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Student Number



Ravenswood

2012
Higher School Certificate
Trial Examination

11 Copies

Year 12

Mrs L Landford

Economics

General Instructions

- Reading time – 5 minutes
- Working time – 3 hours
- Write using black or blue pen
- Board approved calculators may be used
- Write your student number and/or name at the top of every page

Total marks – 100

Section I – Pages 2–10

20 marks

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

Section II – Pages 11–18

40 marks

- Attempt Questions 21–24
- Allow about 1 hour and 15 minutes for this section

Section III – Pages 19–20

20 marks

- Attempt either Question 25 or Question 26
- Allow about 35 minutes for this section

Section IV – Page 21

20 marks

- Attempt Question 27
- Allow about 35 minutes for this section

This paper MUST NOT be removed from the examination room

1 Which of the following will be reduced as a result of lower rates of inflation?

- (A) Uncertainty in the economy
- (B) The purchasing power of money
- (C) The level of investment
- (D) The level of real income

2 The following table shows data for income and consumption in a closed economy.

Disposable Income \$m	Consumption \$m
50	50
100	80
150	110
200	140
250	170

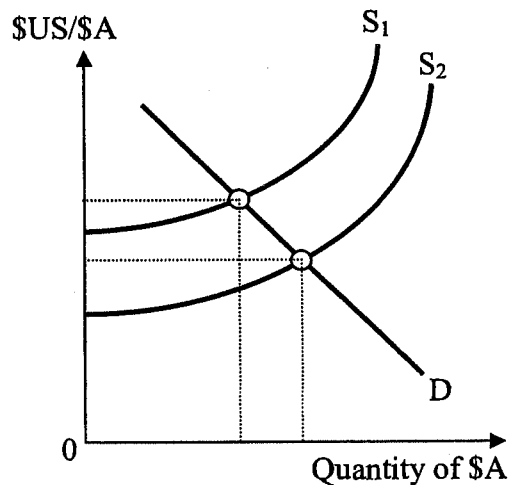
What is the value of the marginal propensity to save (MPS)?

- (A) The MPS is 0.6
 - (B) The MPS is 0.1
 - (C) The MPS is 0.7
 - (D) The MPS is 0.4
- 3 Which of the following would be the most appropriate stance for monetary policy during a period of declining economic activity?
- (A) A reduction in the cash rate and an easing of monetary policy
 - (B) Reducing rates of income tax
 - (C) Increasing payments to social security recipients
 - (D) The Reserve Bank of Australia would decrease the money supply by buying additional government securities

4 Australia's trade pattern can be most accurately described by which of the following statements?

- (A) Australia imports manufactured goods and exports commodities
- (B) Australia exports manufactured goods and imports commodities
- (C) Australia does not need to import commodities
- (D) Australia does not need to import manufactured goods

5 The graph shows the demand and supply of Australian dollars in the foreign exchange market.



Which of the following may have caused the change in the supply of Australian dollars from S_1 to S_2 ?

- (A) A decrease in capital inflow into Australia
- (B) A decrease in demand for foreign imports
- (C) An increase in capital outflow from Australia
- (D) An increase in demand for Australian exports

6 Which is NOT a method for the government to finance a budget deficit?

- (A) Borrowing from the domestic private sector
- (B) Selling assets
- (C) Lending funds to overseas borrowers
- (D) Borrowing from the Reserve Bank

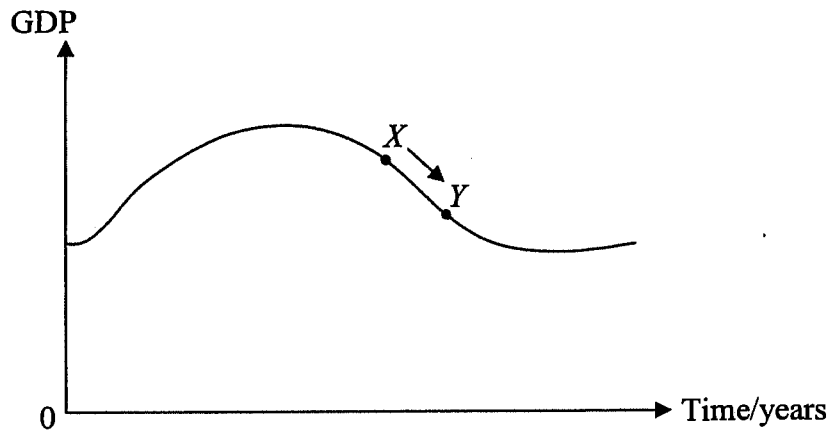
- 7 What would be the most suitable macroeconomic policy combination to address declining economic growth and increasing unemployment in the Australian economy?
- (A) Buying of government securities by the Reserve Bank and decreasing the tax free threshold
 - (B) Buying of government securities by the Reserve Bank and increasing the tax free threshold
 - (C) Selling of government securities by the Reserve Bank and decreasing the tax free threshold
 - (D) Selling of government securities by the Reserve Bank and increasing the tax free threshold
- 8 The following table shows selected information for the balance of payments for a country with a floating exchange rate.

Category	Amount (\$ millions)
Net Services	-12
Net Primary Income	-60
Net Secondary Income	2
Capital and Financial Account	55

What is the goods balance on the current account?

- (A) -\$20 million
- (B) \$15 million
- (C) -\$15 million
- (D) \$55 million

- 9 The graph shows the Australian economy has moved from point *X* to point *Y* in the business cycle.



What is the impact on automatic stabilisers in the Australian economy in this situation?

- (A) Progressive income tax revenue rises and unemployment benefits fall.
 - (B) Progressive income tax revenue falls and unemployment benefits fall.
 - (C) Progressive income tax revenue rises and unemployment benefits rise.
 - (D) Progressive income tax revenue falls and unemployment benefits rise.
- 10 A local manufacturer of building products decides to install new and more effective anti-pollution technology in its factories following the introduction of a carbon tax.

Which of the following outcomes would arise due to this action?

