Student Number

Fort Street High School

2012
HIGHER SCHOOL CERTIFICATE
Midcourse Examination

Economics

General Instructions

Total Marks – 70

- Reading Time: 5 minutes

- Working Time: 2 hours

- Write using black or blue pen

Section I

Total Marks (20)
Attempt Questions 1 – 20
Allow about 35 minutes for this section

Section II

Total Marks (30)
Attempt Questions 21 – 24
Allow about 45 minutes for this section

Total Marks (20)
Attempt either Question 25
Allow about 40 minutes for this section

- Board-approved calculators may be used
- Write your Student Number at the top of each page (write your name if you do not have your Student Number)

Section III

This paper MUST NOT be removed from the examination room

2012 MIDCOURSE EXAMINATION

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Attempt Questions 1 – 20
Allow about 35 minutes for this section

Use the multiple-choice answer sheet for Questions 1 – 20

1. The economy is in equilibrium when

   (A) total spending equals national income

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2. In economics, which is an example of investment expenditure?

   (A) Households purchase government securities

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3. The aggregate demand curve shifts to the left when

   (A) The cost of inputs into production rises

   (B) New technology is developed

   (C) The government increases company income tax rates

   (D) The Reserve Bank of Australia reduces interest rates

4. If an economy's marginal propensity to consume (MPC) is 0.8Y and there is an increase in investment of $200m, what is the ultimate increase national income?

(A) $1000m

(B) $1600m

(C) $40m

(D) $160m

5. Which of the following is an example of macroeconomic demand management policies operating compatibly?

(A) decreased interest rates, increased government spending and increased taxes

(B) decreased interest rates, decreased government spending and decreased taxes

(C) increased interest rates, increased government spending and increased taxes

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6. If the current rate of inflation is at the top of the RBA's target range, which of the following may signal to the RBA to tighten monetary policy?

(A) Higher rates of economic growth, higher savings and increasing rates of unemployment

(B) Lower rates of economic growth, slowing consumption and decreasing rates of unemployment

(C) Lower rates of economic growth, slower consumption and increasing rates of unemployment

(D) Higher rates of economic growth, rising consumption and decreasing rates of unemployment

7. The Consumer Price Index in year 1 is 125 and in year 2 is 130. The rate of inflation between year 1 and year 2 is

(A)   3·8%

(B)   4·0%

(C)   5·0%

(D) 30·0%

8. Which two economic objectives are usually not in conflict?

    (A) Full employment and price stability

    (B) Economic growth and external stability

    (C) Full employment and economic growth

    (D) Economic growth and price stability

9. Which of the following factors could increase the level of structural unemployment in the economy?

    (A) Contractionary budgetary policy

    (B) The use of labour saving technology in production

    (C) A fall in aggregate demand

    (D) An increase in the number of people working part time

10. The table shows Balance of Payments data for a hypothetical economy with a floating exchange rate

Balance of Payments (BoP)	($bn)
Net Services	5
Capital Account	5
Net Goods	-15
Net Income	-50
Net Current Transfers	5

What is the value of the Financial Account?

(A) $45bn

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11. The "crowding-out effect" may be reduced if:

    (A) Government borrowing is used to fund government spending

    (B) Government borrowing slows down the growth in private sector demand

    (C) Additional government spending stimulates private consumption spending

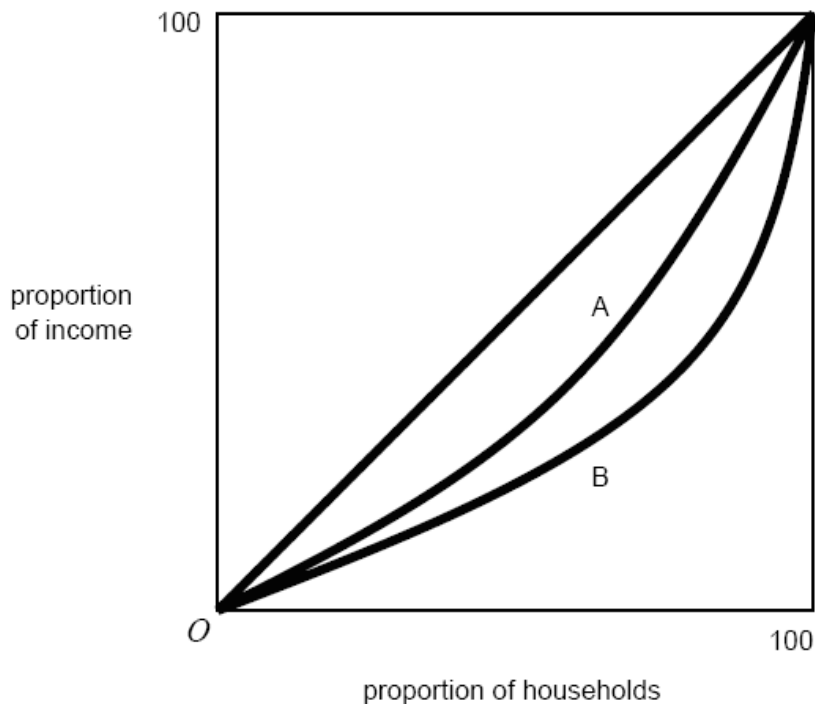   (D) Government borrowing causes domestic interest rates to rise

