Practice Assessment — Task 6: AD/AS & Fiscal Policy (Data Interpretation / Short Answer)

This practice task mirrors **Task 6** in the course assessment outline: a data-interpretation/short-answer paper on the AD/AS model and on fiscal policy. Ten multiple-choice items, then two data/short-answer questions in parts. Recommended time: 50 minutes (40 marks).

Section One — Multiple choice (10 marks)

1. The aggregate demand curve slopes downward because, as the price level falls:

A. the curve shifts right
B. real wealth rises, interest rates fall and net exports rise, raising quantity demanded
C. aggregate supply increases
D. the government raises spending

2. A rightward shift of aggregate demand, holding supply constant, will:

A. lower the price level and raise output
B. raise both the price level and real output
C. lower both the price level and real output
D. raise the price level and lower output

3. The long-run aggregate supply curve is:

A. upward sloping
B. downward sloping
C. vertical at potential output
D. horizontal

4. A sharp rise in oil prices would be shown as a:

A. rightward shift of AD

B. leftward shift of SRAS

C. rightward shift of LRAS

D. leftward shift of AD

5. An expansionary fiscal stance involves:

A. higher taxes and lower government spending

B. higher government spending and/or lower taxes

C. raising the cash rate

D. a budget surplus in all cases

6. A budget is in deficit when:

A. revenue exceeds spending

B. spending exceeds revenue

C. revenue equals spending

D. the cash rate is cut

7. Automatic stabilisers:

A. require a new government decision each time

B. change with the cycle without new decisions, moderating fluctuations

C. are part of monetary policy

D. only operate during booms

8. Crowding out refers to:

A. private investment falling as government borrowing raises interest rates

B. imports displacing domestic production

C. a fall in the exchange rate

D. the RBA cutting the cash rate

9. At the point where AD meets the vertical LRAS, a further rightward shift of AD will:

A. raise real output with no price effect
B. raise the price level with no rise in real output
C. lower the price level
D. shift LRAS right

10. A weakness of fiscal policy compared with monetary policy is:

A. it cannot target specific sectors
B. implementation lags from passing and rolling out measures
C. it is set independently of the political cycle
D. it works instantly

Section Two — Question 11: AD/AS (15 marks)

Stimulus. An economy is operating below full capacity. Consumer and business confidence then rises sharply.

11(a). On a fully labelled AD/AS diagram, show the effect of the rise in confidence. Label the shift and the new equilibrium. (5 marks)

11(b). Explain the effect on the price level and real output. (4 marks)

11(c). Explain what would happen to the price level if aggregate demand continued to rise once the economy reached full capacity. Refer to the LRAS curve. (6 marks)

Section Two — Question 12: Fiscal policy (15 marks)

12(a). Define a budget deficit and outline one way it can be financed. (3 marks)

12(b). Using the AD/AS model, explain how an expansionary fiscal stance could be used to respond to a recession. (6 marks)

12(c). Explain two limitations a government faces when using fiscal policy to manage the economy. (6 marks)

Marking guide (teacher)

Section One: 1 B, 2 B, 3 C, 4 B, 5 B, 6 B, 7 B, 8 A, 9 B, 10 B.

11(a): labelled axes (price level vs real GDP) (1); AD, SRAS shown (1); AD shifts right to AD_2 (1); new equilibrium marked (1); both higher P and higher Y indicated (1). **11(b):** rise in confidence raises C and I → AD right → higher real output and higher price level; reward the cause-and-effect chain (4). **11(c):** once at the vertical LRAS, further AD rises raise only the price level, not real output — purely inflationary; reward reference to capacity constraint and the vertical LRAS (up to 6). **12(a):** deficit = G > T (1); financed by government borrowing/issuing debt (2). **12(b):** G↑ and/or T↓ → AD shifts right, amplified by the multiplier → output rises toward capacity, unemployment falls (up to 6, reward a labelled diagram). **12(c):** any two of implementation lags, political constraints, rising debt, crowding out — explained, 3 marks each.