- (A) An increase in private costs and a reduction in negative externalities
- (B) An increase in private costs and an increase in negative externalities
- (C) An increase in social costs and an increase in negative externalities
- (D) An increase in social costs and a reduction in negative externalities

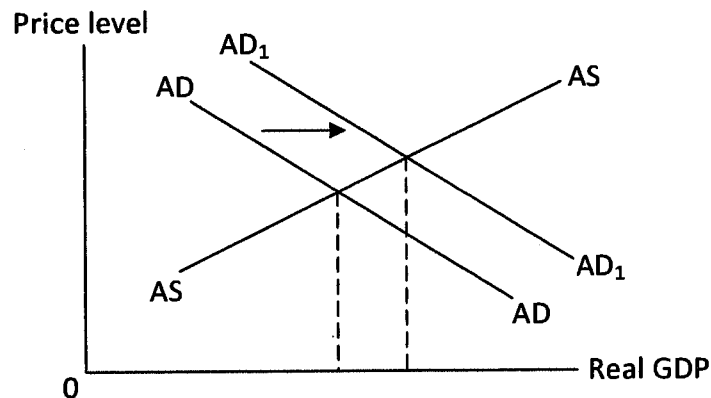
- 11 What is the formula for calculating the level of Economic Growth in an economy?
- (A) $\frac{\text{Real GDP (current year)} - \text{real GDP (previous year)}}{\text{real GDP (previous year)}} \times \frac{100}{1}$
- (B) $\frac{\text{Real GDP (previous year)} - \text{real GDP (current year)}}{\text{real GDP (current year)}} \times \frac{100}{1}$
- (C) $\frac{1}{1 - \text{MPC}}$
- (D) $\frac{\text{Labour Force}}{\text{Working Age Population (15+)}} \times \frac{100}{1}$
- 12 An employee is employed as a casual worker but is willing and able to work more hours than they currently do. This is known as?
- (A) Frictional unemployment
- (B) Long term unemployment
- (C) Hard core unemployment
- (D) Underemployment
- 13 Which of the following underlying inflation rates lies within the RBA's inflation target?
- (A) 0.9%
- (B) 0.1%
- (C) 2.1%
- (D) 1.9%

- 14 The following table shows selected data for an economy in equilibrium.

Injection/Leakage	\$ millions
Exports	80
Taxation	50
Imports	100
Savings	
Investment	150
Government Expenditure	60

What is the level of saving for this economy?

- (A) \$220m
 (B) \$150m
 (C) \$200m
 (D) \$140m
- 15 The graph shows the aggregate demand and supply curves for an economy.



All other things being equal, which of the following could have caused the aggregate demand curve to shift from AD to AD₁?

- (A) An increase in household saving
 (B) An appreciation of the exchange rate
 (C) An increase in business investment
 (D) An increase in interest rates

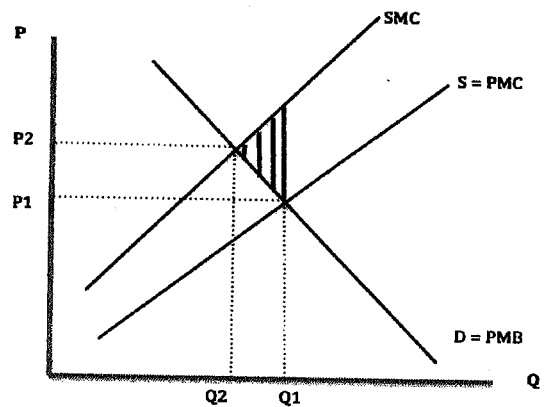
16 The table shows selected data for a hypothetical economy.

	Year 1	Year 2
Cash rate	4.75%	4.0%
Budget outcome	-\$35 billion	+\$25 billion

What is the policy stance of the government of this economy from Year 1 to Year 2?

- (A) Contractionary monetary and fiscal policies
- (B) Expansionary monetary policy and contractionary fiscal policy
- (C) Contractionary monetary policy and expansionary fiscal policy
- (D) Expansionary monetary and fiscal policies

Refer to the following diagram of a **carbon tax** to answer questions 17 and 18

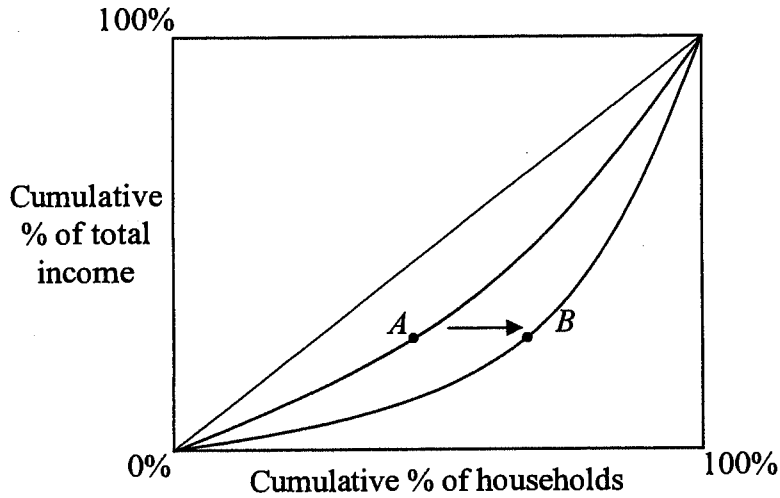


www.economicshelp.org

- 17 At the price and quantity of P1 and Q1, what is not being considered?
 - (A) The equilibrium outcome of the good
 - (B) The marginal private benefit of consuming the good
 - (C) The market price of the good
 - (D) The social costs of the good

- 18 According to the diagram, which of the following statements is correct?
 - (A) Negative externalities are not being taken into consideration by free market forces
 - (B) The production and consumption of fossil fuels cause externalities
 - (C) Fossil fuels are non-excludable and non-rival
 - (D) The Carbon Tax is equal to the distance between P1 and P2

- 19 The diagram shows the movement of a Lorenz curve from *A* to *B* for an economy over time.



Which of the following is true for this economy after the movement of the Lorenz curve from *A* to *B*?

- (A) Decreased income inequality and a lower Gini co-efficient
 - (B) Perfect income equality and a Gini co-efficient equal to zero
 - (C) Increased income inequality and a higher Gini co-efficient
 - (D) Perfect income inequality and a Gini co-efficient equal to one
- 20 If there is a short-term capital outflow from Australia and to Japan, how will it be recorded on Australia's Balance of Payments?
- (A) A debit on the current account
 - (B) A debit on the capital and financial account
 - (C) A credit on the capital and financial account
 - (D) A credit on the current account

Section II

40 marks

Attempt Questions 21–24

Allow about 1 hour and 15 minutes for this section

Answer the questions in the spaces provided. These spaces provide guidance for the expected length of response.

Question 21 (10 marks)

Marks

The following table shows selected data for a closed economy.

Year	Income (Y) (\$m)	Consumption (C) (\$m)	Savings (S) (\$m)	Investment (I) (\$m)
1	300	280	20	50
2	400	360	40	50
3	500	440	60	50

(a) Calculate the value of the Marginal Propensity to Consume (MPC).

1

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(b) Write the formula for the simple multiplier (k) and calculate the value of the simple multiplier using the information in the table.

2

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Question 21 continues on the next page

Question 21 (continued)

Marks

- (c) Explain how an increase in autonomous investment can have a multiplier effect on the level of income in an economy.

3

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- (d) Explain TWO benefits of sustainable economic growth to Australia.

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End of Question 21

Question 22 (10 marks)

(a) Define *flexible exchange rate*.