12. If the Reserve Bank of Australia wishes to pursue a contractionary monetary policy, it could:

   (A) Increase the supply of cash in ESAs and raise the cash rate.
   (B) Increase the supply of cash in ESAs and lower the cash rate.
   (C) Reduce the supply of cash in ESAs and raise the cash rate.
   (D) Reduce the supply of cash in ESAs and lower the cash rate.

13. Which of the following is an example of discretionary fiscal policy?

   (A) a reduction in marginal income tax rates
   (B) an increase in tax collections during a boom
   (C) an increase in the cash rate
   (D) an increase in welfare payments in a recession

14. The diagram below shows Lorenz curves for country A and country B.

proportion of households

14. With reference to the above diagram, which of the following statements is **correct**?

   (A) Country A has a more equitable distribution of income than country B.
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   (C) The Gini coefficient for country A is equal to 1.

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15. The removal of a car's pollution control system in order to improve the car's fuel economy creates

(A) a technical efficiency.

(B) an externality.

(C) a public good.

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16. Cost-push inflation occurs when there is

(A) an increase in the prices of raw materials resulting in an increase in the price of final goods.

(B) an increase in the demand for products resulting in an increase in the price of final goods.

(C) an increase in the level of consumption resulting in an increase in the price of final goods.

(D) an increase in the supply of final goods resulting in an increase in the price of final goods.

17. An example of how automatic stabilisers affect economic activity would be

(A) the government raising marginal tax rates in order to slow down economic growth during a boom.

(B) a rise in government expenditure on roads in order to increase the level of employment during a recession.

(C) slower growth in consumption expenditure as taxpayers move into higher tax brackets as incomes increase.

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18. Which of the following would be an **<u>incorrect</u>** measure of a country's Gross Domestic Product (GDP)?

(A) the total value of expenditure on the final output produced in that country

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(C) the total value of all income earned as a result of producing final output in that country

(D) the total value of currency plus bank deposits in that country

19. Which of the following describes market failure in environmental economics?

   (A) Private costs incurred by producers in using resources to produce output, or the cost incurred by the consumer

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   (C) Social costs imposed on society as a result of private actions and are not considered by the price mechanism

   (D) Ecologically sustainable development

20. The table shows the population and labour force information for a nation

	Number of Persons (millions)
Employed persons	18
Unemployed persons	2
Working age population	32
Total Population	40

What is the value of the unemployment rate and the participation rate?

   (A) Unemployment rate 10% and participation rate 62.5%

   (B) Unemployment rate 10% and participation rate 67%

   (C) Unemployment rate 15% and participation rate 62.5%

   (D) Unemployment rate 25% and participation rate 67%

Section II
**Total marks (30)**
Attempt Questions 21 – 24
Allow about 45 minutes for this section

Question 21 (7 marks)

(a) What is the government's economic objective with regard to unemployment?   1.

(b) Distinguish between cyclical and structural unemployment.   2.

(c) Discuss an appropriate policy mix to reduce the unemployment rate below its current
    rate of 5.2%. (January 2012)

Question 22 (7 marks)
   (a)   On the diagram below, show the effect of a successful microeconomic reform

     policy on an economy in terms of the price level and GDP.
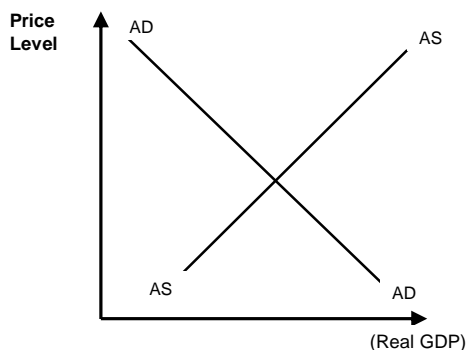
   (b) Explain how microeconomic reform can effect real GDP   2.

