770. About 494,000 people were officially unemployed. The total cost to the community in lost output and income was thus $875 billion per week, or about $45 billion in a full year (1.5% of GDP). Add to this the $860 Jobseeker bill (assuming all eligible people applied) of approximately $25 billion p.a.*

### Other objectives

Economic growth, price stability and full employment are key macroeconomic objectives in all countries. Other objectives such as an equitable distribution of income and welfare can be achieved as a by-product of achieving these objectives. Most countries have considerable inequality of income and wealth. Efficient resource allocation is also an important economic objective related





to macroeconomic performance, although in a policy sense it usually involves changes at the microeconomic level (i.e. to individual sectors of the economy). As will be discussed in chapter 14, increasing productivity and efficiency are regarded as key ways of increasing prosperity in the future.

## Economic objectives: conflict and compatibility

The economic problem applies to national economic objectives as much as it does to personal ones – at any point in time, a nation has limited resources with which to address unlimited wants, so choices have to be made.

Some economic objectives are compatible with each other, in the sense that the policies applied to achieve one objective also help to achieve other objectives at the same time. Other objectives are difficult to achieve simultaneously.

### Compatible policy objectives

Some of the objectives above can be targeted simultaneously, because the policies used to achieve them are complementary. Examples include:

- economic growth and full employment (lower unemployment) – growth creates more demand for goods and services, and thus the resources used in production (derived demand). Economic growth also improves material welfare, so aggregate demand will rise, providing stimulus to the expansion of output and employment. Policies to achieve lower unemployment also promote growth – higher levels of employment reduce the 'GDP gap' and mean the economy operates nearer its potential;
- full employment and equitable income distribution – policies designed to lower unemployment should lead to a more equitable income distribution because, other things being equal, work provides households with the income to consume, save and build wealth;
- price stability and economic growth – keeping inflation low is an important prerequisite for promoting sustainable growth. Low inflation reduces uncertainty, encourages investment in productive activities and assists international competitiveness; and
- efficient resource allocation, productivity and economic growth – efficiency and productivity are the driving force in increasing long run aggregate supply. Improved efficiency use also lowers the cost of supply and helps to reduce inflationary pressures.

### Conflicting objectives

Other pairs of macroeconomic objectives are difficult to target at the same time, as illustrated by the following examples:

- price stability and full employment – policies to reduce demand pull inflation generally aim to reduce the level of economic activity. If this reduces business activity and investment there may be less demand for labour. On the other hand, reducing unemployment by expanding economic activity puts pressure on available resources and prices. This suggests a trade-off between high employment and stable price levels;
- economic growth and price stability – a booming economy places demand pressure on resources, especially if there is no excess capacity – this is inflationary because competition for resources pushes up their prices in factor markets (including labour);
- economic growth and structural unemployment – growth is associated with structural change, which often involves the rise of some sectors of the economy and the decline of others. Structural change impacts on the labour market and long term unemployment; and
- economic growth and equitable income distribution – while economic growth increases the size of the economic pie, not everyone gets an equal slice of that pie! This is especially true in the short term. People employed in the expanding sectors and owners of appreciating assets such as property and shares tend to gain in relative terms.

Note that the 'ceteris paribus' assumption (other things remaining equal) applies when outlining the compatible and conflicting objectives above. The actual size of any of the above effects is difficult to establish because the relationship between cause and effect is rarely direct – there are likely to be several stages in the transmission from one event to another.

## Economic policy institutions

This section briefly describes the institutions in the Australian economy that are primarily responsible for setting policies to achieve those objectives. There are basically three types of economic policy applied in Australia:

- fiscal policy (the use of government revenue raising and spending powers to influence the level of economic activity);
- monetary policy (the use of the 'cash rate' to influence the cost of credit for households and businesses; and
- competition and industry policy (to improve efficiency and productivity).

The first two policies are concerned with managing aggregate demand in the short term – stabilising the business cycle. Competition and industry policy, on the other hand, is directed towards improving competitiveness, efficiency and productivity to drive long term growth – the supply side of the economy.





As discussed in the next chapter, fiscal policy is developed in the Budget – the annual statement of government revenue and expenditure. The institution responsible for constructing the Budget is the Treasury.

The institution responsible for monetary policy (the Reserve Bank of Australia – RBA) has two specific obligations – the conduct of monetary policy and the maintenance of the financial payments system. The nine-member Board holds its monetary policy meeting on the first Tuesday of each month, except in January. Bank staff monitor a large set of domestic and international data series, including major ABS releases and privately compiled Australian business surveys, and present their analysis for consideration by the Board. As noted earlier, the Bank operates independently of government although it is required to 'inform the Government, from time to time, of the Bank's monetary and banking policy'.

At national level, the Productivity Commission conducts research and provides advice to the government on aspects of the economy's efficiency, productivity, and competitiveness – recent examples being inquiries into aged care employment, the maritime logistics system, and national productivity performance.