2

(b) Outline TWO positive effects of an appreciation in the currency of an economy.

2

c) Outline how an appreciation in the value of the Australian dollar influences the rate of inflation.

2

Question 22 (continued)

Marks

- d) Discuss TWO factors that may cause the Australian dollar to appreciate. 4

End of Question 22

Question 23 (10 marks)**Marks**

The table shows terms of trade data for a hypothetical economy

Year	Export Price Index	Import Price Index	Terms of Trade
Year 1	100	100	100
Year 2	115	105	

- a) Define *terms of trade*. 1

- b) Calculate the terms of trade for this economy for Year 2. 1

Question 23 continues on the next page

Question 23 (continued)

Marks

c) Discuss how the change in the terms of trade indicated in the table could affect the economy's imports.

3

d) Explain TWO ways that an economy's export base can contribute to an ongoing current account deficit.

5

Question 24 (10 marks)

Marks

(a) Define what is meant by the term *income inequality*.

2

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(b) How may income inequality impose an economic cost on households in the Australian economy?

3

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Question 24 continues on the next page

Section III**20 marks****Attempt either Question 25 or Question 26****Allow about 35 minutes for this section**

Answer the question on your own paper or in a writing booklet, if provided. Start the question on a new page.

Expected length of the response is *approximately* 800 words or six written pages.

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

- demonstrate knowledge and understanding relevant to the question
- use the information provided
- apply relevant economic terms, concepts, relationships and theory
- present a sustained, logical and cohesive response

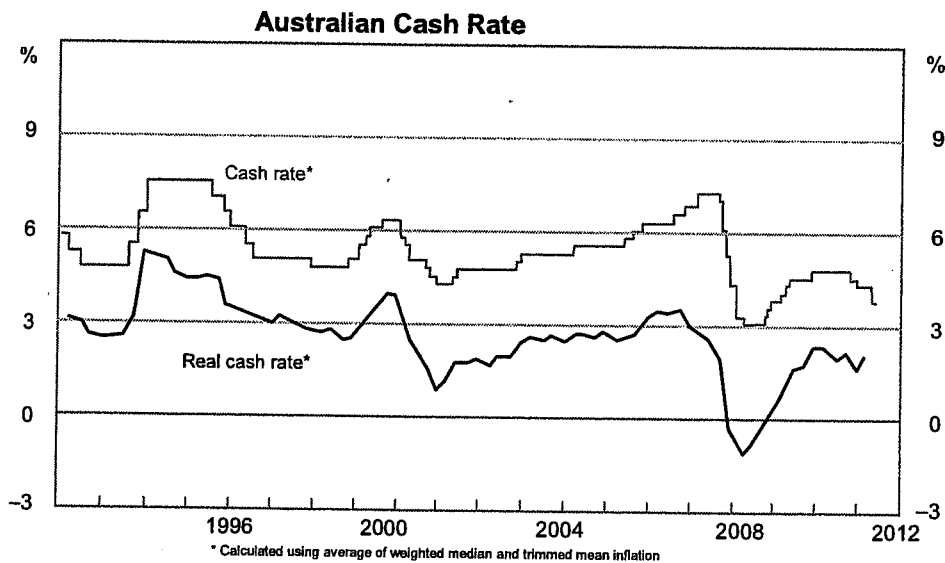
Question 25 (20 marks)

Discuss the Government's use of macroeconomic policies in achieving economic growth, full employment and price stability in the Australian economy.

It is important that the budget return to surplus as it:

- allows monetary policy to respond to economic developments as appropriate, taking account of the near-term challenges facing certain workers and businesses as a result of the patchwork economy and a strong Australian dollar;
- sends a strong message of confidence to the rest of the world of the strength of our economy during a period of heightened global uncertainty. Australia's strong public finances is a reason for Australia receiving a AAA credit rating with a stable outlook from all three major rating agencies for the first time in our history. It is one of only eight countries that currently meets this standard.
- is Australia's best defence at a time when the global economy is undergoing dramatic structural changes and the global outlook remains uncertain. Surpluses strengthen the Government's balance sheet and rebuild our fiscal reserves to create a buffer in uncertain global economic times.

Source: Budget Speech, 8th May 2012, The Honourable Wayne Swan MP, Deputy Prime Minister and Treasurer of The Commonwealth of Australia.



Source: Reserve Bank of Australia, Chart Pack, www.rba.gov.au

OR

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

- demonstrate knowledge and understanding relevant to the question
 - use the information provided
 - apply relevant economic terms, concepts, relationships and theory
 - present a sustained, logical and cohesive response
-

Question 26 (20marks)

Discuss the impact of microeconomic reform policies of Australia's economic performance. In your answer, you should refer to the economic information provided.

Microeconomic reforms have been successful in generating structural changes in the Australian economy. Structural change involves the long-term adjustments in the pattern of production and output. The direct benefits of these reforms have been to reduce inflationary expectations and increase productivity and employment opportunities. For example, the Productivity Commission has estimated that microeconomic reforms have increased GDP by 2.5%, productivity by 1.7% and average household income by approximately \$7000 since 1998/99.

Source: NSW HSC online

Does productivity growth mean lower employment?

At the firm or industry level, a productivity-enhancing factor, such as the introduction of new technology, can mean that fewer workers are required to meet production needs. This is not always the case, however, as a firm with innovative products can stimulate such strong demand that it needs to put on more workers to raise production to meet the demand.

At the aggregate or economy wide level, the general evidence is that productivity growth does not mean fewer employment opportunities. Productivity growth stimulates sufficient growth in income and output to generate overall employment growth. As an illustration, employment growth and a reduction in unemployment accompanied Australia's record productivity growth in the 1990s.

Source: Productivity Commission

Section IV

20 marks

Attempt Question 27

Allow about 35 minutes for this section

Answer the question on your own paper or in a writing booklet, if provided. Start the question on a new page.

Expected length of the response is *approximately* 800 words or six written pages.

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

- demonstrate knowledge and understanding relevant to the question
 - apply relevant economic information, terms, concepts, relationships and theory
 - present a sustained, logical and cohesive response
-

Question 27 (20 marks)

Analyse the impact of Australia's labour market policies on economic growth.

End of paper



Ravenswood

Economics

Select the alternative A, B, C or D that best answers the question. Fill in the response oval completely.

Sample $2 + 4 =$ (A) 2 (B) 6 (C) 8 (D) 9
 A B C D

If you think you have made a mistake, put a cross through the incorrect answer and fill in the new answer.