   (c) Outline the benefits of microeconomic reform to an economy   4

Question 23.   (8 marks)

(a) Outline TWO characteristics of public goods   2.

(b) Explain how the possibility of free rider behaviour affects environmental
    protection.   2.

(c) How can market-based policies be used to manage the natural environment?

Question 24   (8 marks)

(a)   Define the term external stability   1.

(b) Explain how an increase in Australia's savings rate could affect Australia's current
    account deficit.

(c) Analyse the effectiveness of monetary policy in reducing a current account deficit.

Section III

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Question 25

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Answer the question on the writing paper provided. Extra writing paper is available.

In your answer you will be assessed on how well you:

- demonstrate knowledge and understanding relevant to the question

- use the information provided

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8

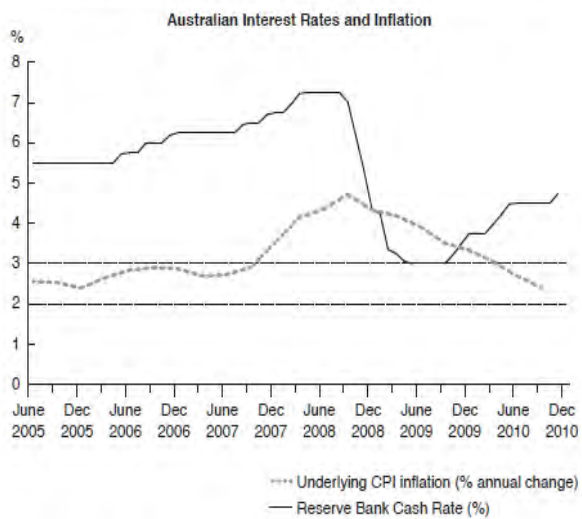- present a sustained, logical and cohesive response

Question 25

Discuss the effectiveness of fiscal policy and monetary policy in affecting recent economic activity.

An important feature of inflation-targeting frameworks is that they are forward looking. We know that it takes time for changes in monetary policy to have their full effect on the economy.
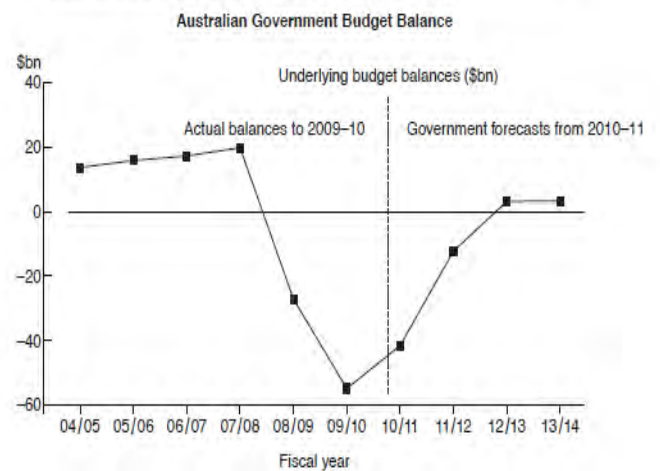
PHILIP LOWE, 2010

Source: Reserve Bank of Australia - Adapted speech by Philip Lowe, Address to Australian Business Economics Annual Forecasting Conference Dinner, Sydney, 8 December 2010

Australian Interest Rates and Inflation

···· Underlying CPI inflation (% annual change)
— Reserve Bank Cash Rate (%)

Of course fiscal policy has always been with us; what has returned in the past couple of years is the use of active discretionary fiscal policy as a counter-cyclical tool.