## The nature and impact of time lags

Economic activity is conducted by the thousands of economic 'agents' (households and businesses; individuals and groups) who make independent decisions based upon their own best interest – examples being how much to produce, what to buy; whether to employ more staff or less; and whether to invest.

Nearly all economic activity is subject to time lags inherent in the production and distribution of goods and services. For many decisions, like buying food, the lag is short. Others, like building a house, involve long periods of time because of the processes involved such as obtaining approval, negotiations with a builder and construction of the building. Some business decisions involve very long lags. A big investment project like the construction of a port or a power plant involves lengthy consideration of the 'business case' – preparation of contracts and plans, hiring of workers, and purchasing of materials. This is sometimes called a 'stock-flow lag': a one-off addition to capital stock will generate a flow of product for a considerable time into the future. A new truck may deliver goods for five years, a cargo ship has an economic life of thirty years .

Current and past decisions affect economic outcomes a long time into the future. This creates complications for those who study economic activity and manage policies around it. How do the policy makers know where the economy lies on the cycle at any point in time? How do they know what policy settings are appropriate?

The first issue is that the data that describes the state of the economy is always out-of-date. Economic indicators take at least a month (and more often three) to compile, analyse and publish. As a result, policy-makers face a recognition lag – the period of time it takes to recognise what is happening in the economy (at

macro level). The recognition lag makes driving the economy somewhat akin to driving a car looking in the rear-view mirror! Policy makers are forced to look backwards to see which direction the economic road just took!

A second time lag (the decision lag) occurs because it then takes policy-makers some time to decide what policy changes should be made in the light of the economic data. In the case of monetary policy, the decision lag is fairly short because the Reserve Bank Board meets every month. In the case of fiscal policy (the Federal Budget), the decision lag is longer because the Budget is prepared annually (although there have been 'mini-budgets' in years where significant events changed revenue or spending plans). Budget proposals also have to be agreed by both houses of Parliament before they become law – sometimes a long and tortuous political process!

It can then take some time for policy decisions to have an effect on household and business behaviour (the effect lag). If taxes were cut, for example, households have more disposable income. If they choose to spend it (rather than save it, or reduce household debt) consumption spending would rise, triggering increases in income, further changes in consumption (the multiplier), and rises in output as business firms react to higher orders. The full impact of the policy change might not be felt for some months.

It is estimated that changes in policy interest rates can take more than 18 months to take effect. If rates were reduced, it could take time for retail banks to pass them on to their customers. It might the take time for households and businesses to react to lower rates – for example, people with fixed mortgages may not be able to switch to a new loan with lower repayments for 2–3 years. Lower interest rates may also have lower impact in times where economic activity and confidence is low, as in a recession.

## Worksheet

*Read chapter 11 of the text in order to answer the following questions.*

1. Briefly outline the economic objectives mentioned in the 1965 Vernon Report. Discuss the degree to which Australia's current objectives should be similar. Are there any objectives would you add to the 1965 list? Would you delete any?
2. What are the four major objectives of macroeconomic policy? Define each objective. Is it possible to quantify each one?
3. How successful has Australia been at achieving each of these objectives in the last five years? Which of the four has posed the largest macroeconomic problem for this economy?
4. Outline the economic costs of economic growth being too low, or too high.
5. Outline the economic costs of high levels of unemployment.
6. Compare the objectives of the Treasury and the RBA.
7. Explain, using examples, the meaning of the phrase 'compatible economic objectives'.
8. Why is it impossible for all of society's economic objectives to be achieved simultaneously? Is this any different from the economic problem at individual or group level?
9. Describe the time lags which can impact on the effectiveness of economic policy.





## Cartoon economics

*The Mitchell cartoon below appeared in the Australian newspaper in June 1993, and is reproduced by kind permission. The driver of the car is the Prime Minister at the time, Paul Keating.*

1. The cartoonist is reflecting on the announcement of the lowest inflation rate in 30 years (June 1993 – rate of inflation approximately 1.4%). Referring to figure 11.1, state the rates of unemployment and economic growth in June 1993.
2. List three advantages of maintaining low inflation in the Australian economy.
3. Refer to figure 11.1. In what stage of the business cycle was Australia in 1992–93?
4. Discuss the cartoonist's message about the costs of reducing inflation and achieving the "gold medal result"
5. Refer again to figure 11.1. Find the inflation rates in each of the business cycle peaks and troughs. Do your figures support the idea that levels of inflation and unemployment are inversely related?


## Multiple choice questions

*Choose the best alternative in the following questions.*

1. Most governments in developed economies play an active role in demand management in order to:
   a. reduce fluctuations in economic activity associated with the business cycle.
   b. collect revenue to finance expenditure on community needs and wants.
   c. redistribute wealth from the rich to the poor.
   d. provide competition for private firms which might otherwise have been able to monopolise the market for a particular commodity.

2. Which of the following is not regarded as an economic objective of the government?
   a. An equitable distribution of income.
   b. Full employment.
   c. Maintaining a stable exchange rate.
   d. Efficient resource allocation.