A B C D

If you change your mind and have crossed out what you consider to be the correct answer, then indicate this by writing the word correct and drawing an arrow as follows: correct

A B ^{correct} C D

1. A B C D
2. A B C D
3. A B C D
4. A B C D
5. A B C D
6. A B C D
7. A B C D
8. A B C D
9. A B C D
10. A B C D

11. A B C D
12. A B C D
13. A B C D
14. A B C D
15. A B C D
16. A B C D
17. A B C D
18. A B C D
19. A B C D
20. A B C D

MARKING CRITERIA

Section I

20 Marks

1	2	3	4	5	6	7	8	9	10
A	D	A	A	C	C	B	B	D	A

11	12	13	14	15	16	17	18	19	20
A	D	C	D	C	B	D	A	C	B

Section II

Question 21(a) *Outcomes assessed: H1, H11*

From Independent Trial Exam 2012

Criteria	Marks
<ul style="list-style-type: none"> Correctly determines the value of the Marginal Propensity to Consume (MPC) from the selected data in the table 	1

Answers could include: The Marginal Propensity to Consume is equal to the change in consumption divided by the change in income (i.e. $\Delta C/\Delta Y$). Between Years 1 and 2 consumption increases by \$80m whilst income increases by \$100m. Therefore the MPC is equal to 0.8 or 4/5.

Question 21(b) *Outcomes assessed: H1, H11*

Criteria	Marks
<ul style="list-style-type: none"> Correctly writes down or states the formula for the simple multiplier (k) and determines the value of the simple multiplier using selected data in the table 	2
<ul style="list-style-type: none"> Correctly states the formula for the simple multiplier (k) <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> Determines the value of the simple multiplier using selected data in the table but does not correctly complete both parts of the question 	1

Answers could include: The formula for the simple multiplier (k) may be written as:

$1/1 - MPC$ or $1/MPS$

The value of the simple multiplier (k) may be found by substituting the value of the MPC in the formula for the simple multiplier:

$k = 1/1 - MPC$

$k = 1/1 - 0.8$

$k = 1/0.2$

$k = 5$

Question 21(c) *Outcomes assessed: H1, H8, H11*

Criteria	Marks
<ul style="list-style-type: none"> Relates cause and effect in showing how an increase in autonomous investment can have a multiplier effect on the level of income in an economy 	2-3
<ul style="list-style-type: none"> Shows the relationship between an increase in autonomous investment and the multiplier effect (through increased spending) but has a limited understanding of how this can lead to an ultimate increase in income in an economy 	1

Answers could include: Autonomous investment is investment spending by businesses which is unrelated to changes in income. For example, an increase in autonomous investment on new plant and equipment will lead to an increase in spending in the economy. Through multiple rounds of spending the initial increase in autonomous investment will ultimately lead to an increase in income in an economy. The final increase in income will be a multiple of the initial increase in autonomous investment. For example, if autonomous investment increased by \$100m, and the value of the multiplier was 5, the ultimate increase in income in an economy would be \$500m.

Question 21(d) Outcomes assessed: H1, H2, H7

Criteria	Marks
<ul style="list-style-type: none">• Makes clear the nature of sustainable economic growth and how it could lead to at least TWO benefits or positive outcomes for Australia, such as higher incomes, living standards and job creation, increased technical progress, social welfare or increased exports	3–4
<ul style="list-style-type: none">• Makes clear the nature of sustainable economic growth and how it could lead to at least ONE benefit or positive outcome for Australia, such as higher incomes, living standards and job creation, increased technical progress, social welfare or increased exports	1–2

Answers could include:

- Economic growth is the increased productive capacity of an economy over time. It is usually measured by an increase in real Gross Domestic Product (GDP) or the total goods and services produced in a year. The process of economic growth is usually accompanied by an improvement in technological progress and innovation. Sustainable economic growth refers to a rate of growth that is not accompanied by increased inflation or a deterioration in external stability in Australia.
- One benefit of sustainable economic growth to Australia is that as real GDP increases, real GDP per capita or income per head increases. This leads to higher incomes in the community and an improvement in living standards, as individuals are able to purchase more goods and services to improve their material well-being.
- Another benefit of sustainable economic growth to Australia is that increased levels of real GDP require increased quantities and qualities of resources used in production including labour. Hence increased rates of sustainable economic growth are accompanied by an expansion in employment opportunities including full time and part time jobs. This will lead to a reduction in unemployment and the absorption of new workers into the workforce through a rise in the participation rate of the working age population.
- Two further benefits of sustainable economic growth include increased welfare and exports. Higher sustainable rates of economic growth lead to higher tax revenue to the Australian government. Some of this revenue can be used to finance transfer payments such as age pensions, family allowances and unemployment benefits to alleviate poverty.

Higher sustainable economic growth through rising real GDP can also lead to the establishment or expansion of export industries. Increased exports lead to specialisation in production, higher export income and a buildup of foreign exchange reserves which can be used to buy imported goods and services. Imports help to further raise living standards in Australia.

From EBE Trial Exam 2012

Question 22 (10 marks)

(a) Define flexible exchange rate.

2

A flexible exchange rate is floated and therefore is determined by the market forces of supply and demand. A flexible exchange rate is vulnerable to any external shocks.

(b) Outline TWO positive effects of an appreciation in the currency of an economy.

2

One positive effect of an appreciation is the increased purchasing power for consumers buying imports. In addition, the ^{value of} servicing costs of net foreign liabilities is reduced due to the valuation effect.

(c) Outline how an appreciation in the value of the Australian dollar influences the rate of inflation.

2

An appreciation of the Australian dollar increases the purchasing power of the Australian currency. Therefore imports are relatively cheaper for consumers and firms causing a decrease in imported inflation.

Question 22 (continued)

Marks

- d) Discuss TWO factors that may cause the Australian dollar to appreciate. 4

The Australian dollar would appreciate when foreign investors need to convert their currencies to invest in Australia. This is dependent on investment opportunities in Australia and interest rates. ~~Investors may invest in Australia in other form~~ Investors may demand the Australian dollar to invest in Australia's exports^{industries} due to the mining boom, ~~earning~~ and invest their savings due to low interest rates. The Australian dollar may also appreciate as foreign investors want to purchase Australia's exports, they need to convert their foreign currency in order to do this. This is dependent on consumer tastes and preferences, commodity prices if they wish to invest in commodities, terms of trade and the international competitiveness of Australia's exports, whether they can compete in global markets through better quality and lower prices.

End of Question 22

From EBE Trial Exam 2012.

Question 23 (10 marks)

Marks

The table shows terms of trade data for a hypothetical economy

Year	Export Price Index	Import Price Index	Terms of Trade
Year 1	100	100	100
Year 2	115	105	

- a) Define terms of trade.

an index shows
changes

Text P 394

"measures the relative movements in the prices of an economy's imports and exports over a period of time."

- b) Calculate the terms of trade for this economy for Year 2.

$$ToT = \frac{X \text{ index}}{M \text{ index}} \times 100$$

$$= \frac{115}{105} \times 100 = 109.5$$

Question 23 continues on the next page

Question 23 (continued)

Marks

c) Discuss how the change in the terms of trade indicated in the table could affect the economy's imports.