DAVID GRUEN, 2009

Source: The Treasury - Adapted speech by Dr David Gruen, Australian Business Economists Annual Forecasting Conference 2009, The Return of Fiscal Policy - 8 December 2009

Australian Government Budget Balance

Underlying budget balances ($bn)

Actual balances to 2009–10   Government forecasts from 2010–11

Fiscal year

END OF PAPER

9

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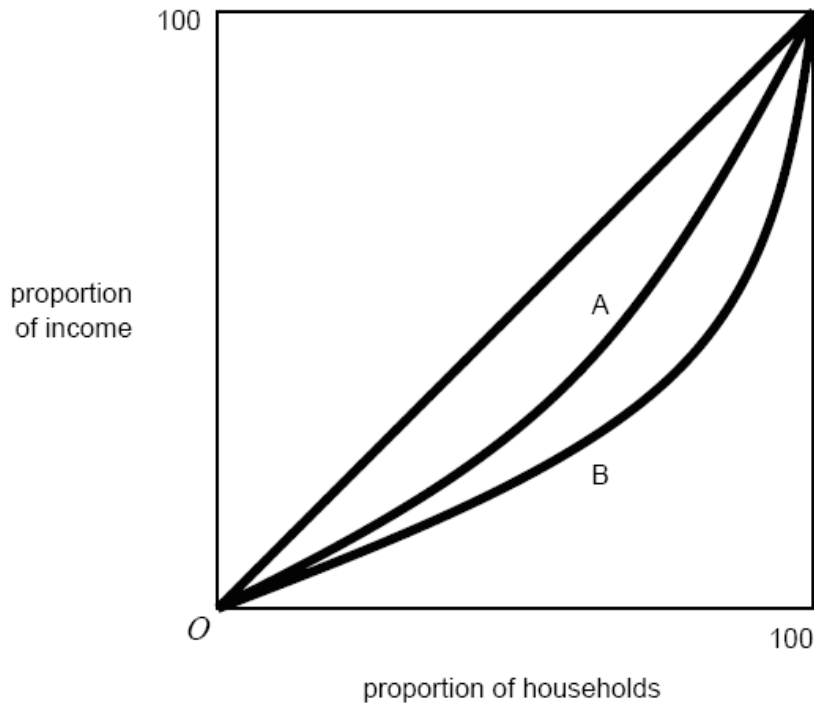| Balance of Payments (BoP)	($bn)
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Section II
Total marks (30)
Attempt Questions 21 – 24
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Question 21 (7 marks)

(a) What is the government's economic objective with regard to unemployment?   1.

Achieve full employment (i.e. zero cyclical unemployment)

☞ **Merely stating the lowering unemployment is an aim is inadequate**

(b) Distinguish between cyclical and structural unemployment.   2.

Cyclical unemployment is a result of insufficient aggregate demand whereas structural unemployment is a result of the inadequate job skills of the unemployed

☞ **Many students wrote that cyclical is due to fluctuations in the business cycle – this should more specifically refer to a downturn (an upturn is also a fluctuation)**

(c) Discuss an appropriate policy mix to reduce the unemployment rate below its current rate of 5.2%. (January 2012)
- **Expansionary monetary policy (i.e. lowering the cash rate or loosening)**
- **Expansionary fiscal policy (i.e. increase in net government spending)**
- **MER:**
- **Increased spending on training & education (e.g. more tertiary places)**
- **Improved job networks**
- **Incentives to work / disincentives to welfare**
- **Further deregulation of the labour market**

☞ **Must refer to both macroeconomic & microeconomic policies to achieve an "appropriate policy mix" (i.e. a mix of cyclical and structural solutions)**
☞ **Answers could include discussion of the limitations of macro or micro policies in reducing unemployment**

Question 22 (7 marks)
(a)   On the diagram below, show the effect of a successful microeconomic reform

policy on an economy in terms of the price level and GDP.

7
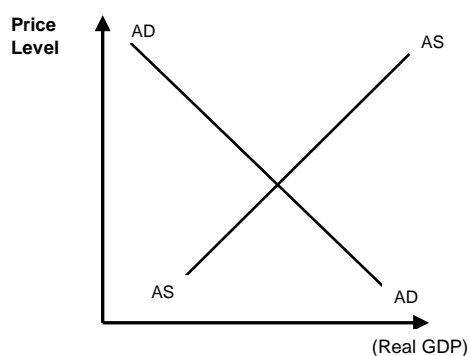
(b) Explain how microeconomic reform can effect real GDP   2.

Improve productivity, lower prices, thus increase real income/GDP

☞ **Students needed to refer to the effect on price to reflect increases in real rather than just nominal GDP**

(c) Outline the benefits of microeconomic reform to an economy   4.