3

Since the terms of trade has improved and the export price index is higher than the import price index, this results in ~~the~~ economy being able to import a greater amount of imports with ^{the same level of} exports and therefore increases individual's purchasing power. Since imports are relatively cheaper, this will cause an economy has a greater income from ~~price of~~ exports, the amount of imports will increase as individuals will have more money from exports to buy imports.

d) Explain TWO ways that an economy's export base can contribute to an ongoing current account deficit.

5

The economy's export base contributes to CAD as a narrow ^{define} export base will ~~restrict~~ restrict the economy's access to a range of ^{products} locally produced goods thus requiring these goods to be imported. An increase in import will ~~thus occur~~ will worsen the balance of goods and services, ultimately contributing to an ongoing CAD. Moreover, the decrease in ~~range~~ variety of exports will increase ^{dependability} ~~dependability~~ on a few major types of exports, such as mineral goods in Australia, ~~and~~ which will have a detrimental effect to the export component of balance of goods and services if a natural disaster occurred and ~~stopped~~ stopped the industry. ~~That~~ A sudden stop in ^a major component of the export ^{base} will thus decrease level of exports, worsening the current account and consequently the GDP.

also, 'vulnerable' to changes in D and P.

Question 24(a) Outcomes assessed: H1

Criteria	Marks
• Correctly states the meaning of <i>income inequality</i>	2
• Demonstrates a limited understanding of the meaning of <i>income inequality</i>	1

Answers could include: Income inequality refers to the extent to which income is distributed in an uneven manner amongst households or the population as a whole. Within a society, income inequality can be measured by a number of methods, including the Lorenz Curve and the Gini co-efficient.

Alternative word to unequal.

Question 24(b) Outcomes assessed: H1, H2, H7

Criteria	Marks
• Demonstrates a sound understanding of how income inequality may impose an economic cost on households in the Australian economy	3
• Sketches in general terms how income inequality may impose an economic cost on households in the Australian economy	2
• Demonstrates a limited understanding of how income inequality may impose an economic cost on households in the Australian economy	1
• States any feature of how income inequality may impose an economic cost on households in the Australian economy	

Answers could include: Some economists argue that income inequality leads to social divisiveness and the marginalisation of some community groups, notably the unemployed and low income earners. This may be a source of social tension leading to pressure for the government to increase spending on social welfare payments in an attempt to alleviate the suffering and deprivation of disadvantaged individuals and families. Supporting the unemployed, families with dependent children and the aged, enables them to avoid poverty traps and is seen as an important advantage of government welfare programmes.

The social costs of inequality are sufficient for many observers to advocate government intervention through welfare programmes and social security payments. The emergence of social divisions based upon differences in income and the resulting social tensions within the economic community can lead to certain groups feeling alienated from market opportunities and the chance of a higher standard of living and quality of life. Hence, the social cost of income inequality results in pressure on the government to provide financial assistance to disadvantaged members of the community which in turn creates an economic cost.

Appropriate government assistance, for example through job search and employment retraining schemes, can help reduce the adverse impacts of unfortunate economic circumstances on both the individual and society. Extensive research conducted by economists in OECD countries suggests there is evidence of a 'working poor' section of the workforce unable to earn high incomes because of low skills and a reliance on adjustments to minimum wages to improve living standards.

The main cause of poverty in these countries is unemployment, particularly long term unemployment which impacts on the young and poorly educated members of the labour force. There appears to be a persistence of structural unemployment in mature economies maintaining high rates of technological progress, with traditional manufacturing jobs disappearing. This has led to increasing numbers of workers becoming dependent on government agencies (many of which are private organisations on government contracts) to help them find alternative employment.

Question 24(b) Cont.

Many people are less concerned about the bigger issue of income distribution but argue for government intervention on the grounds of income inadequacy. This leads to the contentious issue of relative poverty. Generally speaking, a household lives in poverty when its basic needs exceed the available means of satisfying them i.e. income is insufficient to meet the minimum needs of the household. Most of the poor suffer from one or more of the following disabilities: old age, lack of a male 'bread winner', a large number of dependent children, recent migration to a country or prolonged illness. Most studies of poverty tend to show that the incidence of poverty is much higher among people who fall under one or more of these categories.

Egalitarian principles widely supported in most economies would tend to suggest that these less fortunate community members are worthy of support not merely in terms of their own welfare, but for the greater good of society. Once again it is the government and the social welfare system that we turn to, for the needs of these people to be addressed. It is often argued that policies which effectively reduce income inequality provide economic as well as social benefits. By improving the welfare system and creating better opportunities for low income earners and their families to achieve higher market incomes, we enable higher levels of consumption and utility for these income groups, which in turn, increase total utility or satisfaction in society. This is because people on higher incomes gain less utility from an increase in income than people on lower incomes. This is in accordance with the principle of diminishing marginal utility: as more of a good is consumed it will provide progressively less utility to the consumer. Hence in theory, an extra dollar of income is effectively worth more to a lower income earner than to a higher income earner and a more equitable distribution of income should increase total utility, leading to a higher level of overall satisfaction and economic wellbeing in society.

Consumption and expenditure studies (such as the household income and expenditure survey conducted by the Australian Bureau of Statistics) tend to show that low income earners spend a higher proportion of their income than high income earners. Since a greater proportion of their income tends to go towards essentials such as food, clothing and housing, a lower level of income inequality will mean more income will go towards consumption. This in turn means higher levels of economic activity and greater investment and employment opportunities in the economy.

Question 24(c) Outcomes assessed: H1, H2, H5, H6

Criteria	Marks
<ul style="list-style-type: none"> Clearly demonstrates a thorough understanding of how taxation and government transfer payments can be used to reduce the level of income inequality in the Australian economy 	5
<ul style="list-style-type: none"> Clearly demonstrates a sound understanding of how taxation and government transfer payments can be used to reduce the level of income inequality in the Australian economy <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> Clearly demonstrates a thorough understanding of how EITHER taxation OR government transfer payments can be used to reduce the level of income inequality in the Australian economy 	4
<ul style="list-style-type: none"> Demonstrates a sound understanding of how taxation OR government transfer payments can be used to reduce the level of income inequality in the Australian economy <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> Demonstrates a thorough understanding of how EITHER taxation OR government transfer payments can be used to reduce the level of income inequality in the Australian economy 	3
<ul style="list-style-type: none"> Sketches in general terms how taxation OR government transfer payments can be used to reduce the level of income inequality in the Australian economy <p style="text-align: center;">OR</p> <ul style="list-style-type: none"> Demonstrates a sound understanding of how taxation OR government transfer payments can be used to reduce the level of income inequality in the Australian economy 	2
<ul style="list-style-type: none"> Lists any ways in which taxation OR government transfer payments can be used to reduce the level of income inequality in the Australian economy 	1

Answers could include: Firstly, with regard to Australia's system of taxation, the system of progressive taxation of personal income requires each person to pay a higher percentage of their gross income in tax as they earn more. This progressive tax can provide the revenue base from which the government can fund transfer payments such as pensions, job search allowances and family benefits. This will enable the government to redistribute income from high income earners to low income earners. This tax is structured so that lower rates of taxation are applied to low levels of income with a tax free threshold being allowed to the lowest of income earners. For example, the Australian personal income tax system now allows all income earners to receive up to \$18,200 annually before they have to pay any income tax.