- **Expands the productive capacity of an economy (supply) to ensure greater economic growth & lower unemployment**
- **Enables structural change to improve the efficiency & productivity of the economy**
- **Lowers (cost-push) inflation**
- **Improves the flexibility & responsiveness of the economy to adjust to economic changes**
- **Enhances international competitiveness (through structural change, higher productivity and lower inflation)**
- **MER lowers structural unemployment over the longer-term (the NAIRU can only be lowered by MER)**

☞ **Benefits at times confused with processes of reform (e.g. increased competition is not itself a benefit – lower prices brought on by competition is a benefit)**

Question 23. (8 marks)

(a) Outline TWO characteristics of public goods   2.

- **Non-excludable**
- **Non-rival**

☞ **Some students suggested that a characteristic is that they are usually provided by government.**

(b) Explain how the possibility of free rider behaviour affects environmental protection.   2.

Free-rider behaviour results in insufficient quantities of a public good being produced because it is not sufficiently profitable for the private sector to produce greater amounts when people are able to enjoy the benefits of a good without paying for it (e.g. public parks, clean beaches)

(c) How can market-based policies be used to manage the natural environment?

- **ETS**
- **Carbon tax**

→Protect the environment by affecting the price of production and thus encouraging behaviour change

Question 24   (8 marks)

(a)   Define the term external stability   1.

A sustainable level of external financial liabilities

(b) Explain how an increase in Australia's savings rate could affect Australia's current account deficit.

A higher savings rate in Australia should improve Australia's CAD because it addresses the savings-investment gap that is a structural cause of the CAD. Higher savings will reduce the need of Australians to borrow from overseas and thus lower the servicing costs associated with foreign borrowings. These servicing costs (i.e. interest & dividend payments) are recorded in the Primary Income component of the CA and constitute the majority of the CAD.

(c) Analyse the effectiveness of monetary policy in reducing a current account deficit.

Monetary policy can be tightened to lower aggregate demand in the economy, thus slowing import consumption, which has a positive effect on the Balance of Goods & Services (BoGS). It will also lower Australia's inflation rate, which improves its international competitiveness and is thus favourable for the BoGS. However, this is ultimately counterproductive as higher interest rates in Australia change our interest rate differentials with the global economy and subsequently attracts more foreign investment, which increases demand for the $A and thus appreciates the $A. This makes Australian exports relatively more expensive and imports cheaper, which deteriorates our BoGS and thus the CAD. A tightening of monetary policy also increases unemployment in Australia due to its effect on economic growth.

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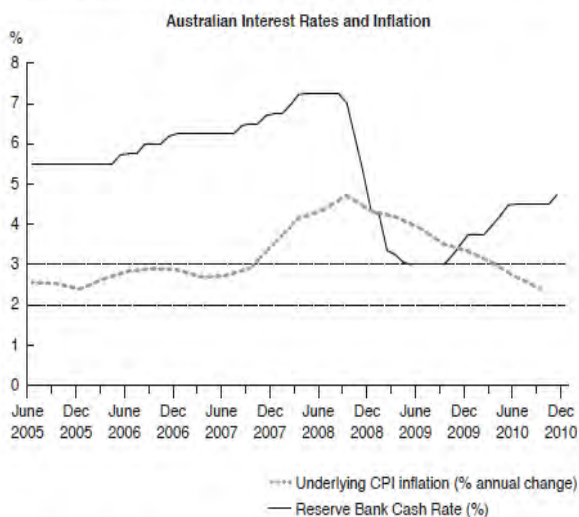- present a sustained, logical and cohesive response

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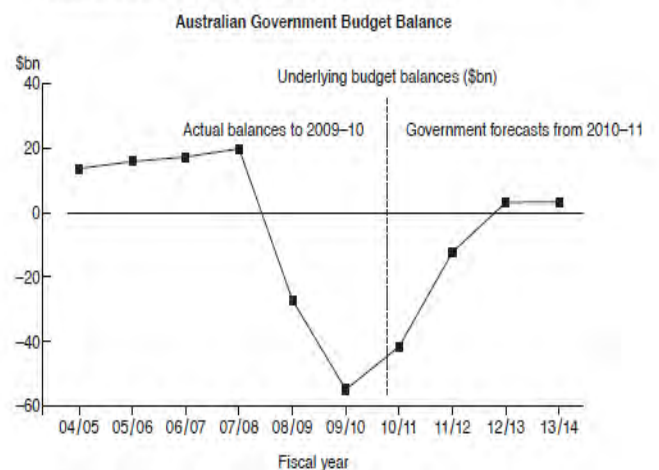>
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