According to the Social Policy Research Centre at the UNSW (*Economic Record*, December 2010), Australia also has one of the most progressive systems of direct taxes of any OECD country, and the direct tax system like the transfer system is the most 'efficient' in reducing inequality of any rich country. Australia reduces income inequality by about as much as countries like Denmark and Sweden, usually seen as the epitome of redistributive welfare states. Moreover, even though Australia spends less than the average on social security benefits, Australia redistributes more to the poorest 20% of the population than any other OECD country except Denmark.

The tax base has been broadened to include other taxes on income and wealth rather than just depending on personal income tax as a source of revenue. Company owners are made to pay corporate income tax (at a rate of 30%) on the profits made by their enterprises. A fringe benefits tax regime was also introduced in the mid 1980s and applied where benefits are paid to workers in the form of company cars, expensive holidays and expense accounts. Further tax reform in the 2012 budget included the introduction of a carbon tax on carbon emissions and a Minerals Resource Rent Tax (MRRT) on the supernormal profits (over \$75m) of large mining companies.

Transfer payments in the form of pensions, job search allowances and family benefits have been used to provide income support for targeted groups such as single parents, large single income families, the unemployed and the disabled. These groups generally receive the lowest incomes in the Australian economy and this type of income support helps to raise the household income received by the least fortunate members of society.

Question 24(c) continues on the next page

Question 24(c) continued

The Social Policy Research Centre at the UNSW has reported that public spending on cash benefits in Australia is lower than in many other countries, but Australia relies more on income testing than anywhere else in the OECD and targets a higher share of its transfers to the poor than elsewhere. As a result of these design features, Australia has the most 'target-efficient' system of cash transfers in terms of inequality reduction of any OECD country – for each dollar of spending on transfers Australia reduces income inequality by approximately 50% more than the USA, Denmark or Norway, twice as much as Korea and two and a half times as much as Japan or Italy, and three times as much as France.

It may also be noted in a higher order response that provisions have been made by the government through the social wage to establish a safety net of minimum wages and working conditions to be applied across the various occupations and industries. In countries like Australia this has been achieved through the award wage system where an award wage sets out the rates of pay, leave entitlements and other benefits a worker is to be afforded by their employer. The award wage system has been used to provide a minimum level of income and working conditions for workers with low skills and low bargaining power in the labour market. For example, in June 2010 Fair Work Australia (FWA) the Federal Government's new industrial relations institution increased minimum award rates by 4.8% (\$26 a week). This increase for low paid workers was expected to benefit around 1.4m Australians.

Other elements have been incorporated into the social wage such as government spending on public health, education, housing, transport and community services. This provides a broader coverage for the support given through the social welfare safety net, particularly for families where the welfare of dependent children is at stake. This assistance is administered through subsidised goods and services such as public health and medical services, housing, transport and education.

Suggested Essay Plan

Question 25

Discuss the Government's use of macroeconomic policies in achieving economic growth, full employment and price stability in the Australian economy.

Introduction

Address all sections of the question and outline the current situation of the **Australian economy**.

Make it clear to the marker that you understand the question and the current economic situation, and will not be writing a pre-prepared essay.

Overview of the current Australian economic situation

"In Australia, most indicators suggest growth close to trend overall. Labour market data show moderate employment growth, even with job shedding in some industries, and the rate of unemployment has thus far remained low.

Inflation remains low, with underlying measures near 2 per cent over the year to June, and headline CPI inflation lower than that."

Statement by the RBA August 2012

Economic Objectives

- Outline of economic growth objectives and sources
- Outline of full employment objective and sources of unemployment (cyclical & structural)
- Outline of price stability objective (2-3%) and sources of inflation

Macroeconomic policy

- Explanation of demand – side policy
- Comparison of expansionary and contractionary policies
- AD/AS diagram

Policy Description	Impact on objective	Evaluation of the policy for achieving the objective (including limitations & conflicts)
Monetary Policy	<ul style="list-style-type: none"> • Economic growth • Full Employment • Price Stability 	
Fiscal Policy	<ul style="list-style-type: none"> • Economic growth • Full Employment • Price Stability 	

Conclusion

Overall statement of the effectiveness of macroeconomic policy and reference to the importance of the **policy mix**, including microeconomic policy, for long term growth.

Relevant Data:

Cash rate 3.5%

2012/13 Surplus \$1.5bill

Economic Growth (Yr to March) 4.3%

Inflation rate (Yr to June 1.2%)

Unemployment Rate (Yr to June 5.2%)

Question 25 Outcomes assessed: H1, H2, H5, H6, H7, H10

Criteria	Marks
<ul style="list-style-type: none"> • Integrates an extensive and appropriate range of economic terms with relevant concepts, relationships and theory • Synthesises own knowledge with the economic information provided to develop a sustained, logical and cohesive response • Provides clear and comprehensive arguments of the issues and points for and against the Government's use of macroeconomic policies to achieve the objectives of economic growth, full employment and price stability 	17–20
<ul style="list-style-type: none"> • Integrates an appropriate range of economic terms, relevant concepts, relationships and theory • Synthesises own knowledge and understanding with the information provided to develop a logical and cohesive response • Provides sound arguments identifying the Government's use of macroeconomic policies to achieve the Government's objectives of economic growth, full employment and price stability 	13–16
<ul style="list-style-type: none"> • Applies appropriate economic terms, concepts and relationships • Uses own knowledge and understanding together with the information provided to develop a cohesive response • Sketches in general terms the Government's use of macroeconomic policies to achieve the Government's objectives of economic growth, full employment and price stability 	9–12
<ul style="list-style-type: none"> • Uses some economic terms, concepts and relationships • Uses information to develop a generalised response • States how the Government's use of macroeconomic policies may impact on economic growth, full employment and price stability 	5–8
<ul style="list-style-type: none"> • Uses some economic terms and/or concepts • Presents a limited response • May refer to monetary policy and/or fiscal policy 	1–4

Question 25 continues on the next page

Question 25 continued

Essay plan: In the introduction students should outline the macroeconomic economic policies used by the Australian government to achieve the objectives of economic growth, full employment and price stability. These policies include the macroeconomic management tools of fiscal policy and monetary policy. As well, students need to identify and define the economic objectives which these policies are directed at, including economic growth, full employment and price stability.

The Australian government seeks to achieve a rate of sustainable economic growth between 3% and 4% without an increase in inflation or a deterioration in external stability. It also uses its macroeconomic policies to keep the unemployment rate close to the Non Accelerating Inflation Rate of Unemployment (NAIRU) which is estimated to be between 4% and 5% of the workforce. If this is achieved there will be full employment in the labour market and no cyclical unemployment. The objective of price stability is a major operating target for the conduct of monetary policy by the Reserve Bank of Australia (RBA). The RBA has established an operational target of 2% to 3% consumer price inflation over the economic cycle. Fiscal policy is the management of government revenue and government expenditure through its annual budget. Also known as budgetary policy, this macroeconomic management tool is delivered through the budget in parliament in May each year, and if deemed necessary a 'mini budget' may be delivered at another time in the fiscal year.

Monetary policy is undertaken by the Reserve Bank of Australia and involves the Reserve Bank changing the official cash rate in order to influence the cost, availability and demand for funds in the Australian economy.

Monetary policy and fiscal policy are macroeconomic policies used to achieve economic objectives related to the demand side of the Australian economy such as economic growth, full employment and price stability. Together these policies can influence the level of national spending, output, income and employment.

(Students can incorporate into their response at this point, economic theory about monetary and fiscal policy, aided by the use of diagrams).

Primarily the use of monetary policy by the Reserve Bank is to address inflation in the Australian economy. The Reserve Bank targets the rate of consumer price inflation at 2% to 3% a year over the course of the business cycle. From November 2010 until November 2011 the cash rate was held by the Reserve Bank at 4.75% (as shown in the stimulus graph). The rate was held at this level for twelve months because the Reserve Bank Board had concerns about the underlying rate of inflation in the Australian economy. The Board adopted a mildly restrictive stance of monetary policy due to the uncertainty of global and domestic factors and the medium term impact on inflation. At the time this included a resumption of the resources boom and strong export volumes to China which provided a stimulus to national income and inflation. In addition natural disasters such as the Queensland floods and Cyclone Yasi impacted on food production and other areas of the economy leading to higher Consumer Price Index and underlying inflation.

However, in November 2011 the Reserve Bank Board adjusted the setting of monetary policy and lowered the cash rate by 0.25% (as shown in the stimulus graph). This change in the cash rate reflected the change in emphasis away from inflation, which was now more in line with the Board's inflation target of 2%–3% and more towards the objectives of economic growth and full employment.

In late 2011 a number of factors were impacting on economic growth and employment in Australia. Globally, the Sovereign Debt Crisis and economic slow-down in Europe were impacting on output in the Chinese economy. These events, coupled with moderate growth in the USA, were starting to impact on the demand for Australian commodities and other exports such as manufactured goods, and services such as tourism and education. Whilst still relatively high, commodity prices were falling and the demand for Australian commodities had declined. At the same time the high value of the Australian dollar had reduced the competitiveness of a number of Australian industries and led to widespread structural change in industry with labour and capital directed to the mining sector from other industries. Domestically, economic growth varied across different sectors in 2011. Sectors experiencing difficulty included manufacturing, retailing and tourism, building and construction and new housing starts. However strong growth in the mining sector was still evident. Clearly, a 'two-speed economy' had emerged in Australia.

Question 25 continues on the next page

Question 25 continued

Between December 2011 and April 2012 the Reserve Bank Board kept the cash rate at 4.25%. Despite some continuing concerns about growth in some sectors of the economy the Board believed that the setting of monetary policy was appropriate given the available data on some key economic indicators, such as inflation, GDP growth and the unemployment rate.

However, in May 2012 the Board decided that there was a need to adjust the setting of monetary policy and decreased the cash rate by 0.5%. The assessment of the economy by the Board was that the government's economic objective of 2%–3% inflation was now clearly within the targeted band, with the annual rate of underlying inflation being at a 13 year low. The expansionary stance of monetary policy adopted by the Board was used to help lower interest rates on household mortgages and provide support for business confidence. In June 2012 the Reserve Bank Board eased the cash rate by 0.25% due to ongoing concerns about job losses and falling output related to structural change pressures in the weaker sectors of the Australian economy, such as manufacturing, retailing and building and construction.

In the past twelve months the stance of monetary policy changed from a mildly contractionary to a mildly expansionary stance. This change sought to support the growth in consumer spending and aggregate demand in the economy and provide some level of stimulus to sectors undergoing structural change in the Australian economy. The easing in the stance of monetary policy also helped to put downward pressure on the exchange rate and arrest the trend of an appreciating exchange rate which was reducing competitiveness.

Fiscal policy, the other main macroeconomic policy tool, changed from an underlying cash deficit in 2011–12 of \$44.4b to a forecast budget surplus of \$1.5b for 2012–13. This change in the fiscal outcome is the biggest one year variation which has been forecast in the past 60 years. Many economists believe that the surplus delivered by the government has been primarily for political reasons rather than being based on sound economic reasoning.

The 2012–13 Budget detailed how the government would “spread the benefits of the resources boom” to Australian families. The Budget delivered a \$5b household assistance package and \$47b in personal income tax cuts. These changes reflected the use of fiscal policy to redistribute income and further fulfil the government's objective of reducing inequality in the distribution of income and wealth. However, there was strong criticism of the Budget from some sectors of the business community, especially firms in the manufacturing and tourism sectors because of the failure of the government to deliver on the planned cut to company tax from 30 cents to 29 cents in the dollar.

The 2012–13 Budget allocated \$1.75b to a national partnership Agreement on Skills Reform and \$101m to better support mature age workers. This allocation, whilst beneficial to the employment sector, may not be sufficient to stem the current debate about the shortage of skilled labour in some growth regions of Australia and the need to contract foreign workers to meet skills shortages.

So whilst monetary policy is now mildly expansionary, fiscal policy is mildly contractionary. The Government has argued that this stance of fiscal policy will allow the Reserve Bank Board to lower interest rates, if appropriate, in the coming months of 2012, in order to stimulate aggregate demand in the weaker sectors of the Australian economy which have been particularly impacted on by the strong Australian dollar and weaker trading conditions in the global and domestic economies.

(Students can include at this point a suitable extract from the stimulus material).

A number of economic issues related to employment in Australia have also been clearly evident over the past twelve months. The unemployment rate has remained low for the past twelve months, at close to 5% on average. Employment figures show there was strong growth in employment in the mining industry with 58,100 new jobs created from January to May in 2012. However, two thirds of the mining jobs were in Western Australia and Queensland. Strong employment growth is also occurring in mining related professions, including engineering and geology.

Due to a downturn in the construction sector in Australia 58,500 workers have lost their jobs in this industry. As well, workers associated with manufacturing industries have been significantly affected by the high Australian dollar. The retail sector in Australia has also suffered with a loss of 23,000 jobs up until the end of May 2012. These figures continue to show the problems with the two-speed economy in Australia. So the aim of the current accommodative stance of monetary policy will be to strengthen aggregate demand and curtail losses in employment numbers, particularly in the retail and construction industries.

Question 25 continues on the next page

Question 25 continued

The current macroeconomic policy mix addresses some of the short to medium concerns in the Australian economy. The return of the budget outcome to a surplus position according to the Treasurer, Wayne Swan, "is Australia's best defence at a time when the global economy is undergoing dramatic structural changes and the global outlook remains uncertain." In the long term the Government is implementing a range of reforms including aged care reforms, a National Disability Insurance Scheme and the long awaited carbon tax.

The Reserve Bank and the Federal Government will continue to monitor the impact of monetary and fiscal policies on the Australian economy. Future economic policy will be framed against financial and economic issues abroad in Europe, China and the USA, as well as concerns about Australia's two-speed economy, consumer confidence and the continuing impact of a high Australian dollar on business and consumer behaviour.



Updated stimulus*

Section III

Question ~~25~~ 26

Outcomes assessed: H1, H2, H6, H9, H10

MARKING GUIDELINES

Criteria	Marks
<ul style="list-style-type: none"> • Synthesises own knowledge with economic information provided to develop a sustained, logical and well structured response • Integrates an extensive and appropriate range of economic terms with relevant concepts, relationships and theory • Provides clear and comprehensive arguments of the positive and/or negative impacts of microeconomic policies on Australia's economic performance 	17-20
<ul style="list-style-type: none"> • Synthesises own knowledge with economic information provided to develop a logical and well structured response • Integrates an appropriate range of economic terms with relevant concepts, relationships and theory • Provides sound arguments identifying the positive and/or negative impacts of microeconomic policies on Australia's economic performance 	13-16
<ul style="list-style-type: none"> • Uses own knowledge with economic information provided to develop a coherent response • Applies appropriate economic terms, concepts and relationships • Sketches in general terms arguments identifying the positive and/or negative impacts of microeconomic policies on Australia's economic performance 	9-12
<ul style="list-style-type: none"> • Uses economic information provided to develop a generalised response • Uses some appropriate economic terms, concepts and relationships • Makes reference to some aspects of the impact of microeconomic policies on Australia's economic performance 	5-8
<ul style="list-style-type: none"> • Presents a limited response • Uses some economic terms and/or concepts relating to microeconomic policies and/or Australia's economic performance 	1-4

Marking Guideline

HSC 2009

Section III

Question ~~25~~ 26.

The majority of responses made use of or referred to the economic information provided.

Better responses identified and explained a range of microeconomic reforms implemented in Australia over time. These responses typically developed clear and comprehensive arguments linking the microeconomic reforms to their positive and/or negative impacts on Australia's economic performance. A common feature of these responses was the incorporation of relevant economic theory and diagrams related to changes in aggregate supply and prices. Better responses typically referred to both the short-term and long-term impacts of microeconomic reform on Australia's economic performance. These responses often linked these changes over time to the data provided in the stimulus. They identified and explained the impacts on internal economic performance, such as lower inflation and more sustainable economic growth, as well as improved international competitiveness. These responses typically demonstrated sophisticated literacy skills, synthesising arguments in a sustained and well-structured response.

Weaker responses were typically general, simply describing different types of microeconomic reform. These responses sometimes offered a limited explanation of the link between microeconomic reforms and economic performance. For example, they may have stated that microeconomic reforms reduced inflation but did not demonstrate an understanding of how particular reforms might have increased efficiency for businesses and lowering their costs, which may translate into lower prices. Some candidates relied on the stimulus material too much, rather than using it to support particular arguments. These responses typically made little or no reference to relevant economic theory.

Section III

Question ~~25~~ 26

Answers could include:

- Structural unemployment
- Structural change
- Allocative, technical and dynamic efficiency
- Deregulation of product/factor markets
- Corporatisation/privatization of PTEs
- National Competition Policy
- Capital widening/deepening
- Commercialisation
- Competitive neutrality
- Microeconomic policy/reform
- Taxation
- Economic infrastructure
- Trade and industry assistance
- Capital/labour/multifactor productivity
- Inflation, unemployment, economic growth, exchange rates
- External balance
- Distribution of income and wealth, standard of living

Stimulus Information

Stimulus 1

- The impact of microeconomic reform on long-term structural change
- The benefits of reform: reduced inflationary expectations, increased productivity (1.7%), employment opportunities, increased GDP (2.5%), average household income (\$7000 since 1998/99)

Stimulus 2

- The positive impact of productivity on demand income and employment

Question 27

Analyse the impact of Australia's labour market policies on economic growth.

<p>- Integrates an extensive and appropriate range of economic terms with relevant concepts, relationships, theories and use of economic data</p> <ul style="list-style-type: none"> • Demonstrates superior economic analysis in a sustained, logical and well structured response • Provides a clear, comprehensive and balanced understanding of the relationship between Australia's labour market policies and their impact on economic growth in the Australian economy 	17–20
<ul style="list-style-type: none"> • Integrates an appropriate range of economic terms, relevant concepts, relationships, theory and use of economic data • Demonstrates sound economic analysis in a logical and well structured response <p>- Provides a sound understanding of the relationship between Australia's labour market policies and their impact on economic growth in the Australian economy</p>	13–16
<ul style="list-style-type: none"> • Applies appropriate economic terms, concepts and relationships • Develops a coherent response • Sketches in general terms the relationship between Australia's labour market policies and their impact on economic growth in the Australian economy 	9–12
<ul style="list-style-type: none"> • Uses some appropriate economic terms, concepts and relationships • Develops a generalised response • Sketches in general terms Australia's labour market policies and the sources of economic growth 	5-8
<p>- Presents a limited response</p> <ul style="list-style-type: none"> • Uses some economic terms and/or concepts relating to Australia's labour market policies and economic growth 	1-4

Answers could include:

INTRODUCTION: Addressing the question and outlining the structure of the essay

- **Explanation of AS and the AS/AD diagram**
- **Sources of economic growth due to an increase in aggregate supply: workers acquiring new skills, increased efficiency and productivity of the labour force, Government policies relating to the cost of labour**
- **The link between labour market policies and increased AS:**
 - **The national system for determining wages**
 - **Dispute resolution**
 - **Methods for determining employment contracts**
 - **Education, training and employment programs**
- **The link between labour market policies and increased AD**
 - **Increased employment and incomes leading to increased consumption**

CONCLUSION: Overall evaluation

